Court File No.: 31-2734090

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED

AND IN THE MATTER OF THE NOTICES OF INTENTION TO MAKE A PROPOSAL OF **YG LIMITED PARTNERSHIP AND YSL RESIDENCES INC.**

APPLICATION UNDER THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED

Joint Book of Authorities of the "Class A LPs"

(YongeSL Investment Limited Partnership, 2124093 Ontario Inc., SixOne Investment Ltd., E&B Investment Corporation, and TaiHe International Group Inc., 2504670 Canada Inc., 8451761 Canada Inc., and Chi Long Inc.)

(Sanction Hearing: June 23, 2021)

June 21, 2021

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TAB 1

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Tudor Sales Ltd. (Re),*
2017 BCSC 119

Date: 20170125
Docket: B131477
Registry: Vancouver

2017 BCSC 119 (CanLII)

Between:

IN THE MATTER OF THE BANKRUPTCY
OF
TUDOR SALES LTD.

Before: The Honourable Mr. Justice A. Saunders

Reasons for Judgment

Counsel for the Trustee, Boale, Wood & Company Ltd:	S. H. Stephens
Counsel for the Applicant Cascade Steel Rolling Mills Inc.:	W. B. Milman K. Macdonald
Counsel for the Applicant Tavi Eggertson:	D. K. Magnus
Place and Date of Hearing:	Vancouver, B.C. January 8, 2016
Further Written Submissions of Cascade Steel Rolling Mills Inc.:	April 19; June 2, 2016
Further Written Submissions of Tavi Eggertson:	May 19, 2016
Place and Date of Judgment:	Vancouver, B.C. January 25, 2017

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Introduction

[1] The applicant Cascade Steel Rolling Mills Inc. ("Cascade"), an acknowledged unsecured creditor of the bankrupt, Tudor Sales Ltd. ("Tudor"), seeks an order under s. 135(5) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985 c. B-3 [*BIA*], that the proof of claim and proof of security of Tavi Eggertson ("Mr. Eggertson") be expunged, reduced, or subordinated to the claims of other creditors.

[2] The applicant Mr. Eggertson, who claims to be a secured creditor, seeks an order that all funds currently held in trust by the trustee, Boale, Wood & Company Ltd. ("Boale, Wood"), be released to him.

[3] The applications were argued on January 8, 2016. Cascade and Tudor were subsequently given leave to make further written submissions as to the import of the decision of the Ontario Superior Court of Justice in *U.S. Steel Canada Inc. (Re)*, 2016 ONSC 569 [*U.S. Steel*]. Those submissions were received by June 2, 2016. A further written submission filed by counsel for Mr. Eggertson, purportedly as sur-reply, has been disregarded, as it was, in its entirety, not proper sur-reply but essentially repetition of arguments previously advanced.

Background

[4] Tudor made an assignment in bankruptcy on November 20, 2013. At that time, Tudor's most recent (unaudited) financial statements were for the fiscal year ending October 31, 2012. Those financial statements recorded shareholder loans owed to Mr. Eggertson, who was a shareholder of Tudor, and its sole officer and director, in the amount of $1,361,359. This loan liability as recorded in the financial statements arose out of two purported loans made to Tudor by Mr. Eggertson in 2005 and 2006 (collectively, the "2005-06 Advances").

[5] Tudor's Form 78 Statement of Affairs, sworn to by Mr. Eggertson on November 20, 2013, included Mr. Eggertson amongst the listed secured creditors. It asserted that Mr. Eggertson's secured claim was in the amount of $1,770,656.70. How that claim amount was arrived at is not disclosed. Mr. Eggertson's evidence

when examined on November 26, 2014 is that this amount was “a guess at best”. As will be seen, since then Mr. Eggertson has at least implicitly resiled from that claim amount.

[6] Cascade, a trade creditor of Tudor, is the single largest unsecured creditor. Its claim of $1,367,746.25 represents approximately 28% of the bankrupt’s total unsecured debt. That claim amount is not in dispute.

[7] Acting under a general security agreement dated March 1, 2006 and registered November 18, 2011 (the “GSA”), Mr. Eggertson sought the appointment of Boale, Wood as receiver. After satisfying itself of the validity of Mr. Eggertson’s security, by way of obtaining an independent legal opinion, Boale, Wood accepted the appointment in November 2013.

[8] Boale, Wood prepared and distributed a trustee’s preliminary report to creditors, in December 2013. That preliminary report stated that there would be a significant shortfall to the secured creditors, and there would be no funds available for distribution to the unsecured creditors, among which was Cascade.

[9] After payment of other secured claims, Boale, Wood – presumably, acting on the belief that the indebtedness to Mr. Eggertson was secured by his GSA – paid out $500,000 to Mr. Eggertson, in March 2014. That left approximately $600,000 on hand for distribution.

[10] Following the aforesaid $500,000 distribution to Mr. Eggertson, Cascade advised Boale, Wood that it was investigating the validity of, and/or the amount secured by, Mr. Eggertson’s GSA. Boale, Wood determined that no further distributions would be made until the issues related to Mr. Eggertson’s security were resolved.

[11] In May 2014, Cascade requested that Boale, Wood undertake an examination of Mr. Eggertson; Boale, Wood declined to do so, citing a lack of funds.

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[12] Cascade then applied for an order under s. 163(2) of the *BIA* that Mr. Eggertson undergo an examination under oath. That order was granted by Mr. Justice Leask, on August 21, 2014.

[13] In response to that application, Mr. Eggertson filed an affidavit in which he asserted that his secured claims were comprised not only of the approximately $1.37 million in shareholder loans described in Tudor's financial statements, but also a further $1.92 million in loans he had made to Tudor in 2011 and 2012 (the "2011-12 Advances"). He put his total claim, net of the $500,000 received in March 2014, at $2,781,359. He affirmed that claim in a formal Proof of Claim delivered on October 31, 2014, in response to a Notice by Trustee Requiring Filing of Proof of Security.

[14] Cascade examined Mr. Eggertson under oath on November 26, 2014.

[15] In the course of Boale, Wood's review of Mr. Eggertson's claim, the trustee identified documentation – in evidence on these applications – that the 2011-12 Advances had been recorded in Tudor's books as being due from "TE Steel", a related company whose expenses Tudor had funded. Mr. Eggertson was advised of Boale, Wood's position that those advances should not form part of his claim against Tudor, by way of an email from the trustee's legal counsel dated December 9, 2014. The materials filed on these applications do not disclose any response to this position having been made by Mr. Eggertson.

[16] On the basis of the transcript of the examination of Mr. Eggertson, Cascade sought a ruling from Boale, Wood in January 2015, asking that Mr. Eggertson's proof of security be disallowed under s. 135 of the *BIA*, and that the trustee demand the return of the previously distributed funds. Boale, Wood declined to do so, again citing a lack of resources, leaving it to the creditors to bring the present applications.

<u>Positions of the Parties</u>

[17] Mr. Eggertson's evidence is that the 2005-06 Advances consisted of two loan amounts made by him: $890,000 on October 29, 2005; and a further $500,000 in

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December 2006. He says that there were subsequently adjustments in Tudor's accounts as a result of payments made to him by Tudor, resulting in a net reduction of $28,641, leaving a total shareholder loan of $1,361,359.

[18] The first payment of $890,000 was money that his accountants (also Tudor's accountants) had recommended be paid to him by the company as a bonus, in addition to his salary. He took the bonus, in the sense that he declared it as income on his tax return, but says that he left the money in the company as a loan.

[19] Determination of the amount of that bonus had been, as he described it, tax-driven. His evidence is that "everything that I did when I worked at Tudor Sales was tax driven".

[20] The $890,000 payment was originally described in Tudor's October 31, 2005 financial statements as "unsecured, non-interest bearing and … no fixed terms of repayment". Mr. Eggertson contends that it was always intended that this money be repaid to him eventually.

[21] The $500,000 loan of December 2006 was made by him to Tudor, he says, because the money was "needed for growth". Elsewhere in his evidence, he stated that the money was needed by the company "to buy product".

[22] After the GSA was executed in March 2006, notes in subsequent financial statements described his shareholder loans – both the $890,000 bonus left in the company, and the $500,000 loan he made in December 2006 – as interest-bearing. However, the notes continued to refer to the loans as "unsecured". Although Mr. Eggerston signed off on the financial statements each year, he says these notes were incorrect, in that he intended the GSA to cover those loans. The financial statements began to refer to the shareholder loans as secured, beginning in 2011.

[23] There was no written documentation of those shareholder loans, no fixed interest rate, or formula by which the interest rate could be determined, and no schedule for repayment. The loans are described in the October 31, 2012 financial statements of Tudor under a note that reads:

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> Advances, secured by a general security agreement over all present and future personal property, bears interest of 8% (October 31, 2011 – 8%; November 1, 2010 – 36%) per annum with no fixed terms of repayment.

[24] Mr. Eggertson's evidence is that the interest rate at which he was paid each year in respect of his shareholder loans fluctuated with the fortunes of the company, depending on advice received from his accountants. At times, when the company was doing well, the interest rate was as high as 36%. At other times – in particular, for the fiscal year 2009 – the interest rate set by the accountants would turn out to have been too high relative to the company's performance, and the financial statements would record him as having partially forgiven interest payment.

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[25] Mr. Eggertson says that the 2011-12 Advances were made on the expectation that they were loans to Tudor secured by the GSA. These advances were used to fund the operations of T. E. Sales Inc. (formerly T. E. Steel Sales Inc.), a company controlled by his wife. (He says that the financial statements of Tudor are mistaken in referring to T. E. Sales as a related company.) T. E. Sales Inc. had no assets; it, in turn, had used the advances to fund a tequila importation venture in which Mr. Eggertson had an interest.

[26] The documentation relied upon by Boale, Wood in December 2014, in denying Mr. Eggertson's claim for these advances, is a Detailed Trial Balance. It records certain expenditures reallocated by the accountants, including an amount respecting "Casi di Tavi", which I infer is the company Casa de Tavi, identified by Mr. Eggertson as one of the entities involved in the tequila venture in which he had an ownership interest. There are other references to "bottles" and "liquor", and numerous references to "TT" and "TE Steel TT", which I infer, from his description of the venture in his examination evidence, to be related to "Tavi Tequila".

[27] Mr. Eggertson's evidence is that though the tequila venture was in its infancy, he hoped to build the brand, and hoped that Tudor would eventually be repaid out of profits from the sale of "Tavi Tequila" imported into British Columbia. He regarded this, he says, as an investment by Tudor. Elsewhere in his evidence, he says that he

intended to make a gift to Tudor of all rights to Tavi Tequila, once the venture began consistently generating revenue.

[28] Mr. Eggertson's position is that the Tudor financial statements are inaccurate and incomplete, in that they do not include the 2011-12 Advances used to fund those expenditures in the shareholder loans. He says that he had an ongoing disagreement with his accountants as to the allocation of expenses amongst Tudor and his other ventures. That disagreement led to him firing his accountants, he says, after the 2012 financial statements were prepared.

[29] Mr. Eggertson's position is that whether his full claim is recognized, or whether he is obliged to discount the amount of the 2011-12 Advances and limit his claim to the remaining balance of the 2005-06 Advances, his secured claims exceed the amount remaining in trust with Boale, Wood, and he says he is entitled to payment of that amount in full.

[30] Cascade's primary submission is that the 2005-06 Advances, though carried on the books of Tudor as loans, are properly characterized as equity, and must be subordinated to the claims of Tudor's creditors.

[31] Alternatively, Cascade asserts that if the 2005-2006 Advances were loans, those loans were repaid in full through Mr. Eggertson having been paid an exorbitant salary, and through him having been paid interest at exorbitant rates, as high as 36%.

[32] With respect to the 2011-12 Advances, Cascade says that Tudor's 2012 financial statements report advances made to "related parties" that were not in fact related to Tudor but were in fact ventures owned or controlled by Mr. Eggertson, or from which he stood to profit personally, and that Mr. Eggertson simply used Tudor as a vehicle to make those expense payments. Cascade submits, essentially, that Mr. Eggertson's use of Tudor as a vehicle was a matter of convenience to him and that he cannot shelter his payments made through Tudor under Tudor's GSA, thereby defeating the legitimate commercial interests of Tudor's trade creditors.

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[33] Cascade relies upon ss. 137, 139, and 140.1 of the *BIA*, which provide as follows:

> **Postponement of claims — creditor not at arm's length**
>
> 137 (1) A creditor who, at any time before the bankruptcy of a debtor, entered into a transaction with the debtor and who was not at arm's length with the debtor at that time is not entitled to claim a dividend in respect of a claim arising out of that transaction until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the trustee or of the court a proper transaction.
>
> …
>
> **Postponement of claims of silent partners**
>
> 139 Where a lender advances money to a borrower engaged or about to engage in trade or business under a contract with the borrower that the lender shall receive a rate of interest varying with the profits or shall receive a share of the profits arising from carrying on the trade or business, and the borrower subsequently becomes bankrupt, the lender of the money is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied.
>
> …
>
> **Postponement of equity claims**
>
> 140.1 A creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity claims have been satisfied.

Discussion and Analysis

[34] With respect to the shareholder loans claim arising out of the 2005-06 Advances, the threshold question is whether the amounts advanced to Tudor by Mr. Eggertson are properly characterized as a debt, or as equity.

[35] These purported loans having been a non-arm's-length transaction, I am guided by the description of the court's role in characterizing, or re-characterizing, such payments, as recently set out by Justice Wilton-Siegel in *U.S. Steel:*

> [167] Where … the parties are not at arm's length, the issue is not what the parties say they intended regarding the substance of the transaction as a matter of contractual interpretation. The expressed intention of the parties is clear. However, given the absence of any arm's length relationship, there can be no certainty that the language of the agreements reflects the underlying substantive reality of the transaction. Accordingly, the issue for a court is whether, as actually implemented, the substance of the transaction is, in fact, different from what the parties expressed it be in the transaction documentation.

> [168] In other words, the task of a court is to determine whether the transaction in substance constituted a contribution to capital notwithstanding the expressed intentions of the parties that the transaction be treated as a loan. It is therefore not appropriate to limit the inquiry into the intentions of the parties to a review of the form of the transaction documentation. Such an exercise reduces to a "rubber stamping" of the determination of a single party to the transaction, i.e., the sole shareholder, and it does not address the substance of the transaction as it was actually implemented. In such circumstances, the determination of whether a particular claim is to be treated as debt or equity must address not just the expressed intentions of the parties as reflected in the transaction documentation but also the manner in which the transaction was implemented and the economic reality of the surrounding circumstances.

[36] Further on in that judgment, Wilton-Siegel J. discussed the various factors which he found appropriate to determination of the debt claim before him, given the particular financial instruments utilized by the parties. He began that discussion with an explanation of the difference between equity and debt from an expert report tendered by one of the parties, authored by an economist, Dr. John Finnerty, which I also adopt:

> [183] An appropriate starting point is the definition of debt and equity for financial purposes set out in paragraphs 32 and 34 of the Finnerty Report:
>
>> At its heart, the difference between equity and debt lies in the fundamental nature of their respective claims on the assets and cash flow of the company. Debt involves borrowing funds subject to a legal commitment to repay the borrowed money with interest at an agreed rate by a stated maturity date. This commitment is embodied in a contract, and this contract is implemented by the borrower. Lenders receive a contractually agreed set of cash flows, typically through periodic interest payments and one or more principal repayments, the last of which occur on the maturity date. … In contrast to debt, an equity claim entitles the holder to a share of the company's profits and residual cash flows after the company has made all the contractually required debt service payments. That is, the debt ranks senior to the equity with respect to the company's cash flows. Similarly, the debt ranks senior to the equity in the event the company must be liquidated and its assets sold to repay its debt obligations. The equityholders get what is left after the holders of the debt have been paid in full; if the debtholders can't get paid in full, then the equityholders get nothing.

[37] The characterization of the 2005-06 Advances as equity, and not debt, is most strongly supported by the variable nature of the interest payments recorded in the financial statements as having been made to Mr. Eggertson. As a consequence of being variable with the company's profitability, the amount of the payments made

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to Mr. Eggertson could not have been determined each year until any and all current liabilities to secured and unsecured creditors had been satisfied. As noted above in the quotation from the Finnerty Report in *U.S. Steel*, “debt ranks senior to the equity with respect to the company’s cash flows”. Functionally, therefore, Tudor’s payments to Mr. Eggertson were being treated as subordinated to all such current liabilities, a fact which is inconsistent with his claim to secured creditor status.

[38] Furthermore, the nature of the company’s liability to Mr. Eggertson was more consistent with equity than with debt, in that there was no schedule for repayment of these advances, and there was no certain formula to determine the interest amount. Payments, rather, were discretionary, based on the advice of the accountants, and varying with Tudor’s profitability. The ability to draw payment in this manner is not normally incidental to the rights of a creditor; instead, it is a hallmark of ownership.

[39] It is not the lack of a strict schedule for repayment in itself that is relevant; neither do I give any weight to the absence of loan documentation. This is because the relationship of a wholly-owned subsidiary to its parent obviates the need for same: see *U.S. Steel* at para. 217. It is, instead, the nature of those interest payments that reveals the true substance of the transaction.

[40] This characteristic of the transaction – the variable nature of the interest payments, fluctuating with the company’s profitability – is, I find, sufficient in itself to lead to the 2005-06 Advances being characterized as equity. In addition, I also regard the circumstances surrounding the 2005-06 Advances as germane. At the time of the first of those advances, October 29, 2005, Mr. Eggertson was not a shareholder of Tudor; the company’s sole shareholder was his father, Donald Eggertson. However, as disclosed in the company’s securities register, Mr. Eggertson became a shareholder as of January 1, 2006, only approximately two months later, when his father transferred nine of his 100 Class A common shares to Mr. Eggertson. There is no record of any consideration for the transfer having been paid. There is no evidence that it was a gift.

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[41] In December 2006, Mr. Eggertson made his second advance, of $500,000. The security register discloses that that same month, his nine Class A common shares – a 9% holding – were exchanged for 100 Class D redeemable preferred shares. Tudor's 2007 financial statements indicate those shares were redeemable for $2,542,539. They therefore represented either approximately 50% or 67% of the value of the company (depending if the value of his father's remaining Class D shares was $1,231,538 – the redemption value noted in the 2007 financial statements – or $2.5 million, the figure at which Mr. Eggertson deposed those shares to have been redeemed in 2010).

[42] I agree with Cascade's submission that the very close proximity in time between these advances made by Mr. Eggertson, and at first his acquisition of a shareholder interest, and then the increase in value of that interest, strongly implies that his advances were in substance consideration paid for his ownership stake, making them equity contributions.

[43] The existence of the GSA does not assist Mr. Eggertson. The GSA itself makes no specific reference to the 2005-06 Advances. In fact, the shareholder loans arising out of those advances were not even described as secured loans in Tudor's financial statements until 2011, when the company went into default on its lending covenants, reinforcing the view that the advances were not originally intended as secured debt. In any event, as *U.S. Steel* makes clear, what is at issue is not the superficial appearance of the transaction or transactions arising out of the transaction documentation, but the manner in which the transaction or transactions were actually implemented in the circumstances of the surrounding economic reality.

[44] I therefore find Mr. Eggertson's claim in respect of the purported shareholder loans of $1,361,359 to be in respect of an equity claim, and subordinated to all creditor claims, pursuant to s.140.1 of the *BIA*.

[45] Alternatively, if characterized more appropriately as debt, rather than equity, Mr. Eggertson's claim would fail by reason of s.139 of the *BIA*. That section is premised on there being a contract between lender and company under which the

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loan is to be repaid out of a share of profits, or is to receive a rate of interest varying with the profits. The evidence clearly discloses that such interest was paid by Tudor to Mr. Eggertson. The loans being non-arm's-length transactions, the intention of Mr. Eggertson to have Tudor pay him interest varying with the profits is sufficient to bring the loans within the ambit of s.139. Although no formal written contract existed between these two non-arm's length parties, Mr. Eggertson cannot thereby claim to be in a stronger position as a consequence.

[46] Nor do I find Mr. Eggertson has any legitimate claim arising out of the 2011-12 Advances. Mr. Eggertson presents no accounting evidence supporting his position that the tequila business expenses ought properly to have been allocated to Tudor. Nor is there any evidence that Tudor was regarded as being indebted to him for those advances, or that the flow of monies through Tudor's accounts to T. E. Steel and then to the tequila venture represented a *bona fide* investment on behalf of Tudor. Tudor was not a shareholder in Casa de Tavi; Mr. Eggertson was. It was his venture, regardless of whether he had a genuine intention that it might one day benefit Tudor.

[47] Under s.137(1) of the *BIA*, a non-arm's-length transaction may only support a claim to a dividend in respect of a bankruptcy claim arising out of that transaction, in preference to other creditors' claims, when the transaction is judged to be "proper". I am not satisfied that Mr. Eggertson's investment in his tequila venture is properly regarded as an indirect investment achieved by means of a loan to Tudor. There is simply no justification for allowing Mr. Eggertson the luxury of securing his investment in the venture through the mechanism of the GSA granted by Tudor, and thereby defeat the legitimate interests of trade creditors.

[48] In my view, Cascade is correct in arguing that Mr. Eggertson, as a non-arm's length party, bears the onus of proving the transactions are "proper". But if I am wrong in that view, I do nevertheless regard it as proven on the evidence that the 2011-12 Advances were not proper debt transactions as between Mr. Eggertson and Tudor.

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[49] For these reasons, the application of Mr. Eggertson is dismissed, and the application of Cascade is allowed.

"A. Saunders J."

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TAB 2

CITATION: U.S. Steel Canada Inc. (Re), 2016 ONSC 569
COURT FILE NO.: CV-14-10695-00CL
DATE: 20160229

2016 ONSC 569 (CanLII)

SUPERIOR COURT OF JUSTICE - ONTARIO

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO U.S. STEEL CANADA INC.

BEFORE: Mr. Justice H. Wilton-Siegel

COUNSEL: *Michael E. Barrack, Robert Thornton, Jeff Galway, Kiran Patel* and *Max Shapiro,* for United States Steel Corporation

Alan Mark, Peter Ruby, Tamryn Jacobson, Logan Willis and *Jesse-Ross Cohen,* for the Province of Ontario

Gordon Capern, Kris Borg-Olivier and Denise Cooney for USW and Locals 1005 and 8782

Andrew Hatnay, Barbara Walancik and *Adrian Scotchmer,* Representative Counsel for the non-unionized active employees and retirees

Sharon Kour, for the Applicant U.S. Steel Canada Inc.

Robert Staley, Jonathan Bell and William Bortolin, for the Monitor Ernst & Young Inc.

HEARD: January 14, 15, 20, 21, 22, 25, 26 and 27, 2016

ENDORSEMENT

[1] In this proceeding, United States Steel Corporation ("USS") seeks a determination of 14 Proofs of Claim (the "USS Claims") filed in these proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") regarding U.S. Steel Canada Inc. ("USSC").

[2] Objections to the treatment of certain of these Claims as debt rather than as "equity claims" for the purposes of the CCAA, and to the enforceability of the security asserted in respect of certain of these Claims, have been filed by each of: (1) the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (the "USW") on its own behalf and on behalf of USW Local 1005 and USW Local 8782 (collectively, the "Union"); (2) Her Majesty the Queen in Right of Ontario and the Superintendent of Financial Services (Ontario) in his capacity as administrator of the Pension

Benefits Guarantee Fund (collectively, the "Province"); and (3) Representative Counsel to all non-USW active employees and retirees of USSC (collectively, the "Objecting Parties").

[3] This motion principally addresses the objections filed by the Objecting Parties (the "Objections"). The following are the USS Claims in respect of which Objections have been made:

Claim Reference #	Description of Claim	Amount of Claim
9	Unsecured Term Loan	$1,847,169,934
10	Unsecured Revolver Loan	U.S. $120,150,928
11	Secured Revolver Loan	U.S. $72,938,390
11(a)	Secured Cliffs LRD Transaction	U.S. $14,538,463
11(b)	Secured Credit Support Payments	U.S. $3,742,479
11(c)	Secured Intercompany Trade	U.S. $31,252,193

The Claim numbers above, and amounts reflected in this table, are taken from the Third Supplementary Seventh Report of the Monitor dated July 29, 2015 (the "Third Supplementary Monitor's Report") at para. 11.

[4] In these Reasons, Claims #9 and #10 are referred to as the "USS Unsecured Claims" and Claims #9, #10 and #11 are referred to collectively as the "USS Debt Claims". In addition, Claims #11, #11(a), #11(b) and #11(c) are referred to as the "USS Secured Claims", and Claims #11(a), #11(b) and #11(c) are referred to as the "USS Remaining Secured Claims".

Background

[5] The following is a brief summary of the background to this proceeding. Further detail regarding the relationship between USS and USSC and the USS Claims that have given rise to the Objections is set out below.

USSC

[6] USSC is an integrated steel manufacturer that conducts most of its business from two large steel plants located in Ontario: the Hamilton Works located in Hamilton, Ontario and the Lake Erie Works located in Nanticoke, Ontario.

[7] USSC is an indirect wholly-owned subsidiary of USS. Prior to its acquisition by USS in 2007, USSC was known as Stelco Inc. ("Stelco").

[8] As a result of its financial difficulties, USSC applied for relief under the CCAA and was granted CCAA protection pursuant to an Initial Order dated September 16, 2014 (the "Filing Date") (as amended and restated from time to time, the "Initial Order").

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The USS Parties

[9] USS is an integrated steel producer with major operations in North America and Central Europe. USS is a publicly-traded, Delaware corporation and its shares are listed for trading on the New York Stock Exchange.

[10] 1344973 Alberta ULC ("ABULC") was an Alberta corporation incorporated on August 22, 2007 to be the acquisition vehicle for the purposes of the USS acquisition of Stelco.

[11] U.S. Steel Canada Limited Partnership ("Canada LP") is a limited partnership formed under the laws of Alberta. Canada LP is an indirect wholly-owned subsidiary of USS. At the time of the USS acquisition of Stelco, Canada LP owned all the outstanding shares of ABULC and was, therefore, ABULC's direct parent. As a result of the amalgamation of ABULC and USSC on December 31, 2007 described below, Canada LP has become the direct parent of USSC.

[12] United States Steel Credit Corporation ("Credit Corp") was a Delaware corporation that was a wholly-owned subsidiary of USS. Credit Corp was merged into another wholly-owned subsidiary of USS on December 20, 2013.

[13] U.S. Steel Kosice s.r.o. ("USS Kosice") is a Slovakian corporation that is an indirect wholly-owned subsidiary of USS.

The USS Acquisition of Stelco Inc. in 2007

[14] On August 26, 2007, the USS board of directors approved the USS acquisition of Stelco, and USS, Stelco and ABULC entered into an arrangement agreement giving effect to the proposed transaction. The plan of arrangement by which the acquisition was implemented was subsequently approved by the Ontario Superior Court of Justice on October 30, 2007, and the acquisition transaction closed on October 31, 2007 (the "Acquisition").

Financing the Acquisition and the Flow of Funds

[15] The total amount spent by USS in connection with the Stelco acquisition was approximately $1.939 billion, or U.S. $2.056 billion at then prevailing exchange rates. The relevant corporate structure and the flow of funds are shown on the Funds Flow Chart attached as Schedule A to these Reasons. In these Reasons, all dollar amounts are denominated in Canadian dollars unless otherwise specifically indicated.

[16] ABULC was the acquisition vehicle that directly acquired Stelco. ABULC was financed by the following loans and capital contributions:

(a) Canada LP loaned ABULC $700 million pursuant to a loan agreement dated October 29, 2007 described below (the "Term Loan");

(b) Canada LP provided ABULC with equity in the amount of $600 million; and

(c) Credit Corp loaned ABULC approximately U.S. $744 million pursuant to a loan agreement dated October 29, 2007 described below (the "Credit Corp Loan").

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[17] ABULC used the funds received from Canada LP and Credit Corp as follows: (1) ABULC used $1.046 billion to purchase the outstanding shares of Stelco; (2) ABULC loaned Stelco approximately $741 million, which Stelco used to pay out its third party debt (other than a loan from the Province of Ontario); (3) ABULC loaned Stelco approximately $59 million, which Stelco used to pay out its option holders; (4) ABULC loaned Stelco approximately $61 million, which Stelco used to pay out its warrant holders; (5) ABULC loaned Stelco $32.5 million, which Stelco used to make a payment to its four main pension plans; and (6) ABULC loaned Stelco $40 million to fund Stelco's working capital.

[18] The funds used to acquire Stelco were derived from multiple sources. First, USS obtained new debt financing in the principal amount of U.S. $900 million in the form of facilities provided by a banking syndicate led by J.P. Morgan Chase Bank, N.A. These facilities comprised an unsecured three-year term loan in the principal amount of U.S. $500 million and an unsecured one-year term loan in the amount of U.S. $400 million. The one-year term loan was subsequently refinanced by USS as part of a larger offering of ten-year bonds in the public market. Second, USS obtained approximately U.S. $400 million by drawing on an existing receivables purchase facility. Third, USS utilized approximately U.S. $153 million of cash on hand at the USS level and €434,415,519.56, or $597,860,287.50, of cash on hand in USS Kosice.

[19] The source of the financing for the Acquisition, the structure of the Acquisition and the flow of funds to ABULC for such purposes was developed by USS between the date of the Arrangement Agreement and the date of the Acquisition. The principal consideration in the development of this structure was tax-efficiency from the perspective of USS. With respect to ABULC, the amounts received by it as debt and equity were driven by the "thin capitalization" rules under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). In addition, the amount of the funding reflected a USS policy of avoiding any secured third party indebtedness at the level of any subsidiary. As a result, it was necessary to fund Stelco with the amount necessary to repay all outstanding third party debt at the date of the Acquisition, other than a loan from the Province.

<u>Post-Acquisition Corporate Reorganization & Refinancing</u>

[20] On November 1, 2007, immediately following the Acquisition, Stelco was renamed U.S. Steel Canada Inc.

[21] Between October 31, 2007 and the year-end, the Credit Corp Loan was repaid in full. Certain of the repayments were made from additional advances under the Term Loan which are described in greater detail below.

[22] Following such additional advances by Canada LP to ABULC under the Term Loan in 2007, the outstanding principal amount outstanding under the Term Loan on December 31, 2007 was $1,227,363,149.82. The total amount outstanding on that date including accrued interest was $1,240,009,143.

[23] ABULC and USSC amalgamated on December 31, 2007 to continue as USSC (the "Amalgamation"). As a result of the Amalgamation, the obligations of ABULC under the Term Loan became obligations of the amalgamated entity, USSC.

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The History of the Credit Corp Loan

[24] As described above, pursuant to the Credit Corp Loan, Credit Corp advanced U.S. $744,463,605 to ABULC on or about October 31, 2007. The funds provided by the Credit Corp Loan were notionally intended to fund Stelco's third party debt at the date of acquisition that was denominated in U.S. dollars. USS intended the facility to be a short-term facility that would be repaid within two months. Larry Brockway, the Senior Vice-President, Chief Financial Officer and Chief Risk Officer of USS ("Brockway"), testified that the "purpose of the agreement was to help stair-step the structure into a more permanent structure as part of the ultimate steps between the acquisition and year end".

[25] Consistent with this objective, the Credit Corp Loan was repaid by means of: (1) a repayment of approximately U.S. $26 million in November 2007; (2) a repayment of approximately U.S. $41 million on December 4, 2007, which was funded by an advance to ABULC under the Term Loan on the same day described below; (3) a U.S. $87 million repayment by ABULC on December 21, 2007, comprised of U.S. $10 million presumably funded out of a U.S. $20 million equity injection from Credit Corp to ABULC on the same day and application of U.S. $77 million out of the $470 Million Advance described below; and (4) a reduction in the amount of approximately U.S. $595 million pursuant to the SHC Transaction described below.

The SHC Transaction

[26] The following summarizes the description of the SHC Transaction set out in the Third Supplementary Monitor's Report.

[27] At the time of the Acquisition, Stelco indirectly owned all of the outstanding shares of Stelco Holding Company ("SHC"), a corporation incorporated under the laws of Delaware. SHC's principal assets were interests in two mining joint ventures – Hibbing Taconite Company ("Hibbing") and Tilden Mining Company ("Tilden").

[28] At the time of the Acquisition, SHC had a liability to Stelco in the amount of approximately U.S. $393 million. This amount principally represented the excess of the amount owing by Stelco to SHC for iron-ore pellets produced by Hibbing and Tilden and shipped to Stelco, representing SHC's *pro rata* share of such production, less the amount of annual cash calls on SHC in respect of Hibbing and Tilden, which were paid by Stelco on behalf of SHC. This liability was booked as an advance from SHC to Stelco, and had increased in each year prior to 2007. The liability also included legacy liabilities of Stelco to certain other subsidiaries of SHC that were dormant. Stelco had not repaid any amount on account of these advances, and had no intention of doing so prior to the Acquisition, due to the adverse tax consequences of dividending the amount of any such payment back to Canada.

[29] The Acquisition presented an issue of tax inefficiency for USS, referred to as a "tax sandwich", that would result if distributions from SHC (as dividends or interest) were made to USSC in Canada and, in turn, distributed to USS in the United States. To address this issue, USS caused ABULC, USSC and SHC to enter into certain transactions which were effected by book entries in the financial accounts of the relevant corporations pursuant to a payment direction

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agreement dated December 21, 2007 (the "Payment Direction") (collectively, the "SHC Transaction").

[30] The SHC Transaction involved the following steps:

(1) ABULC loaned USSC the amount of U.S. $393 million out of the $470 Million Advance (defined below);

(2) USSC repaid the outstanding advance to SHC in the same amount;

(3) USSC sold its equity interest in SHC to USS for consideration in the form of a promissory note dated December 31, 2007 in the principal amount of U.S. $595 million payable to the wholly-owned subsidiary of USSC that owned the shares of SHC. The face amount of the promissory note of U.S. $595 million represented USS' estimation of the fair market value of SHC at the time of the sale; and

(4) The promissory note was distributed by such wholly-owned subsidiary to USSC on December 31, 2007 which, in turn, assigned the note to Credit Corp in reduction of the remaining principal amount outstanding under the Credit Corp Loan, which was slightly less than U.S. $593 million.

[31] The effect of the SHC Transaction was to transfer ownership of SHC from USSC to USS by way of satisfaction of the remaining amount outstanding under the Credit Corp Loan as of December 31, 2007.

The Term Loan

[32] The following summarizes the provisions of the Term Loan that are relevant for the issues in this proceeding and the history of draws and accrued interest under the Term Loan resulting in the USS claim in respect of the Term Loan.

The Relevant Provisions of the Term Loan

[33] The Term Loan is an unsecured loan facility having a term of 30 years repayable by USSC at any time without premium or penalty. The full amount of the outstanding principal is therefore due on October 31, 2037, to the extent it is not repaid before that date. USS says that it selected a 30-year term for the Term Loan because it viewed its investment in Stelco as a long-term one. The 30-year term was also the maximum term countenanced for U.S. tax purposes.

[34] Interest on the Term Loan accrued daily and compounded semi-annually at an interest rate of 9.03% per annum. USS obtained and relied upon advice from an independent, third-party consultant regarding an acceptable interest rate for a company with a similarly rated risk for 30-year debt. Interest is payable on the last business day of the year on the second anniversary after the year in which it accrues. As a result, interest under the Term Loan was payable from 24 to 36 months after the date it began to accrue.

[35] The Term Loan was denominated in Canadian dollars. The Term Loan originally allowed for a maximum borrowing of $1 billion. The maximum availability under the Term Loan was increased from $1 billion to $1.5 billion on December 21, 2007. As mentioned, the

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amount of $700 million was initially advanced on October 31, 2007. The Term Loan provided that further advances could be obtained "with prior written notice … pursuant to a request for advance" set out in a form similar to a scheduled document to the Term Loan.

[36] The loan agreement contains certain representations and covenants of ABULC/USSC and events of default. The events of default include an event of default if the borrower is "unable to meet debts". Upon the occurrence of an event of default, the maturity date is accelerated and Canada LP has the right to demand repayment.

History of Advances and Repayments under the Term Loan

[37] As mentioned above, Canada LP advanced $700 million to ABULC on October 31, 2007 in connection with the Acquisition. This amount became a direct obligation of USSC after the Amalgamation. In addition, during the period from the Acquisition to the Amalgamation, ABULC recorded three additional advances. On December 4, 2007, ABULC recorded two advances totaling approximately U.S. $61 million, of which U.S. $41 million was applied to reduce the Credit Corp Loan and the balance was advanced to USSC for working capital purposes. On December 22, 2007, ABULC recorded an advance of U.S. $470 million under the Term Loan pursuant to the Payment Direction (the "$470 Million Advance"). The foregoing advances under the Term Loan are collectively referred to as the "initial advances".

[38] During 2008, USSC made interest payments to Canada LP under the Term Loan totalling approximately $113 million. Of this amount, $99,940,908 was paid in October and November 2008. Such payments were made in advance of their due date under the Term Loan Agreement, which provided that such interest was not payable until December 31, 2010. In addition, USSC made a principal repayment of $19 million in January 2008. The only additional funding provided to USSC by USS or any of its affiliates in 2008 was an equity injection of approximately $55 million in October 2008.

[39] In 2009, USSC received additional advances from Canada LP under the Term Loan totalling $211.2 million. These advances were made during the months of February, June, September, November and December 2009. No interest or principal was paid during 2009. In addition, as set out in the table above, USS provided equity injections totalling $61 million during 2009. These capital contributions were made in February, July and October 2009.

[40] There were no further advances under the Term Loan after 2009. At the end of 2010, USS decided to waive the remaining interest that was due under the Term Loan in respect of interest accrued during 2008. Since there had been substantial interest payments made in 2008, the accrued interest that was waived in December 2010 was only $10.5 million. USS says that, given USSC's other funding needs at the time, the interest payment could only have been made if USSC received additional funding. Further, due to taxation on interest payments, it did not make economic sense to fund USSC with additional debt or equity in order to enable USSC to repay interest on the Term Loan. USS says that this was the first time that USS considered waiving interest due under the Term Loan. In other words, it asserts that it did not have such expectation at the time that it entered into the Term Loan.

[41] USS continued the practice of waiving interest in each year after 2010. Accordingly, in each of the years 2010 to 2013, USS waived approximately one-half of the accrued and unpaid

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interest due in that year. In total, USS has waived interest obligations of USSC totaling approximately $428 million and has accrued interest under the Term Loan in approximately the same amount.

[42] As of the Filing Date, the total amount outstanding under the Term Loan, including accrued interest, was $1,847,169,934.

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The Revolver Loan

[43] Pursuant to an agreement dated May 11, 2010 between USSC and Credit Corp (as amended from time to time, the "Revolver Loan Agreement"), Credit Corp established a Revolver Loan to provide working capital to USSC to support its operating activities. The Revolver Loan Agreement was subsequently amended successively by an agreement dated July 31, 2012 (the "First Revolver Amendment"), an agreement dated January 28, 2013 (the "Second Revolver Amendment") and an agreement dated October 30, 2013 (the "Third Revolver Amendment") in the circumstances described below. In these Reasons, the loan outstanding under the Revolver Loan Agreement, as so amended from time to time, is herein referred to as the "Revolver Loan" and the Term Loan and the Revolver Loan are collectively referred to as the "Loans" and individually are referred to as a "Loan".

[44] USS has filed two proofs of claim in respected of the Revolver Loan. The first claim is an unsecured claim (being Claim #10) in the amount of U.S. $120,150,928, representing the outstanding loan on October 30, 2013, together with accrued interest since that date. The second claim is a secured claim (being Claim #11) in the amount of U.S. $72,938,390, representing the loan advances since October 30, 2013 plus accrued interest. The following sets out the principal terms of the Revolver Loan, including the related security, and the history of advances and payments in respect of the Revolver Loan.

Terms of the Revolver Loan

[45] The Revolver Loan was originally an unsecured loan having a fifteen-year term. Accordingly, all outstanding advances are due on May 11, 2025. As mentioned, the Revolver Loan originally provided for a maximum availability of U.S. $350 million.

[46] Advances under the Revolver Loan accrued interest at the applicable federal interest rate for the month in which the advance was drawn and compounded interest semi-annually. The applicable interest rate as of the date of the Revolver Loan was 4.42% per annum.

[47] The loan agreement contains certain representations and covenants of USSC, including originally, a solvency representation, and events of default. The events of default include an event of default in the event that the borrower is "unable to meet debts". Upon the occurrence of an event of default, the maturity date is accelerated and Credit Corp had the right to demand repayment. The loan agreement is governed by the laws of the Commonwealth of Pennsylvania.

The History of Advances and Repayments Under the Revolver Loan

[48] Credit Corp advanced a total of U.S. $120 million under the Revolver Loan from its establishment in May 2010 through the third quarter of 2011. Of this amount, U.S. $75 million

was advanced in May 2010, U.S. $25 million was provided in two advances in August 2010, and a further U.S. $20 million was advanced in June 2011.

[49] In the period from November 2011 to April 2012, USSC had somewhat more stable cash flows. Credit Corp advanced approximately U.S. $136 million under the Revolver Loan during this period. During the same period, USSC made interest payments totaling almost U.S. $9 million and principal repayments of approximately U.S. $61.8 million under the Revolver Loan. Thereafter, the outstanding balance began to grow with additional advances in each month in 2012, other than October.

[50] By July 31, 2012, the outstanding principal balance of the Revolver Loan was, however, approaching the cap of U.S. $350 million. On that date, Credit Corp and USSC executed the First Revolver Amendment, which increased the maximum availability under the Revolver Loan to U.S. $500 million. Apart from removal of the solvency representation of USSC, the First Revolver Amendment did not otherwise amend the provisions of the Revolver Loan Agreement, including the events of default. The solvency representation of USSC was removed at the request of USSC's management, which had a concern about USSC's solvency given its recent losses and the level of its debt. The circumstances pertaining to this action are addressed further below.

[51] By January 28, 2013, however, after additional advances to USSC under the Revolver Loan, the outstanding principal balance of the Revolver Loan had again reached the maximum availability. USSC's business plan for 2013 indicated that it would need substantial additional financing during that year in order to finance its operations. Accordingly, on that date Credit Corp and USSC executed the Second Revolver Amendment, which increased the maximum availability under the Revolver Loan from U.S. $500 million to U.S. $600 million, on the condition that USSC grant a security interest in favour of USS in respect of its inventory of iron ore pellets sold to it by SHC. The Second Revolver Amendment did not otherwise amend the provisions of the Revolver Loan Agreement as it existed on January 28, 2013, including the events of default and consequences of a default.

[52] In furtherance of the provisions of the Second Revolver Amendment, USSC granted a security interest in favour of Credit Corp over all of its inventory of iron ore pellets sold to USSC by SHC, and related proceeds, pursuant to a security agreement dated January 28, 2013 executed by USSC and USS (the "Security Agreement").

[53] In February 2013, USS determined that the foreign currency exchange fluctuations on the Revolver Loan, which was a U.S. dollar-denominated loan, had become unacceptable as a result of the volatility of USSC's revenues, and accordingly of its quarterly earnings, due to fluctuations in the Canadian dollar. Over a period of several months thereafter, Canada LP injected significant amounts of equity into USSC to provide for USSC's working capital funding needs and to allow USSC to pay down the Revolver Loan.

[54] Between February and September 2013, as set out above, equity injections provided to USSC totaled over $680 million. Payments of principal and interest on the Revolver Loan over the same period totaled over U.S. $390 million. As of October 30, 2013, the amount outstanding under the Revolver Loan had been reduced to $116,969,996.

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[55] On October 30, 2013, Credit Corp and USSC executed the Third Revolver Amendment. The Third Revolver Amendment contains a recital to the effect that the parties wish to amend and restate the Revolver Loan "in order to permit the Borrower to access the remainder of the [Revolver] Loan." The Third Revolver Amendment continued the availability under the Revolver Loan in the amount of U.S. $600 million. However, it divided borrowings under the facility into two tranches: (1) the "First Tranche Indebtedness", being the outstanding amount of $116,969,996, which was entitled to the security interest over iron-ore pellets constituted by the Security Agreement; and (2) the "Second Tranche Indebtedness", being any advances after October 30, 2013, which were entitled to the general security interest constituted by the October Security Agreement (as defined below). The Third Revolver Amendment did not otherwise amend the provisions of the Revolver Loan as it existed on October 30, 2013, including the events of default and consequences of a default.

[56] Concurrently with the execution of the Third Revolver Amendment, USSC and Credit Corp executed an amendment and restatement of the Security Agreement pursuant to an agreement also dated October 30, 2013 (the "October Amendment"). Pursuant to the October Amendment, USSC granted a general security interest over all of its personal property in favour of Credit Corp. The October Amendment contained a recital to the effect that Credit Corp "is willing to continue to provide Loans pursuant to [the Revolver Loan], only if [USSC] enters into this Amendment". The General Security Agreement, as amended by the October Amendment, is herein referred to as the "October Security Agreement". Apart from broadening the security interest granted in favour of Credit Corp, the October Amendment did not otherwise amend the provisions of the Security Agreement as it existed as of October 30, 2013.

[57] USS has acknowledged that, as of October 30, 2013, although USSC was meeting its obligations as they fell due, the total liabilities of USSC exceeded the market value of its assets and, accordingly, USSC was otherwise "insolvent", including for the purposes of section 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA").

[58] After the execution of the Third Revolver Amendment and the October Security Agreement, Credit Corp advanced loans to USSC under the Revolver Loan totaling U.S. $71 million. These loans were outstanding at the Filing Date. USSC did not make any payments of either principal or interest after October 30, 2013 in respect of the First Tranche Indebtedness under the Revolver Loan outstanding as of October 30, 2013.

[59] Accordingly, at the Filing Date, the total amount outstanding under the Revolver Loan, including accrued interest, was U.S. $193,089,318. The portion of this balance attributable to advances made prior to October 30, 2013, i.e., to the First Tranche Indebtedness plus accrued and unpaid interest thereon since that date, was U.S. $120,150,928. This is the amount of the USS unsecured claim in respect of the Revolver Loan. The portion attributable to advances made after October 30, 2013, i.e., to the Second Tranche Indebtedness, was U.S. $72,938,390, representing U.S. $71 million of advances plus interest. This is the amount of the USS secured claim in respect of the Revolver Loan.

Internal Procedure for Additional Draws and Equity Capital Contributions

[60] In order to request funding under the Term Loan after December 31, 2007 and under the Revolver Loan, USSC would prepare and submit to USS a cash flow forecast setting out its

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anticipated cash requirements for the following 13-week period. The submission of these weekly cash flow forecasts, and the related correspondence and discussions between USS and USSC, constituted USSC's formal request for funding.

[61] USS would review the forecast and determine whether funds would be advanced, and if so whether they would be advanced as debt under the Loans or as an equity injection. Typically the funds would be advanced as debt unless additional debt would cause USSC to go offside the "thin capitalization" tax rules under the *Income Tax Act*.

[62] There is no dispute that all advances made under the Term Loan were documented and recorded by both Canada LP and USSC as debt and that all advances made under the Revolver Loan were similarly documented and recorded by both Credit Corp and USSC as debt. It is also not disputed that all contributions to equity by Canada LP were recorded by both Canada LP and USSC as equity. In this regard, the Monitor has noted that USSC's books and records relating to these intercompany transactions are well organized and documented, including with respect to each specific advance of cash in the form of equity or debt.

[63] The following table summarizes the equity capital injections by USS into USSC between October 31, 2007 and the Filing Date:

Equity Contributions (CAD $Millions)

Period	Original Contribution	Equity Advances	Total
Oct 31, 2007	600		600
Nov 30, 2007	-	-	600
Dec 31, 2007	-	20	620
2008	-	55	675
2009	-	61	736
2010	-	612	1,347
2011	-	213	1,561
2012	-	-	1,561
2013	-	764	2,325
Sept 15, 2014	-	-	2,325
Total	**600**	**1,725**	**2,325**

Source: USSC Share Consideration Registry

[64] The Remaining USS Secured Claims USS has asserted the following three Claims, which it says are secured pursuant to the November Security Agreement (as defined below):

Claim	Amount (USD)	Claim Reference #
Secured Cliffs Transaction	$14,538,462.95	11(a)
Secured Credit Support Payments	$3,742,478.78	11(b)
Secured Intercompany Goods & Services	$31,252,193.05	11(c)

As mentioned, these Claims are collectively referred to as the "USS Remaining Secured Claims". It is my understanding that the Objecting Parties do not challenge the quantum of these

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Claims but assert that the security for these Claims is unenforceable on the grounds described later in these Reasons.

Secured Cliffs Transaction (Claim #11(a))

[65] USS filed a secured claim for U.S. $14,538,462.95 with respect to the amount of a payment made by USS to Cliffs Natural Resources and Cliffs Sales Company (collectively, "Cliffs") for certain iron ore delivered by Cliffs to USSC, which iron ore was, in turn, resold by USS to USSC under the following circumstances.

[66] Cliffs and USS are parties to an agreement dated January 1, 2008 for the supply of iron ore (the "Cliffs Agreement"). The iron ore delivered by Cliffs to USSC was sourced by the USS Procurement Department as part of the raw materials services arrangement between USS and USSC that was provided for in the "Limited Risk Distributor Agreement" referred to below.

[67] The Claim relates to four shipments of iron ore, and associated screening charges, totaling U.S. $14.1 million, which were delivered by Cliffs to USSC in August 2014, prior to the Filing Date and outstanding obligations in the amount of U.S. $0.4 million for screening charges incurred in January and May 2014 for which Cliffs had not previously issued invoices.

[68] On September 16, 2014, pursuant to an agreement between USS and USSC (the "Iron Ore Agreement"), in order to avoid an interruption of the supply of a critical raw material under the Cliffs Agreement, USS agreed to make the payment to Cliffs and to transfer title of the iron ore pellets to USSC provided that USSC confirmed the corresponding obligation of USSC to USS in payment of such iron ore would be secured under the November Security Agreement.

[69] The Monitor has confirmed that USSC received delivery of the iron ore prior to the Filing Date and that USS made the payment of $14.1 million to Cliffs on October 2014. The Monitor has also confirmed that, under the Cliffs Agreement, title to the iron ore did not pass to USS until USS paid for the iron ore after the Filing Date. At that time, USS effectively took title to the iron ore and re-sold it to USSC pursuant to the Limited Risk Distributor Agreement described below.

[70] Accordingly, this Claim is a claim of USS for the payment of goods sold by USS to USSC after the Filing Date pursuant to arrangements set out in the Iron Ore Agreement that were entered into prior to the commencement of these proceedings under the CCAA.

Secured Credit Support Payments - Claim #11(b)

[71] USS filed a secured Claim for U.S. $3,703,450 for contribution and indemnity as guarantor of certain USSC obligations as follows:

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Vendor	Amount (USD)
Independent Electricity System Operator ("IESO")	$2,616,156.27
Union Gas Limited ("Union Gas")	$669,109.87
Norfolk Southern Corporation ("Norfolk")	$457,212.64

[72] USS received demands subsequent to the Filing Date from IESO, Union Gas and Norfolk pursuant to existing guarantee agreements between USS in favour of each of such parties in respect of goods and services supplied to USSC prior to the Filing Date. USS made payments to these vendors pursuant to these guarantees subsequent to the Filing Date. This Claim is therefore an aggregation of USS' rights of subrogation which arose on payment of these three obligations of USSC after the Filing Date pursuant to the USS guarantees in favour of the third parties.

Secured Intercompany Goods & Services - Claim #11(c)

[73] In the ordinary course of business, the USS Affiliates provided raw materials and other goods as well as various services to USSC both informally and under several intercompany agreements. Invoices relating to the intercompany goods and services received by USSC in a calendar month were typically paid on a gross basis on or about the 15th day of the following month as part of a normal reconciliation process between USSC and USS.

[74] USS filed a secured claim totaling U.S. $31,252,193.05 in respect of the sale of goods and the provision of services on an intercompany basis after the date of the November Security Agreement.

[75] As stated above, the sale of goods and the provision of services by USS to USSC took place both informally and under several intercompany agreements. The relevant intercompany agreements include the following: (1) two Marketing, Distributorship and Supply Agreements, dated March 1, 2009 and December 1, 2008, which governed cross-border sales within the USS group, i.e., the sale of steel produced in the U.S. or Canada and sold to a customer in the other country; (2) a Limited Risk Distributor Agreement, dated February 1, 2008, between USS and USSC under which USSC purchased significant quantities of raw material on an as-needed basis from USS; (3) an ERP Cost Sharing Agreement, amended January 1, 2011, that governed the costs of an enterprise-wide financial and operational software solution known as "Oracle"; (4) a Corporate Services Agreement, dated November 1, 2007, pursuant to which USS provided, among other things, financial and accounting, corporate strategic planning, tax planning and audit services to USSC; and (5) a Business Services Agreement, dated January 1, 2014, among USS, USSC and USS Kosice that related to certain IT and financial transaction processing services.

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[76] The claims that are aggregated as Claim #11(c) are therefore contractual claims of USS for payment of the goods and services provided pursuant to these agreements prior to the Filing Date.

Procedural History of this Proceeding

[77] Pursuant to a claims process order of the Court in these CCAA proceedings dated November 13, 2014 (the "Claims Process Order"), creditors of USSC were required to file Proofs of Claim (as defined in the Claims Process Order) in respect of affected Claims with the Monitor by December 22, 2014.

Actions of the Monitor under the Claims Process Order

[78] With respect to any claims filed by USS, U.S. Steel Holdings, Inc., Canada LP or any affiliates of USS (other than USSC or any of USSC's subsidiaries), paragraph 28 of the Claims Process Order ordered:

(a) the Monitor to prepare a report to be served on the Service List and filed with the Court, detailing its review of all USS claims and recommendations it has, if any, with respect to the determination of such claims;

(b) the Monitor to seek a scheduling appointment before the Court, on notice to the Service List, to schedule a hearing of a motion to determine the USS claims; and

(c) that the USS claims shall not be accepted or determined as Proven Claims without approval of this Court.

[79] USS and its subsidiaries and affiliates filed 14 Proofs of Claim with the Monitor, being the "USS Claims".

[80] On March 10, 2015, the Monitor issued its Seventh Report in these CCAA proceedings dated March 9, 2015 (the "Monitor's Seventh Report").

[81] As described at paragraph 8 of Monitor's Seventh Report, the USS Claims may be summarized and aggregated into the following three categories:

(a) non-contingent Secured Claims (as defined in the Claims Process Order), which total U.S. $122,432,496.11 (being the "USS Secured Claims");

(b) unsecured Claims, which total U.S. $127,805,815.36 (being Claims #1 to 8, #10 and an unsecured portion of Claim #11) and $1,847,169,934.04 (being Claim #9); and

(c) contingent Secured Claims, which total $78,761,395.00 (which are not addressed in these Reasons).

[82] The review process undertaken by the Monitor (and in certain cases by the Monitor's counsel) of the USS Claims is described at paragraphs 36-40 of the Monitor's Seventh Report. Based on its review of the USS Claims, the Monitor recommended to the Court that:

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(a) USS bring a motion to approve the USS Secured Claims and the USS Unsecured Claims; and

(b) the USS Secured Claims and the USS Unsecured Claims be found to be Proven Claims in their entirety as filed by USS.

[83] Based on the Monitor's recommendations to the Court, USS commenced this proceeding by a notice of motion dated March 13, 2015. Pursuant to this motion, USS seeks to have the USS Secured Claims and the USS Unsecured Claims approved by the Court as Proven Claims pursuant to the Claims Process Order.

The Objections of the Province, the Union and Representative Counsel

[84] The following briefly summarizes the claims set out in the Objections of the Objecting Parties that have given rise to this trial. In addition, an objection was filed by Robert and Sharon Milbourne (collectively, the "Milbournes"). However, the Milbournes chose not to participate in the hearing of this motion. The Court has therefore treated their objection as withdrawn.

The Objection of the Province of Ontario

[85] On April 14, 2015, an Objection was filed on behalf of the Province.

[86] The Province submitted that the facts of this case raise significant issues with respect to the validity and enforceability of the security interests underlying the secured portions of the USS Claims as well as the proper characterization of the USS Claims. It argued that, in light of these issues, there was an insufficient basis on which to accept the USS Claims as Proven Claims. It argued that a hearing was required to evaluate these issues, which evaluation should include a consideration of whether the security claimed by USS was valid and enforceable given, among other matters, that the adequacy of consideration received by USSC in exchange for the grant of security has not been established. The Province also submitted that the Court should consider whether the USS Claims constitute *bona fide* indebtedness, or whether they are properly characterized as equity contributions from a controlling parent company.

[87] The Objection of the Province was supplemented by a clarification dated August 21, 2015, which set out in greater detail the bases upon which the Province asserts that the Term Loan and the Revolver Loan should be re-characterized as "equity claims" and that the security for the USS Secured Claims should be declared to be a fraudulent preference or otherwise unenforceable. As these arguments are addressed below in the Court's analysis, I do not propose to repeat them in this section.

The Objection of the Union

[88] On April 14, 2015, an Objection was filed by the Union. By way of overview, the Union submitted that USS, as the shareholder of USSC, directed the operations of USSC in a manner that has caused USSC to significantly underperform, thereby incurring substantial losses and requiring it to incur significant debt. In addition, the Union submitted that such actions undermined the ability of USSC to meet its on-going funding obligations to the USW pension plans of USSC. The Union argued that, as a result, USS has diluted the potential recoveries of the Union members and the USW pension plan beneficiaries in this CCAA proceeding.

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[89] The Union broadly categorized its objections as follows:

(a) an objection to the granting of security interests on the assets of USSC;

(b) an objection to the characterization of most of the USS Claims as debt when they are properly characterized as equity; and

(c) an objection grounded in USS' conduct in relation to its Canadian plants, unionized pensioners, pension plan members and beneficiaries, which gives rise to claims of oppression and breaches of fiduciary duty.

[90] With respect to the objection in (a), the Union submitted that USS' secured claim is based on security interests effectively granted by USS to itself, at a time when there was no independent board of directors or advisors, for insufficient consideration, and in a manner which amounted to an improper preference and/or fraudulent conveyance. With respect to the objection in (b), the Union submitted that a significant portion of USS' debt is really in the nature of equity and should be re-characterized as such based on, among other factors, the fact that (i) much of the debt was incurred to acquire Stelco; (ii) USS completely controlled USSC; (iii) USS was the sole source of USSC's financing; (iv) USS provided commercially unreasonable interest and repayment terms; (v) USS had no reasonable expectation of repayment on the purported loans; and (vi) USSC was significantly undercapitalized throughout the years following its acquisition by USS.

[91] The first two claims of the Union overlap significantly, if not completely, with the arguments raised by the Province in its Objection. The remaining claims are not being addressed on this motion. The process for addressing such claims was the subject of an earlier hearing and the Court's endorsement that was released as *U.S. Steel Canada Inc. (Re)*, 2015 ONSC 5103.

The Objection of Representative Counsel

[92] On April 14, 2015, an Objection was filed also filed by Representative Counsel for all non-USW active employees and retirees of USSC. In its Objection and at the trial in this proceeding, Representative Counsel adopted the particulars of the Objections filed by the Province and the Union as applicable to the non-USW active employees and retirees of USSC.

The Disputed USS Claims

[93] For completeness, the Objections that were made in respect of Claims #1-5 in the Monitor's Seventh Report, which are unsecured claims in the aggregate amount of U.S. $3,085,746, have now been withdrawn by the Objecting Parties. Further, no Objections have been made in respect of Claims #6-8 in such Report, which are unsecured claims in the aggregate amount of U.S. $338,169. Therefore, based on the Monitor's Seventh Report, Claims #1-8 inclusive should be confirmed as Proven Claims. The USS Claims which are the subject of this motion, and in respect of which the Objections are maintained, are the following:

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Claim Reference #	Description of Claim	Amount of Claim
9	Unsecured Term Loan	$1,847,169,934
10	Unsecured Revolver Loan	U.S. $120,150,928
11	Secured Revolver Loan	U.S. $72,938,390
11(a)	Secured Cliffs LRD Transaction	U.S. $14,538,463
11(b)	Secured Credit Support Payments	U.S. $3,742,479
11(c)	Secured Intercompany Trade	U.S. $31,252,193

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[94] For clarity, none of the parties object to the quantum of the USS Claims which are the subject of the present motion.

[95] The USS motion and the Objections were addressed collectively at a trial conducted over eight days. The evidence adduced at the trial consisted of affidavit evidence and oral testimony, the relevant portions of which are described below.

Applicable Statutory Law

[96] The following provisions of the CCAA are relevant for the Objections that the USS Claims should be re-characterized as "Equity Claims" for the purposes of these CCAA proceedings:

> 2. In this Act,
>
> "Claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> "Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> > (a) a dividend or similar payment,
> >
> > (b) a return of capital,
> >
> > (c) a redemption or retraction obligation,
> >
> > (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

"Equity Interest" means

(a) in the case of a corporation other than an income trust, a share in the corporation -- or a warrant or option or another right to acquire a share in the corporation -- other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust -- or a warrant or option or another right to acquire a unit in the income trust -- other than one that is derived from a convertible debt;

6. (8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

[97] The following provisions of the CCAA are relevant to the Objections that the security for the secured USS Claims, being the general security interest granted by USSC in favour of Credit Corp in the October Security Agreement and in favour of USS, United States Steel International, Inc. and SHC in the November Security Agreement, should be invalidated on the grounds of a fraudulent preference:

36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

(2) For the purposes of subsection (1), a reference in sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*

(*a*) to *"date of the bankruptcy"* is to be read as a reference to *"day on which proceedings commence under this Act"*;

(*b*) to *"trustee"* is to be read as a reference to *"monitor"*; and

(*c*) to *"bankrupt"*, *"insolvent person"* or *"debtor"* is to be read as a reference to *"debtor company"*.

[98] Section 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA") provides as follows:

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(1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person

(a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and

(b) in favour of a creditor who is not dealing at arm's length with the insolvent person, or a person in trust for that creditor, that has the effect of giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.

(2) If the transfer, charge, payment, obligation or judicial proceeding referred to in paragraph (1)(a) has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made, incurred, taken or suffered with a view to giving the creditor the preference — even if it was made, incurred, taken or suffered, as the case may be, under pressure — and evidence of pressure is not admissible to support the transaction.

The Issues for Determination in This Proceeding

[99] There are two principal categories of Objections addressed in this proceeding: (1) that the USS Debt Claims are, in substance, "equity claims" for the purposes of the CCAA; and (2) that the security for the USS Secured Claims is either unenforceable for lack of consideration or void as a fraudulent preference under section 95 of the BIA, as incorporated into these proceedings by virtue of section 36.1 of the CCAA. These two issues will be addressed in order after first describing certain expert evidence adduced at trial by the parties.

Expert Financial Evidence

[100] The Province and USS introduced expert evidence from three financial experts who testified at trial. The following briefly summarizes the principal issues addressed in the reports and testimony of these experts. The significance of such evidence is considered below in the Court's analysis of the characterization of the Term Loan and the Revolver Loan.

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The Finnerty Report

[101] The Province introduced into evidence a report dated August 21, 2015 of Dr. John Finnerty (the "Finnerty Report"). Dr. Finnerty was qualified as an expert in financial economics. Among other things, the Finnerty Report analyzed the Term Loan and the Revolver Loan against fifteen factors, described later in these Reasons and referred to as the "*AutoStyle* factors", that are used in American courts in debt re-characterization cases. It was Dr. Finnerty's opinion that, from the perspective of financial economics, the terms of the Term Loan and the Revolver Loan, and the manner in which they were implemented, are suggestive of equity rather than debt.

[102] The Finnerty Report concluded that, in respect of the Term Loan, eight of the *AutoStyle* factors are more consistent, from a financial economics perspective, with a characterization of equity, one, being the maturity date provisions and the schedule of debt service payments, is more consistent with a characterization of debt, and the remaining six factors are "indeterminate" from a financial economics perspective.

[103] The eight factors identified in the Finnerty Report as being more consistent with an equity characterization of the Term Loan are the following: (1) the interest rate provisions and the history of interest payments; (2) the inadequacy of capitalization of ABULC at the date of the acquisition; (3) the absence of security for the advances; (4) the inability of USSC to obtain similar financing from outside institutions, based upon the Hall Report described below; (5) the extent to which advances under the Term Loan were effectively subordinated to claims of outside creditors; (6) the absence of a sinking fund to provide debt repayments; (7) the "hollow" right of USS to enforce principal and interest obligations; and (8) the failure of USSC to repay the Term Loan on the due date or to seek a postponement thereof.

[104] The Finnerty Report reached a similar opinion in respect of the Revolver Loan. The Finnerty Report concludes that ten of the *AutoStyle Plastics* factors are more consistent with equity. These are the eight factors enumerated above as being more consistent with equity in respect of the Term Loan, plus: (9) the source of the debt repayments; and (10) the lengthy fixed maturity date and the schedule of debt service payments. The Finnerty Report concludes that the extent to which the advances under the Revolver Loan were used for working capital, rather than to acquire capital assets, is more consistent with a debt characterization and the remaining two factors are "indeterminate".

The Hall Report

[105] The Province also introduced into evidence a report dated August 21, 2014 of Brad Hall (the "Hall Report"), a director of Alix Partners LLC, who was qualified as an expert in institutional lending.

[106] The Hall Report concludes that a third-party lender in an arm's length transaction would not have provided financing to ABULC/USSC in the amounts and on the terms provided by USS pursuant to the Term Loan and pursuant to the Revolver Loan. The Hall Report was incorporated into, and relied upon, by Dr. Finnerty in the preparation of the Finnerty Report.

[107] These conclusions in the Hall Report are based on an assessment of the terms of the Term Loan and the Revolver Loan against the standard of a bank or other institutional lender

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offering unsecured term loans and unsecured revolving loans (herein referred to as a "third-party lender").

[108] In the opinion of Mr. Hall, a third-party lender would have based any term loan granted to USSC in 2007 on the historical financial performance of Stelco, rather than on the projections relied upon by USS for the purposes of the Acquisition, and would have disregarded any of the synergies projected by USS. In addition, a third-party lender would not have granted a term loan on an unsecured basis, nor would it have been prepared to accept the provisions of the Term Loan in respect of the maturity date, principal repayments or interest payments.

[109] Similarly, Mr. Hall was of the view that a third-party lender would not have granted an unsecured loan in the amount of the Revolver Loan in 2010 nor would it have accepted the provisions of the Revolver Loan respecting the maturity date or interest payments. In addition, the Hall Report addresses the financial performance covenants that a third-party lender would typically require, principally debt/equity, Debt/EBITDA and EBITDA/interest tests, and observed that, given USSC's financial performance after 2008, USSC would not have complied with the latter two tests as typically applied at the time of advances under the Revolver Loan.

[110] The Hall Report also concluded that the terms of the Term Loan were not comparable with the loans provided by the prior arm's length lenders to Stelco or by the arm's length lenders that provided financing at or about the same time to USS. I do not find these opinions of assistance with respect to the issues in this proceeding.

The Austin Smith Report

[111] USS introduced into evidence a report dated September 4, 2015 of Yvette R. Austin Smith (the "Austin Smith Report"), a principal of the Brattle Group, which addressed certain features of the Finnerty Report and the Hall Report. For present purposes, the Austin Smith Report reached three principal conclusions, aspects of which are relevant for the determinations below in these Reasons.

[112] First, the Austin Smith Report says that the conclusions in the Finnerty Report — that, from a financial economics perspective, the terms of the Term Loan and the Revolver Loan, and the manner of their administration, are strongly suggestive of an equity investment — relies too heavily on hindsight to be credible. The Report suggests that, as a result, the application of the *AutoStyle* factors does not assist in establishing the substance of these transactions or the intent of the parties at the time of the establishment of the Loans.

[113] Second, the Austin Smith Report concludes that the opinion in the Hall Report that USSC could not have financed the Term Loan and the Revolver Loan "in the amounts and on the terms as provided by USS" relies on a flawed credit analysis of USSC that, therefore, does not address USSC's debt capacity after the Acquisition.

[114] Third, the Austin Smith Report suggests that the opinions in the Hall Report, and therefore in the Finnerty Report, ignore the reality of diverse corporate debt markets in their concentration on the third-party lender market.

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Observations Regarding the Expert Financial Evidence

[115] I do not propose to make any finding regarding the differences of opinion expressed in the Finnerty Report and in the Austin Smith Report on the particular issues raised in the latter as it is not necessary to do so for the purposes of the determinations herein. However, the following three observations regarding the matters addressed in the expert evidence relied upon by the Objecting Parties are relevant to the approach set out below in these Reasons.

[116] First, in respect of most of the *AutoStyle* factors to which Dr. Finnerty refers as suggestive of equity rather than debt, Dr. Finnerty expressly or implicitly measures the Term Loan and the Revolver Loan against the standard of a bank or other institutional lender offering unsecured term loans and unsecured revolving loans, that is, against the standard of a third-party lender offering such loans.

[117] At the risk of some oversimplification, Dr. Finnerty's logic is as follows. The Term Loan and the Revolver Loan purport on their face to be an unsecured term loan and an unsecured revolver loan. The market for such loans is the third-party lender market. However, the terms and conditions of the Term Loan and the Revolver Loan are not terms and conditions that would be acceptable to a third-party lender nor were the Loans administered in certain respects in the manner that would be expected of a third-party lender. Therefore, from the perspective of financial economics, the Loans must be equity. It is the validity of the last proposition in this chain that is at issue in this proceeding. The conclusions of Dr. Finnerty are more or less relevant in this proceeding depending upon whether a third-party lender standard is appropriate in addressing financial arrangements between a parent corporation and its wholly-owned subsidiary. This issue is addressed below.

[118] Second, as Dr. Finnerty testified, of the fifteen *AutoStyle* factors, three principal factors inform his conclusions that the Loans are more suggestive of equity rather than debt. These factors are: (1) the absence of available financing from third-party lenders on the terms and in the amount of the Term Loan and the Revolver Loan; (2) the waiver of interest payments under the Term Loan in 2010 and thereafter; and (3) the "fungibility of debt and equity", which refers to the payment of interest and repayment of principal by USSC out of equity injections received from USS, principally in respect of the Revolver Loan. It is therefore appropriate to focus on the evidentiary value of these three considerations, rather than on the larger list which effectively repeats the same considerations.

[119] Lastly, I would observe that, while Dr. Finnerty was qualified as an expert in financial economics, substantially all of his expert evidence related to his view of third-party lender behaviour in various circumstances, rather than to any more formal analysis that was informed by the analytical framework of financial analysis.

Expert Legal Evidence

[120] USS and the Province also introduced expert legal evidence from two lawyers who testified at trial regarding a specific issue of Pennsylvania law. The following briefly summarizes the issue of law and the testimony of these experts. The issue is significant for the analysis of the validity of the security for the USS Secured Claims.

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The Issue

[121] The Revolver Loan Agreement contained an event of default in section 11c as follows: "Borrower consents to the appointment of a receiver, trustee or liquidator of all or substantially all of its assets, is unable to meet debts, or files bankruptcy". The same event of default was continued after each of the First Revolver Amendment, which removed the solvency representation, the Second Revolver Amendment and the Third Revolver Amendment.

[122] The expert testimony addressed the meaning of the phrase "unable to meet debts" as a matter of contractual interpretation under the laws of Pennsylvania. Both experts testified that the principles of contractual interpretation under Pennsylvania law are substantially similar to the principles under Ontario law with, based on USS' expert, a tendency toward somewhat greater emphasis on the strict construction of contracts.

[123] I would observe that, while the expert testimony was tendered in respect of this provision in the Revolver Loan Agreement, the same event of default appears in section 13(c) of the Term Loan Agreement which is governed by the laws of Alberta.

The McMichael Report

[124] USS introduced into evidence a report dated August 21, 2015 of Lawrence McMichael (the "McMichael Report"). It was Mr. McMichael's opinion that the phrase "unable to meet debts" connoted a balance sheet solvency test which, under Pennsylvania law, would be performed on a market value basis. Accordingly, Mr. McMichael was of the opinion that the contractual interpretation of clause 11c of the Revolver Loan Agreement resulted in an event of default in the circumstances in which the aggregate liabilities of USSC exceeded the fair market value of its assets.

The Di Massa Report

[125] The Province introduced into evidence a report dated September 4, 2014 of Rudolf Di Massa, Jr. (the "Di Massa Report"). It was Mr. Di Massa's opinion that the phrase "unable to meet debts" did not connote an insolvency test as such, whether on a balance sheet basis or on a going concern basis. Mr. Di Massa was of the view that the correct statutory interpretation of this phrase meant "unable to satisfy or manage its obligations relating to operating activities on an on-going basis given its financial resources from all available sources". He described this event of default as essentially a direction from USS to USSC to manage its financial obligations by obtaining credit from all available sources, including from trade creditors through an extension of payment terms and from USS itself by drawing up to the maximum availability under the Revolver Loan Agreement.

[126] An important feature of Mr. Di Massa's interpretation is his view of the operation of the Revolver Loan Agreement, which is significant in three respects. Mr. Di Massa's opinion implies that an event of default would not arise unless and until USSC had drawn the maximum availability under the Revolver Loan Agreement and was unable to foresee obtaining credit from any other possible sources on a prospective basis. It also implies that, under the Revolver Loan Agreement, USS was obligated to continue to advance funds until such maximum availability was reached, subject to the occurrence of one of the other events of default in the Agreement.

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Lastly, as the phrase "unable to meet debts" is the only event of default that appears to address the state of insolvency, and, as Mr. Di Massa is of the view that this phrase does not serve as an insolvency event of default, his interpretation has the result that the Revolver Loan Agreement lacks an express insolvency event of default.

The Findings of the Court

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[127] The Court finds that, under the laws of Pennsylvania, the words "unable to meet debts" in the Revolver Loan Agreement mean that the fair market value of the assets of USSC are less than the total of its liabilities, that is, that the words connote a balance sheet solvency test. I reach this conclusion for the following four reasons.

[128] First, this interpretation is more consistent with the plain meaning of the words "unable to meet debts" than the interpretation proposed by Mr. Di Massa. In particular, it recognizes the absence of the additional words "when due", or words to a similar effect. Such words appear in the events of default in sections 11a and 11b of the Revolver Loan Agreement. If they had been incorporated into the "unable to meet debts" event of default, I think it is clear that they would have indicated an intention to apply an event of default in the event of an inability to meet USSC's obligations as they fell due, i.e. a going concern event of default. Their absence indicates an intention that the event of default would relate to the alternative definition of insolvency under the laws of Pennsylvania, being the extent of assets relative to liabilities. For this reason, while it is true that the parties could have used more specific language if they had intended a balance sheet insolvency event of default, instead of the rather archaic phrase that appears, I do not think that such words connote a going concern event of default or the approach proposed in the Di Massa Report.

[129] Second, as a related matter, the interpretation proposed in the Di Massa Report requires reading in language that is neither present nor customary. Such an interpretation should be rejected in favour of an interpretation that gives effect to the plain meaning of the language of the event of default.

[130] Third, even assuming an ambiguity in the language of the event of default, the Di Massa Report relies heavily on an inference based on the removal of the solvency representation from the Revolver Loan agreement by the First Revolver Agreement. The solvency representation spoke to both balance sheet solvency and solvency on a going concern basis. It is suggested that it would have been illogical for USS and USSC to have removed the solvency representation and maintained a balance sheet event of default. It is also suggested that interpretation of the event of default as a balance sheet solvency event of default would have resulted in a continuing state of default under the Revolver Loan Agreement, with automatic acceleration of the Revolver Loan, which could not have been intended.

[131] As discussed later in these Reasons, I do not think that any conclusion can be drawn regarding the intention of the parties in respect of the removal of the solvency representation. In particular, I do not think that there is any evidence regarding the surrounding circumstances in which the First Revolver Amendment was negotiated and executed that bears on the interpretation of the event of default.

[132] Fourth, an important principle of contractual interpretation is that, in the case of ambiguity, a court should prefer the more commercially reasonable interpretation. In my view, for the following reasons, the interpretation proposed by Mr. Di Massa results in an unreasonable result from a commercial perspective.

[133] In this case, while the interpretation in the McMichael Report may have had the result that USSC was in default as of the execution of the Third Revolver Amendment, if not before, I do not see a particular difficulty in this. Unlike a third-party lender, there is no evidence that USS had a particular concern with the occurrence of a balance sheet event of default under the Revolver Loan. It could always choose to waive any event of default and advance further funds notwithstanding the occurrence of an event of default. In this respect, the evidence of Mr. Di Massa that a commercial lender would not engage in such behaviour is not a relevant consideration.

[134] On the other hand, USS would have had a significant concern with any renunciation of its ability to control the extent, if any, of future advances of funds. As Mr. McMichael testified, lenders, including parents of wholly-owned subsidiaries, do not intend to be bound to lend money that they do not believe will be repaid. This is particularly important with respect to the operation of the Revolver Loan Agreement in October 2013 given the amount of the undrawn facility — being approximately U.S. $383 million — and the cash burn of USSC in 2013, including the anticipated cash burn for the rest of the year. In addition, USS would not have intended the availability under the Revolver Loan to extend beyond what was absolutely necessary, having just completed a significant de-leveraging exercise for other reasons.

[135] Further, as noted above, the interpretation in the Di Massa Report has the result that there is no balance sheet event of default in the Revolver Loan Agreement. As a parent corporation controls the advance of funds to a subsidiary, and thereby its ability to meets its obligations on an on-going basis, a parent corporation would not necessarily need an event of default for a failure to meet on-going obligations. It would, however, require a balance sheet event of default for protection against third parties in the event of an insolvency of its subsidiary.

[136] Given the foregoing considerations, I consider that the interpretation proposed by Mr. Di Massa produces a commercial unreasonable result while the interpretation of Mr. McMichael results in a commercially viable loan arrangement.

The Debt Re-Characterization Claims

[137] I propose to address the debt re-characterization claims of the Objecting Parties in the following order. First, I will deal with two threshold issues. Next, I will address the test to be applied by the Court in the analysis of the characterization of both the Term Loan and the Revolver Loan. I will then address the debt characterization claims of the Objecting Parties in two parts. The first part addresses certain general considerations raised by the Objecting Parties that are common to both the Term Loan and the Revolver Loan. The second part sets out my analysis of each of the Term Loan and the Revolver Loan in turn in light of the Court's determinations regarding these general considerations.

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Threshold Issues

[138] The two threshold questions to be addressed are: (1) the onus of proof; and (2) the test to be applied in the evaluation of the debt re-characterization claims respecting the USS Debt Claims. I will address each issue in turn.

The Onus of Proof

[139] As would be expected, USS argues that the burden of proof lies with the Objecting Parties and the Objecting Parties argue that it lies with USS. I will deal separately with the burden of proof pertaining to the debt re-characterization claims of the Objecting Parties and the claims that the security for the USS Secured Claims is invalid or otherwise unenforceable.

[140] The issue of the burden of proof in respect of the debt re-characterization claims appears to be a matter of first impression as the parties have been unable to find any case law on this issue. I conclude that the Objecting Parties have the burden of proof that the USS Debt Claims are properly characterized as "equity claims" under the CCAA for the following three reasons.

[141] First, in a claims process under the CCAA, a creditor bears the onus of proving the validity and amount of its debt claim. It is not required to go further and prove the negative. In other words, it does not have to demonstrate that a claim is not an "equity claim". If another creditor chooses to assert such an argument, I think it must bear the onus of proving that an otherwise proven debt claim is more properly characterized in substance as an "equity claim".

[142] Second, put in procedural terms, the motion of the creditor, in this case USS, is limited to a determination of the validity and amount of its debt claim in order to establish a "Proven Claim" under the Claims Process Order. The objection of any other creditor, in this case the Objecting Parties, is in substance a cross-motion for a declaration that the debt claim, if accepted, constitutes in substance an "equity claim" for the purposes of the CCAA. I do not agree with the Objecting Parties that the motion of the objecting creditor should be regarded as the substantive equivalent of a statement of defence which must be addressed to establish the validity and amount of a moving party's debt claim.

[143] Lastly, an important consideration is that the debt re-characterization claims of the Objecting Parties are based on the underlying substantive reality of the Term Loan and the Revolver Loan. These are factual matters, rather than matters based on allegations of inequitable behavior on the part of USS. I accept that there may be an argument for a reversal of the onus of proof in the circumstances of a *bona fide* allegation of bad faith or inequitable conduct on the part of an insider or a controlling shareholder of a debtor company that could engage an equitable remedy in favour of the injured party or an analogous statutory remedy. However, as mentioned, that is not the basis of the claims of the Objecting Parties on this motion.

[144] The Objecting Parties' argument that the security for the USS Secured Claims is invalid or, in the alternative, unenforceable raises two issues, although I conclude that the Objecting Parties bear the onus of proof in either case.

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[145] With respect to the claim that the October Security Agreement and the November Security Agreement are unenforceable for lack of consideration, I think the same principles govern the issue of onus as apply with respect to the issue of onus regarding the treatment of the USS Debt Claims as "equity claims". A creditor asserting a Secured Claim must move for a determination that the security is valid. To such end, the creditor must establish that the security was delivered by the debtor company, that the security is expressed to cover the creditor's claim, and that any necessary registrations were effected under applicable legislation. An objection of any other creditor that such security is invalid or otherwise unenforceable on any other basis would involve a cross-motion by such objecting creditor seeking a declaration to such effect.

[146] With respect to the claim that the October Security Agreement and the November Security Agreement constitute fraudulent preferences for purposes of section 95 of the BIA, the Objecting Parties acknowledge that the case law establishes that they bear the onus of proof.

The Test to Be Applied

[147] The more difficult threshold issue is identification of the test to be applied to determine whether the USS Debt Claims are debt obligations or "equity claims".

[148] The Term Loan and the Revolver Loan are, on their own terms, loans rather than equity contributions. The terms and conditions of the Term Loan Agreement and the Revolver Loan Agreement unequivocally evidence loan agreements. The Term Loan and Revolver Loan are both documented as loans in contracts entitled "Loan Agreement" in which the parties are described as lender and borrower. Each loan agreement prescribes a term and an interest rate, requires repayment, and has no terms expressly tying any payments to the financial performance of USSC. USS and USSC also had very different processes for approval and transmission of loan advances and equity contributions. The financial accounts of Canada LP or Credit Corp, as applicable, and USSC accurately recorded the loan advances separately from equity contributions.

[149] The form of the documentation for the Loans, and the foregoing actions, are the point of departure. USS says it intended the outstanding advances under the Term Loan and the Revolver Loan to be loans rather than capital contributions. Accordingly, USS says that the USS Debt Claims are in respect of loans and are not "equity claims". The issue for the Court on this motion is, therefore, whether the foregoing actions and documentation are determinative. USS argues that there is no further issue for the Court for two alternative reasons based, respectively, in the language of the CCAA and in the pre-2009 Canadian case law. I will address these two arguments in turn.

The Provisions of the CCAA

[150] USS argues that the most recent amendments to the CCAA, which introduced the definition of "equity claims", comprehensively codified the treatment of "equity claims" with the result that the issue of whether a particular claim is to be treated as debt or equity is solely a matter of statutory interpretation. It relies on *Re Sino-Forest Corp.*, 2012 ONCA 816, 114 O.R. (3d) 304, at paras. 30 and 36, for this proposition.

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[151] In the circumstances of this case, USS argues that the USS Debt Claims are not claims in respect of a share of USSC, or a warrant or option or another right to acquire a share of USSC. It submits that, accordingly, the USS Debt Claims are not claims in respect of an "equity interest" and, therefore, are not "equity claims". USS says that, as a result, the USS Debt Claims are claims in respect of loans.

[152] I agree that the issue of whether a particular claim is to be treated as debt or equity is a matter of statutory interpretation. I also agree that the USS Debt Claims do not fall within paragraph (d) of the definition of "equity claim" which refers to "a monetary loss resulting from the ownership, purchase or sale of an equity interest". This provision addresses the circumstances of shareholders pursuing securities misrepresentation or oppression actions against a debtor company. It prevents recovery of claims by such shareholders for the value paid for their shares prior to the satisfaction of claims of debt-holders of the debtor company: see *Re Sino-Forest Corp*., 2012 ONSC 4377 (Commercial List), at paras. 71, 80, 96, aff'd 2012 ONCA 816, 114 O.R. (3d) 304.

[153] However, I do not read the definitions of "equity claim" and "equity interest" as narrowly as USS. The USS argument relies implicitly on the need for the demonstration of the issuance of shares as a requirement of an "equity claim". In doing so, USS ignores the reality of a sole shareholder situation and reaches an unreasonable conclusion.

[154] In the circumstances of a sole shareholder, there is no practical difference for present purposes between a shareholding of a single share and a shareholding of multiple shares. Accordingly, for the purposes of the definition of an "equity claim", there should be no difference between a payment to a debtor company on account of the issuance of new shares and a payment to a debtor company by way of a contribution to capital in respect of the existing shares.

[155] On this basis, I conclude that, as a matter of statutory interpretation, the definition of an "equity claim" must extend to a contribution to capital by a sole shareholder unaccompanied by a further issue of shares. Put another way, I conclude that a payment by a sole shareholder of a debtor company on account of a capital contribution constitutes a payment in respect of a share of the debtor company. Such a payment would therefore constitute an "equity interest" and a claim in respect of such payment in a CCAA proceeding would be a claim for a return of such capital and therefore an "equity claim".

[156] Further, I conclude that there is no reason why the reference to "a return of capital" in paragraph (b) of the definition of "equity claim" should be limited a claim in respect of an express contribution to capital by a shareholder. A transaction can be a contribution to capital in substance even if it expressed to be otherwise.

[157] Accordingly, I conclude that the issue for the Court in this proceeding is whether the USS Debt Claims constitute claims for a return of capital in respect of the shares in USSC owned by USS. In order to decide that issue, the Court must decide whether the advances made under the Term Loan and the Revolver Loan constituted loans to USSC or contributions to the capital of USSC in respect of the outstanding shares of USSC owned by USS. To the extent any of such advances constituted a contribution to capital, any claim for such amounts as Proven Claims in

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these CCAA proceedings would constitute a claim for a return of capital and, therefore, an "equity claim".

Pre-2009 Canadian Case Law

[158] USS makes an alternative submission in the event the Court finds that the definition of "equity claim" does not preclude a determination of whether the USS Debt Claims are be treated as debt or equity. USS says that the applicable Canadian case law regarding debt re-characterization issues, which pre-dates the recent amendments to the CCAA, requires that a court have regard solely to the intention of the parties as a matter of the contractual interpretation of the relevant documentation in determining whether any transaction gave rise to an "equity interest".

[159] In this case, as mentioned above, USS says that the relevant documentation consists of the Term Loan Agreement, the Revolver Loan Agreement and the documentation pertaining to the advances and payments thereunder. USS submits that the intention of both parties at the time of execution of the Term Loan Agreement and the Revolver Loan Agreement, and at the time of all advances thereunder, is manifest on the face of such documents. It submits that, as a matter of contractual interpretation, it is clear that USS and USSC intended that such transactions would constitute debt obligations of USSC rather than capital contributions by USS to USSC. USS says that Canadian case law provides no basis for going beyond the exercise of contractual interpretation to evaluate whether the USS Debt Claims should be characterized as "equity claims" on some other basis.

[160] In making this argument, USS relies, in particular, on the decision of the Supreme Court in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In that decision, the issue was whether certain monies provided to the Canadian Commercial Bank (the "CCB") had been provided by way of a loan or a capital investment. At paragraph 51, the Court approached the issue before it as a matter of contractual interpretation as follows:

> As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

[161] The Supreme Court concluded that the transaction in that case was a loan, noting that: (1) there was nothing in the express terms of the agreements in question which supported a conclusion that the money was advanced as an investment; and (2) there were express provisions supporting a characterization of the advance as a loan, including provisions for repayment, for an indemnity should full repayment not be made from the sources contemplated, and for equal ranking with the ordinary creditors of CCB: see *Canada Commercial Bank*, supra at para. 63.

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[162] In *(Re) Bul River Mineral Corporation*, 2014 BCSC 1732, 16 C.B.R. (6th) 173, Fitzpatrick J. summarized the principles in *Canadian Commercial Bank* in the following manner, which I find helpful in the present case:

> (a) the fact that a transaction contains both debt and equity features does not, in itself, determine its characterization as either debt or equity;
>
> (b) the characterization of a transaction under review requires the determination of the intention of the parties;
>
> (c) it does not follow that each and every aspect of a "hybrid" debt and equity transaction must be given the exact same weight when addressing a characterization issue; and
>
> (d) a court should not too easily be distracted by aspects of a transaction which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

This summary demonstrates that the issue before the court in *Canadian Commercial Bank* was the characterization of an instrument that had characteristics of both debt and equity.

[163] I do not find the decision of *Canadian Commercial Bank* helpful in the present circumstances for the reason that the present circumstances differ in two important respects.

[164] First, the subject-matter in *Canadian Commercial Bank* was, as mentioned, a hybrid security, i.e., a security having characteristics of both debt and equity. Therefore the issue was whether the security in question should be characterized as a debt obligation or a capital investment. The present proceeding does not involve a hybrid security. As mentioned above, the relevant documentation unequivocally evidences loan transactions on their face.

[165] Second, the parties to the transaction in *Canadian Commercial Bank* were at arm's length and the transaction documentation represented the outcome of arm's length negotiations between the parties. The parties to the Term Loan Agreement and the Revolver Loan Agreement were not at arm's length. As a result, the form of the documentation, including the characterization of the transaction as debt rather than equity, was determined by USS in its sole discretion, subject only to satisfaction of any applicable Canadian legal considerations raised by USSC.

[166] In such circumstances, the task of a court is qualitatively different from that in *Canadian Commercial Bank*. In that decision, given the hybrid nature of the security under consideration, the issue was whether the parties intended that the institutions providing financial support to the CCB were making a capital investment in the bank or were making a loan to it. In other words, the intentions of the parties were unclear without a contractual analysis to determine the substance of the transaction that had been agreed upon. At the same time, given the arm's length relationship between the parties, the language of the agreements could be relied upon as an accurate reflection of the intentions of the parties regarding the substantive reality of the transaction.

[167] Where, however, as in the present circumstances, the parties are not at arm's length, the issue is not what the parties say they intended regarding the substance of the transaction as a

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matter of contractual interpretation. The expressed intention of the parties is clear. However, given the absence of any arm's length relationship, there can be no certainty that the language of the agreements reflects the underlying substantive reality of the transaction. Accordingly, the issue for a court is whether, as actually implemented, the substance of the transaction is, in fact, different from what the parties expressed it be in the transaction documentation.

[168] In other words, the task of a court is to determine whether the transaction in substance constituted a contribution to capital notwithstanding the expressed intentions of the parties that the transaction be treated as a loan. It is therefore not appropriate to limit the inquiry into the intentions of the parties to a review of the form of the transaction documentation. Such an exercise reduces to a "rubber stamping" of the determination of a single party to the transaction, i.e., the sole shareholder, and it does not address the substance of the transaction as it was actually implemented. In such circumstances, the determination of whether a particular claim is to be treated as debt or equity must address not just the expressed intentions of the parties as reflected in the transaction documentation but also the manner in which the transaction was implemented and the economic reality of the surrounding circumstances.

[169] USS also refers to the decision of the Court of Appeal in *Metropolitan Toronto Police Widows and Orphans Fund v. Telus Communications Inc*., [2005] O.J. No. 2309 (C.A.), leave to appeal to S.C.C. denied, [2005] S.C.C.A. No. 379, at paras. 38-40. In these paragraphs, the Court of Appeal stated that: (1) the determination of the legal character of a transaction is not a simple mechanical exercise of assessing and tallying up a list of factors and then deciding whether they net out to one or the other; and (2) that a court must give legal effect to the intention of the parties as expressed in the language of an agreement. In that case, the Court of Appeal also recognized that the respective needs of the parties to an agreement are an indication of their intention and that parties are entitled to structure their contractual relationships as they see fit, absent a sham or public policy considerations dictating otherwise.

[170] I do not find this decision to be helpful in the present circumstances for the same reasons as the decision in *Canadian Commercial Bank* does not address the issues in the present proceeding. *Metropolitan Toronto Police Widows and Orphans Fund* involved the characterization of a securitization transaction as either a sale or a loan. In that context, the issue before the Court of Appeal was a matter of contractual interpretation. The transaction was an arm's length commercial transaction. Accordingly, the documentation before the court in that case could be relied upon to accurately reflect the intentions of the parties regarding the underlying economic reality of the transaction. I do agree, however, with the statement of the Court of Appeal in that decision that determination of the substantive nature of a transaction is not conducted by means of a simple "scorecard" of factors.

[171] I would observe, however, that in large measure the difference between the parties in this proceeding – which appears to reduce to the significance to be attached to the manner in which the Loans were administered – is perhaps more semantic than real. The Objecting Parties proposed, and USS accepted, that a useful summary of the appropriate approach to be taken in the present proceeding was set out in a non-binding, American decision, *In re Fedders North America, Inc*., 405 B.R. 527 (2009), U.S. Bankruptcy Court, D. Delaware, at para. 59, as follows:

> The law regarding recharacterization is well-settled in this jurisdiction. The Third Circuit has held that the overarching inquiry with respect to recharacterizing debt

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> as equity is whether the parties to the transaction in question intended the loan to be a disguised equity contribution. *In re SubMicron Systems Corp.*, 432 F.3d 448, 455-56 (3d Cir.2006). This intent may be inferred from what the parties say in a contract, from what they do through their actions, and from the economic reality of the surrounding circumstances. *Id.* at 456. Recharacterization has nothing to do with inequitable conduct, however. *See In re AutoStyle Plastics, Inc.*, 269 F.3d 726 at 748-49 (6th Cir. 2001) (discussing the differences between equitable subordination and recharacterization)

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[172] On this basis, the parties do not dispute the process so much as the result. They have fundamentally different views on the intentions of USS and USSC regarding the substance of the transaction which I think can be summarized as follows.

[173] The Objecting Parties say that the Term Loan Agreement and the Revolving Loan Agreement reflect arrangements under which USS intended, at all times, on the one hand, to return excess cash to USS when it became available, and, on the other hand, to write off the principal or interest to the extent that payments of either were due and sufficient cash was not available.

[174] USS acknowledges that the Term Loan and subsequently the Revolver Loan were established with the intention of constituting the principal vehicles by which cash would be advanced to USSC, initially for the purposes of the Acquisition and subsequently for working capital purposes, and by which excess cash in USSC from any source would be repatriated to USS. USS says, however, that, at all times, it extended advances and made payments under the Term Loan and the Revolver Loan in accordance with their terms. USS argues that nothing in the manner in which it established or operated the Term Loan and the Revolver Loan reflected, in substance, a contribution to the capital of USSC, and that the only contributions to capital were made outside the loan arrangements in the form of the equity injections set out in Exhibit "O" to the Monitor's Seventh Report.

[175] These two competing views of the substance of the Term Loan and the Revolver Loan frame the debt re-characterization issues addressed in these Reasons.

The American Multi-Factor Analysis

[176] Given these competing views of the Term Loan and the Revolver Loan, it is necessary to determine an appropriate test for the determination of whether the USS Debt Claims are in substance claims in respect of loans or are "equity claims". The Objecting Parties urge the Court to adopt the multi-factor analysis prevailing in American courts under which courts evaluate a long list of factors drawing conclusions about what factors are most determinative in any given fact scenario.

[177] As referenced above, a leading case in this area is *In re AutoStyle Plastics, Inc.*, 269 F.3d at 749-50 (6th Cir., 2001), in which the court articulated the following eleven factors:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the

> source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

In addition, courts in other American circuits have considered the following additional factors: (1) the right to enforce payment of principal and interest; (2) participation in management flowing as a result; (3) the failure of the debtor to repay on the due date or to seek a repayment postponement; and (4) the intent of the parties: see *In re Submicron Systems Corporation*, 432 F.3d (3rd Cir., 2006), at 455-456. In the interest of simplicity, in these Reasons I refer to the fifteen factors enumerated in this paragraph as the "*AutoStyle* factors", although I acknowledge this is technically inaccurate.

[178] The Objecting Parties refer to the following description of the multi-factor analysis from *In re Submicron Systems Corporation*, at 455-456, which appears to restate the approach set out above in *Re Fedders*:

> In defining the re-characterization inquiry, courts have adopted a variety of multi-factor tests borrowed from non-bankruptcy case law. While these tests undoubtedly include pertinent factors, they devolve to an overarching inquiry: the characterization as debt or equity is a court's attempt to discern whether the parties called an instrument one thing when in fact they intended it as something else. That intent may be inferred from what the parties say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstances. Answers lie in facts that confer context case-by-case.

[179] There does not appear to be any reported Canadian or Commonwealth cases in which courts have purported to apply the multi-factor, re-characterization tests relied upon by the Objecting Parties prevailing in American courts. The Objecting Parties urge the Court to formally adopt the foregoing eleven or fifteen factors in making a determination in this proceeding.

[180] American courts find authority for this approach in the general equitable powers granted to a bankruptcy court under the provisions of section 105(a) of the United States *Bankruptcy Code*, 11 U.S.C 1982, which is the equivalent of section 11 of the CCAA. USS says the Court lacks similar authority under the CCAA on the basis that the recent amendments to the CCAA in this area have limited the scope of a court's authority under section 11. USS relies on the earlier decision of the Court in *U.S. Steel Canada Inc. (Re)*, 2015 ONSC 5103, at para. 51, as follows:

> … I consider that the language of the definition of an 'Equity Claim" and of the provisions of section 36.1 operates as a "restriction set out in the Act" for the purposes of section 11 of the CCAA which has the effect of limiting the authority of the Court in any determination regarding an "Equity Claim" or in any proceedings brought under section 36.1.

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However, that decision does not address the extent of the Court's authority under the CCAA in the evaluation of whether a security or a transaction expressed to be a debt claim is, in substance, an "equity interest". At a minimum, any such evaluation requires consideration of a number of the factors considered by American courts in the multi-factor analysis and by Canadian courts in evaluating the underlying substance of a transaction.

[181] The more immediate, and more important, issue for the Court is a framework for identification of the specific considerations or factors to be applied in the context of the present proceeding. The American cases evidence the obvious reality that, in any given situation, different factors or considerations will be more or less persuasive. Insofar as the American cases suggest a "scorecard" approach, however, I have rejected such an approach in favour of an evaluation of the substantive reality of the USS Debt Claims. In the end, in this proceeding, the *AutoStyle* factors constituted no more than the starting point, in the form of a list of factors upon which the parties drew to support their characterization of the USS Debt Claims. In short, it is not necessary to adopt the American, multi-factor analysis as a formal matter in the determination of the issues before the Court, and I therefore decline to do so.

The Approach of the Court

[182] As a first step in the identification of the specific considerations that should inform the determination of the substance of the USS Debt Claims, I propose to start with a conceptual understanding of the dividing line between debt and equity.

[183] An appropriate starting point is the definition of debt and equity for financial purposes set out in paragraphs 32 and 34 of the Finnerty Report:

> At its heart, the difference between equity and debt lies in the fundamental nature of their respective claims on the assets and cash flow of the company. Debt involves borrowing funds subject to a legal commitment to repay the borrowed money with interest at an agreed rate by a stated maturity date. This commitment is embodied in a contract, and this contract is implemented by the borrower. Lenders receive a contractually agreed set of cash flows, typically through periodic interest payments and one or more principal repayments, the last of which occur on the maturity date. … In contrast to debt, an equity claim entitles the holder to a share of the company's profits and residual cash flows after the company has made all the contractually required debt service payments. That is, the debt ranks senior to the equity with respect to the company's cash flows. Similarly, the debt ranks senior to the equity in the event the company must be liquidated and its assets sold to repay its debt obligations. The equityholders get what is left after the holders of the debt have been paid in full; if the debtholders can't get paid in full, then the equityholders get nothing.

[184] With this definition in mind, the Province suggests that the Court should address the substance of the Term Loan and the Revolver Loan from the perspective of whether the evidence is more consistent with an intention and a practice of repayment of principal plus interest under these Loans, or the payment of the residual cash flow and assets of USSC. I think this is a helpful approach, even if at a general level.

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[185] Therefore, in the context of a parent-subsidiary relationship, the fundamental consideration in assessing whether a transaction is a loan is whether a holder of the instrument expects at the outset to be repaid the principal amount of the loan with interest out of cash flows of the company. The definition above implies a belief on the part of a lender that its debtor has the financial capacity to generate cash flow sufficient to pay interest and repay principal over the term of the loan, regardless of the profitability of the debtor from time to time in the course of that term.

[186] This approach suggests that the issue of whether the Term Loan and the Revolver Loan should be characterized as debt or equity can best be addressed by considering two issues: (1) the expectation of USS regarding repayment of principal with interest of the Term Loan and the Revolver Loan out of cash flows of USSC over the term of these Loans; and (2) the reasonableness of such expectation.

[187] The first of these questions addresses a subjective issue – the expectations of USS. Obviously, if, at the time of making advances under a Loan, USS had no expectation that USSC would honour any payment obligation under the Loan when due in the absence of available cash at such time and, for example, intended from the outset to waive all interest as it became payable and to forgive the principal indebtedness when it became due, the Court would disregard the form of the documentation as, in effect, a sham.

[188] The second question addresses a more objective issue assuming the existence of an expectation of repayment with interest of the Loan – the reasonableness of such expectation. This question engages, among other issues, the adequacy of capitalization of a wholly-owned subsidiary and the debt capacity of the subsidiary. If USSC were only nominally capitalized, this might be relatively easy to disprove. In this proceeding, as in most cases, however, this issue will involve, among other things, expert evidence regarding the availability of financing in capital markets generally.

[189] It is important for present purposes to note that, given that the burden of proof rests with the party asserting that a purported loan is, in substance, a capital contribution, the onus lies on the Objecting Parties, as the parties seeking to re-characterize the Loans as equity, to demonstrate that there was no reasonable basis for USS's expectations. There are good policy reasons for such a standard.

[190] Any determination of the reasonableness of a lender's expectations at the time of the making of a loan, or an advance under a loan, is prospective in nature and therefore highly speculative. It necessarily involves consideration of a borrower's financial capacity under a variety of possible future economic scenarios. A court should be cautious in reaching a conclusion that there was no reasonable expectation in the absence of a detailed consideration of such scenarios and compelling evidence that there was no basis for the lender's expectations under any of such scenarios. In addition, a determination that a lender acting in good faith nevertheless had no reasonable basis for believing that its subsidiary had the financial capacity to generate cash flow sufficient to pay interest and repay principal over the term of the loan will inevitably rely heavily on the opinion of financial experts. Any expert opinion on such an issue, however, is at least as much a matter of judgment as it is of fact, except perhaps in exceptional circumstances. Accordingly, a court must have a very high degree of confidence in any such expert financial evidence before it finds that a lender acting in good faith nevertheless had no

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reasonable basis for believing that its subsidiary had the financial capacity to generate cash flow sufficient to pay interest and repay principal over the term of the loan.

[191] Given the foregoing considerations, I conclude that, in order to find that the USS Debt Claims are "equity claims", the Court must be satisfied that either: (1) at the time of making an advance under the Term Loan or the Revolver Loan, USS did not believe that USSC would be able to repay such advance with interest out of USSC's cash flows over the term of the Term Loan or the Revolver Loan, as applicable; or (2) that, at the time of such advance, there was no reasonable basis on which USS could have expected USSC to generate cash flow sufficient to pay interest on, and repay the principal of, such advance over the term of the Term Loan and the Revolver Loan, as the case may be.

[192] Three related principles are also important for the analysis of the character of the USS Debt Claims.

[193] First, while the Term Loan and later the Revolver Loan constituted a significant part of USS' investment in USSC, the Loans do not represent all of that investment. As described above, USS has also made a significant investment that has been expressly treated as equity. This distinction is important. In this proceeding, the issue is limited to the characterization of the debt component of that investment. Clearly, the return on the equity portion of USS' investment will be dependent on the residual cash flow from USSC after payment of trade creditors as well as repayment with interest of the Term Loan and the Revolver Loan. However, the fact that these Loans form part of USS' total investment in USSC does not automatically mean that USS' expectation of repayment of these Loans is the same as its expectation of receiving a return on its equity investment.

[194] A parent corporation is able to divide its investment in an acquired corporation between debt and equity as it chooses. Such allocation of its investment is not determinative for the reasons discussed above. However, equally, such allocation must be respected unless it is demonstrated that the parent corporation did not have a reasonable expectation of repayment with interest of the portion of the investment which has been treated as debt when the loan was advanced. There is no basis in the CCAA for an automatic re-characterization into equity of a portion of an investment that has been structured as debt merely because the entire investment is, in a general sense, dependent for a return on the success of the investment. Put another way, a parent corporation can loan money to a wholly-owned subsidiary without that loan being treated automatically as part of the parent corporation's equity investment in the subsidiary.

[195] Second, the characterization of the USS Debt Claims must be analysed as of the date of the advances under each of the Term Loan and the Revolver Loan. Subsequent behaviour of either or both of the parties to the Term Loan Agreement or the Revolver Loan Agreement may be relevant, but only to the extent that such behaviour illuminates the intentions of the parties regarding the Term Loan or the Revolver Loan as of the date of the advances thereunder. Behaviour subsequent to any advance cannot, on its own, justify a re-characterization of such advance.

[196] Third, the characterization of the advances under each of the Term Loan and the Revolver Loan cannot be viewed in isolation from the economic circumstances in which the advances were made.

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[197] In this respect, the economic backdrop to the advances under the Term Loan and the Revolver Loan during the period 2008 to 2013 can be summarized as follows. The advances under the Term Loan between October 31, 2007 and December 31, 2007 were made in the context of a buoyant steel market. Economic conditions changed dramatically in the autumn of 2008 after the collapse of Lehman Brothers and the onset of the financial crisis in that year. Worsening conditions prevailed throughout 2009 and into early 2010. Thereafter, in each of 2010, 2011 and 2012, USS and USSC experienced mini-cycles consisting of one or two encouraging quarters succeeded by a weak performance for the remainder of these years. In 2013, USS and USSC experienced a weak market throughout the year with the result that matters reached a critical stage. Under a new chief executive officer and a new chief financial officer, who assumed their offices effective September 1, 2013, USS commenced a review of its operations which revealed, among other difficulties, that while USSC represented 10% of USS' revenues, it contributed 50% of its operating losses.

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General Considerations Regarding Determination of the Debt Re-characterization Issues

[198] Although the exercise of evaluation of the character of the Term Loan and the Revolver Loan ultimately requires a consideration of each of the advances individually, the issue is best addressed initially on a collective basis. As the Objecting Parties suggested, consideration of the characterization of the Term Loan and the Revolver Loan together recognizes, or perhaps more appropriately starts, from the position that the Term Loan and the Revolver Loan were used and administered by USS in the same manner and that the difference in their terms principally reflected tax and accounting considerations rather than any significant substantive difference in function. In this section, I propose to consider the probative value of the factors upon which the Objecting Parties principally rely as evidence that the Term Loan and the Revolver Loan were, in substance, equity contributions by USS to USSC.

[199] The Objecting Parties identified the following principal considerations or factors which, in their view, demonstrated that advances under the Term Loan and the Revolver Loan were equity contributions rather than loans for USSC: (1) the absence of any arm's length negotiation regarding the terms and conditions of the Loans; (2) the deferred interest payment dates and the long maturity dates of both the Term Loan and the Revolver Loan; (3) the history of interest payments and waivers under the Term Loan; (4) the absence of any security; (5) the extent of USS' control over the business, operations and financial performance of USSC; (6) the fact, as acknowledged by USS, that USSC would not have been able to obtain financing from a third-party bank or institutional lender in the amount and on the terms and conditions of either of the Term Loan or the Revolver Loan; and (7) their view that payments on account of the Term Loan and the Revolver Loan were effectively subordinated to payment of trade creditors.

[200] The Objecting Parties argue that, collectively, these considerations establish that USS had no expectation of repayment with interest of the advances under the Term Loan and the Revolver Loan out of cash flow from USSC. They say these factors demonstrate that, in substance, the Term Loan and the Revolver Loan were financial instruments under which USS was intended to receive the residual cash flow and assets of USSC as, and to the extent, available without an expectation of repayment with interest of either Loan, and were therefore capital contributions.

[201] Significantly, the Objecting Parties argue that each of the foregoing factors has probative value when measured against the standard of behavior that would be expected of a third-party lender. As mentioned above, this position reflects the approach in the Finnerty Report. USS argues that such a standard is inappropriate and, accordingly, that the factors upon which the Objecting Parties rely are not indicative of "equity interests".

[202] I propose to assess the submissions of the Objecting Parties respecting these general considerations in the following order. First, I will address in greater detail my understanding of the purposes and the administration of the Term Loan and the Revolver Loan. Then, I propose to address the issue of the significance of third-party lender behaviour in the context of a wholly-owned subsidiary relationship. Lastly, I will consider the probative value of the principal considerations relied upon by the Objecting Parties in light of the conclusions regarding the third-party lender standard.

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The Purposes and Administration of the Term Loan and the Revolver Loan and the Differing Perspectives of the Parties

[203] As mentioned, USS established the Term Loan, and subsequently the Revolver Loan, with the intention that they would be the principal vehicles by which cash flows could be moved between USS and USSC and, in particular, surplus cash in USSC could be repatriated to USS. Additional equity injections were also made from time to time by USS, but only to the extent that USSC required additional capital to stay onside the "thin capitalization" rules under the *Income Tax Act* and for the purposes of the "de-leveraging" exercise described above.

[204] The initial advances of the Term Loan were directed to ABULC for the purpose of the Acquisition. Subsequent advances prior to and including December 31, 2007 were used by USS to repay the Credit Corp Loan, repay USSC's liabilities to SHC and, in a lesser amount, for working capital purposes. The advances in 2009 totaling $211.2 million were also used for working capital purposes. A substantial portion of the interest under the Term Loan in 2008 was paid in that year, two years before its due date. Such interest was paid out of surplus cash on hand as a result of the strong financial performance of USSC in 2008 prior to the slowdown that began in the fourth quarter of that year.

[205] USS then established the Revolver Loan in 2010 as a more tax-efficient means of moving cash between USS and USSC after withholding tax was eliminated on interest payments from USSC to USS, permitting tax-free interest payments from USSC to Credit Corp, which was an American corporation. For that reason, the Revolver Loan was denominated in U.S. dollars. Prior to the "de-leveraging" exercise in 2013, the outstanding balance under the Revolver Loan slightly exceeded the maximum availability of U.S. $500 million. In 2013, payments of principal and interest totaling approximately U.S. $390 million, that were funded out of equity injections aggregating over U.S. $680 million, reduced the outstanding balance to the amount of the First Tranche Indebtedness.

[206] In order to maximize its flexibility for such cash management purposes, USS structured both the Term Loan and the Revolver Loan to provide for the most generous maturity dates and interest payment dates possible given constraints imposed by tax legislation. Further, both the Term Loan Agreement and the Revolver Loan Agreement contained minimal representations and warranties and very basic events of default. In addition, until the Second Revolver Amendment,

both the Term Loan and the Revolver Loan were unsecured facilities. The Second Revolver Amendment in January 2013 provided for security on iron-ore pellets pursuant to the Security Agreement for the principal, if not the sole, purpose of maintaining the intended tax treatment for payments in respect of the Revolver Loan, given the interest waivers granted under the Term Loan in 2010, 2011 and 2012. As mentioned, with the arrival of a new chief financial officer effective as of September 1, 2013, USS began to evaluate its investment in USSC more closely. As of the end of October 2013, USS determined that it would only advance funds to USSC that it believed USSC would be able to repay. As a result, all subsequent advances were secured under the October Security Agreement and the November Security Agreement.

[207] There is, however, no suggestion that USS and USSC disregarded the debt character of the Term Loan and the Revolver Loan in moving cash between USSC and USS. Accordingly, all advances under the Term Loan and the Revolver Loan were documented as such and were distinguished, both in terms of documentation and accounting, from equity injections. All interest payments on the Loans were similarly documented by both parties and treated accordingly for tax and accounting purposes. Principal payments were similarly documented by both parties. There is no evidence that the payments made in respect of the Term Loan or the Revolver Loan failed to satisfy the requirements under Canadian and American tax legislation for treatment as debt and, in particular, that any payments were deemed to be dividends.

[208] On the other hand, there is no doubt that the Term Loan and the Revolver Loan were provided by USS to USSC on terms and conditions that USSC could not have obtained from third party banks and other non-bank institutional providers of term financing and operating credit facilities. In particular, the payment provisions respecting interest and principal, and the absence of security, would not have been available to USSC.

[209] USS says that both the documentation and the manner of administration of the Loans reflect debt obligations. USS says that there is nothing in the cash management arrangements described above between a parent and a wholly-owned subsidiary that can justify re-characterization of the Loans as capital contributions for the purposes of the CCAA. In particular, USS argues that nothing in these financing arrangements suggests that it did not expect to receive repayment with interest of the funds advanced under the Loans. It also says that the fact that the Term Loan and the Revolver Loan were provided to USSC on terms that were not available to USSC from third parties is irrelevant.

[210] The Objecting Parties argue that USS established and administered the Term Loan and the Revolver Loan in the manner of, and using its rights as, a shareholder rather than a lender. They say that USS' actions are collectively more consistent with an intention to receive the residual cash flow and assets of USSC, as and when available, without any expectation of repayment with interest of the advances under the Loans. A more precise expression of their position is that the Term Loan Agreement and the Revolving Loan Agreement reflect arrangements under which USS intended at all times to return excess cash to USS when available and to write off the principal or interest in respect of the Loans to the extent that payments were due and sufficient cash was not available. I have excerpted below certain passages from the written submissions of the Union and the Province that I think capture the essential approach of these parties and which also assist in clarifying the positions of these parties.

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The Relevance of the Third-Party Lender Standard

[211] Clearly, a significant fact in this proceeding is that, at all relevant times, ABULC and USSC, as applicable, were wholly-owned subsidiaries of USS. In addition, unlike many parent-subsidiary relationships in which the subsidiary carries on a business independently of the parent, USSC was very closely integrated into the business of USS. After the Acquisition, all management and operational functions previously conducted by Stelco were effectively centralized within USS. USSC became a part of the North American flat-rolled steel division of USS. This relationship is significant in two related respects.

[212] The Objecting Parties argue that the USS control of USSC is an important factor in assessing whether, in substance, the Term Loan and the Revolver Loan were debt instruments or contributions to capital. They say that USS had a significant ability to influence the profitability of USSC through such control. They say that such control is, in some way, an indication of an equity contribution. I will address this below in the next section.

[213] The issue of control is also significant for present purposes as a gateway to the related issue of the relevance of a third-party lender standard as a basis for evaluation of the terms and conditions, as well as the administration, of the Term Loan and the Revolver Loan. As mentioned, USS provided financing to USSC that would not have been available to USSC from banks and other institutional lenders. The Objecting Parties place great weight on this factor as demonstrating that the Term Loan and the Revolver Loan were not real loan transactions, but rather were disguised equity contributions. Equally important, most, if not all, of the *AutoStyle* factors identified above upon which the Objecting Parties rely are informed, in whole, or in part, by a comparison of USS' actions against a standard of a typical third-party lender.

[214] The Objecting Parties suggest the Court should look to a third-party lender standard in two principal respects – in order to assess the terms and conditions of the Term Loan and the Revolver Loan and in order to assess the actions of USS and USSC in the administration of these Loans including payments thereunder. As these are significant factors in the analysis proposed by the Objecting Parties, I propose to address these two issues in some detail.

[215] It is important to recognize at the outset that there is no necessary reason why a parent corporation would act in the same manner as a third-party lender in the provision of financing facilities to its wholly-owned subsidiary. In particular, the terms and conditions of lending arrangements between a wholly-owned subsidiary and its parent will, in many if not most cases, depart from typical lending arrangements between a third-party lender and a borrower.

[216] As a practical matter, compliance with tax regulations in order to ensure favourable tax treatment will be a significant, if not the main, driver regarding these matters. In this case, USS determined the relative amounts of loans and equity injections based principally on tax considerations to the USS group of companies considered as a whole. Generally, these considerations dictated maximization of debt to obtain interest deductibility under the United States *Internal Revenue Code*, 26 U.S.C., subject to compliance with the "thin capitalization" rules under the *Income Tax Act*, which established a maximum debt/equity structure.

[217] In addition, in a wholly-owned subsidiary relationship, there is no need for extensive documentation, nor is there a need for the types of contractual protections typically found in

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commercial loan agreements. Given the parent's ability to control the subsidiary's actions as its sole shareholder, there is also no need for a strict schedule of repayment of principal. Further, there is no reason why a parent corporation would enforce any rights of default that may arise in the course of a loan so long as the parent corporation believes that the subsidiary has value. Such rights are asserted only as required to protect the parent corporation in the event that a third party asserts its rights as a creditor against the subsidiary or to terminate the parent corporation's support of the subsidiary. Similarly, it is not realistic to expect that a wholly-owned subsidiary will conduct its affairs pursuant to a corporate governance structure that includes independent directors until such time as the interests of the parent corporation and the subsidiary diverge.

[218] There is nothing improper in any of the foregoing arrangements. To be clear, the Objecting Parties do not suggest that there is. They submit that a parent corporation can choose to structure its arrangements however it chooses for tax and other purposes. However, they say that such arrangements should not govern the determination of whether such loans give rise to "equity claims" for the purposes of the CCAA. On their approach, the determination of the treatment of such claims under the CCAA should be made on the basis of a different test than that which satisfied tax and other regulatory rules and regulations prior to an insolvency.

[219] The dispute between the parties, and a principal issue on this motion, is therefore whether there are any consequences, in the context of CCAA proceedings, to a parent corporation that has structured its investment in a wholly-owned subsidiary in the manner of the Loans, that is, in a manner that complies with all applicable tax and other regulations but is not consistent with how a third-party lender would have structured any loan facilities in favour of USSC and how any such lender would have acted in the circumstances of USSC's subsequent financial performance.

[220] A comparison of the relationship between USS and USSC against a notional relationship between USSC and a third-party lender provides a helpful clarification of certain factors that are relevant for present purposes, as is discussed below. However, I find that a comparison between the behavior of USS and the behavior of a notional third-party lender is not an appropriate test in the evaluation of whether the advances under the Term Loan and the Revolver Loan were capital contributions to USSC. I reach this conclusion for the following reasons.

[221] First, the Loans were structured, and excess cash was moved between USSC and USS, in the manner described above for legitimate business reasons and in accordance with all applicable legal requirements. There is no express authority in the CCAA for disregarding these arrangements in such an evaluation apart from the very general language in the definition of "equity claim" referring to a return of capital. In particular, there is no express authority for disregarding the business purpose of financing arrangements in the evaluation of whether loan instruments are, in substance, "equity interests" giving rise to "equity claims".

[222] Second, the Objecting Parties assert that the USS Debt Claims constitute claims for a return of capital. In the absence of any statutory definition of capital, or guidance regarding the determination of capital, for the purposes of the definition of an "equity claim", considerable weight should be given to the accounting and tax determination of capital of the debtor company in any CCAA proceedings. In this case, there is no suggestion that the Term Loan or the Revolver Loan were treated as capital for such purposes.

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[223] Third, the Objecting Parties submit, as an operating principle, that the less the Term Loan and the Revolver Loan resembled financing available from a third-party lender, and the less the actions of USS in the administration of the Loans resembled those that would have been expected of a third-party lender, the more the advances under the Loans resemble equity contributions. I do not accept this principle for the reason that I do not see a necessary connection between a failure to adhere to the third-party lender standard and an absence of an expectation of repayment with interest of a loan in the circumstances where the departure from the third-party lender standard reflects a valid business purpose.

[224] I accept that there may be circumstances where the departure from a third-party lender standard may not serve any valid business purpose related to a parent-subsidiary relationship. In such circumstances, it may well be that such actions would suggest an equity contribution, that is, that the only explanation for the parent corporation's actions is that the loan transaction was in fact a capital contribution. However, that is not the case in the present circumstances. As mentioned above, the interest payment terms, the maturity dates of the Loans and the absence of a schedule for principal repayments provided USS and USSC with a certain amount of flexibility to align the payment of interest and the repayment of principal with the economic performance of USSC against the backdrop of a highly cyclical industry. In particular, it provided USSC with the ability to defer payments of interest and principal for a period of time in the event of adverse economic performance without triggering default provisions or a reversal of income expense for tax purposes.

[225] Fourth, as a related matter, the third-party lender standard ignores the very real business purposes that a parent corporation could have for departing from a third-party lender standard in the administration of financing established in favour of a wholly-owned subsidiary.

[226] The Objecting Parties submit that the less a parent corporation acts to enforce its rights in an insolvent situation in the manner that would be expected of a third-party lender, the more it demonstrates that the financing arrangements between the parent corporation and the subsidiary are in fact equity contributions rather than loans. This submission ignores the reality that a parent corporation which believes that there is value remaining in a subsidiary, even if the subsidiary is technically insolvent, will not act to enforce its security in the manner that would be expected of a third-party lender whose objective is necessarily limited to maximizing the prospects for the immediate recovery of its principal and interest. Nor would a parent corporation seek to negotiate some further benefit such as fees or additional equity in such circumstances. The subsidiary has no additional benefit to give when the parent already owns 100% of the benefit of its enterprise. Given such considerations, the actions of a parent corporation in departing from a third-party lender standard do not evidence the absence of an expectation of repayment with interest of a loan to its subsidiary when the loan was made. Moreover, in this respect, the position of the Objecting Parties contradicts the purposes of the CCAA, which should encourage efforts that seek to continue the operations of a distressed subsidiary.

[227] Fifth, more generally, the premise underlying the position of the Objecting Parties, as is demonstrated by the foregoing discussion, is that a parent corporation is acting as a shareholder to the extent that it fails to act in a manner that would be expected of a third-party lender. They express this argument by saying that, to the extent a parent corporation is not looking at a loan to its subsidiary through the lens of a third-party lender, it must be looking at the loan from the

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perspective of a shareholder and, as such, in reality, the loan must be equity. In short, a parent corporation cannot wear two hats at the same time.

[228] I do not think this is correct. A parent corporation lending to its wholly-owned subsidiary can have regard to the existence of its rights as a shareholder in structuring and administering a loan to its subsidiary without ceasing to be a lender. The issue to be considered is whether the actions of the parent corporation demonstrate that it had no expectation of repayment with interest of the loan. There is no necessary connection between a parent corporation lending to a subsidiary on a basis that departs from a third-party lender standard and the absence of such an expectation.

[229] Sixth, there is also a significant issue with the definition of a third-party lender proposed as the standard by the Objecting Parties. The Objecting Parties propose the standard of a bank or an institutional lender providing unsecured term or operating facilities on the basis of their expert financial evidence regarding an appropriate proxy for the Term Loan and the Revolver Loan. This is an unduly restrictive standard given the purpose of the test for an "equity claim", which is to assist in determining whether USS had a reasonable expectation of repayment with interest at the time it extended advances under the Term Loan and the Revolver Loans. While the willingness of a third-party to lend on the terms provided by a parent corporation could support such a conclusion, the absence of third-party lender financing is not sufficient to establish that no other financing would have been available to the subsidiary on a viable basis. Where a party seeks to disprove the alleged reasonableness of an expectation of repayment of a loan with interest, or the absence of any debt capacity of a borrower, it is necessary to canvas the availability of viable financing across capital markets more broadly.

[230] Lastly, the Objecting Parties acknowledge that the standard that they propose would apply solely for purposes of proceedings under the CCAA and, perhaps, the BIA. There are three difficulties with this result.

[231] First, as mentioned, a court should give considerable weight to the characterization of payments to the extent that third parties, such as the Canadian and American tax authorities, have accepted the treatment of such payments in the past in the absence of any express authority in the CCAA to do otherwise. In this case, there is a history of characterization of payments consistent with loan transactions that includes not only the loan documentation but also interest payments, principal repayments and interest waivers under the Term Loan. There is no evidence that either the Canadian or the American tax authorities have raised any issue with the treatment of any such payments for tax purposes.

[232] Second, while tax treatment cannot be determinative, these tax regimes represent another third-party standard that has some independent validity in evaluating the substantive reality of loan instruments.

[233] Third, as a policy matter, I see no policy benefit in having separate rules in the tax and accounting domain, on the one hand, and in the CCAA domain on the other. It is important for stakeholders in a corporation to have rules that yield reasonable certainty for planning purposes. A consequence of the approach proposed by the Objecting Parties would be that a parent corporation seeking such certainty in respect of the treatment of a loan to its subsidiary would have to limit its financing arrangements to those which an independent consultant considers to be

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comparable to financing facilities that would be provided by a notional third-party lender. There are a number of difficulties with this approach from a policy perspective for which there is no obvious corresponding benefit. The principal difficulty is the overriding of valid business purposes by the imposition of a restrictive standard for the purposes of any future CCAA proceedings. In addition, there would be additional costs associated with such a policy, a need for updates as advances are made over time in changing market conditions, and a potentially inefficient limitation of financing options from a financial perspective.

[234] Based on the foregoing considerations, I am not persuaded that the third-party lender standard proposed by the Objecting Parties, and which underlies many of the specific factors upon which the Objecting Parties rely, is appropriate in the present context for determining whether the Loans were, in substance, capital contributions. This conclusion has the following implications in respect of the manner in which the factors identified above are to be applied in the evaluation of the Term Loan and the Revolver Loan as debt obligations or capital contributions.

[235] First, with respect to factors (1) to (4), such factors are relevant to the issue of the expectations of USS at the time of advances under the Loans. However, these considerations must be evaluated in terms of what they indicate about the expectations of USS without regard to any comparison with any notional third-party lender. In other words, it is not a relevant consideration in determining whether USS had an expectation of repayment with interest that a notional third-party lender would not have provided financing arrangements to USSC having these features.

[236] Second, the fact that a notional third-party lender would not have extended financing facilities to USSC on the terms and conditions of the Term Loan and the Revolver Loan is also not determinative of whether USSC had the debt capacity to service the advances under the Term Loan and under the Revolver Loan when they were made. It is therefore not determinative of the reasonableness of USS' expectation of repayment with interest of the Loan.

[237] The foregoing conclusion does not, however, foreclose entirely the relevance of the availability of financing from independent sources. As discussed above, I accept that a test based on the availability of financing from an external source of financing, not limited to a third-party lender, could be a means of evaluating the debt capacity of a wholly-owned subsidiary. Framed in such terms, such a test would bear on the reasonableness of a parent corporation's expectations of repayment of the principal with interest of a particular loan or advance based on the debt-capacity of the subsidiary. However, there is no reason to narrow consideration of such debt capacity to the availability of third-party lender financing, unless the evidence clearly establishes that no other financing facilities would have been available to the subsidiary had it sought external financing.

[238] Third, in the analysis below, I do not accord any significant weight to the test suggested by the Objecting Parties – that the less the Term Loan and the Revolver Loan reflect the characteristics of a third party loan from a bank or other institutional lender, the more such Loans resemble equity. In my opinion, to the extent that such Loans depart from the third-party lender standard for reasons that have a legitimate business purpose that is related to the wholly-owned subsidiary relationship or its business, the Court cannot disregard the legitimacy of such arrangements in its analysis. Given a legitimate business purpose for departing from the

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standard of behavior of a third-party lender, there is no necessary reason why a parent corporation could not also have had an expectation of repayment with interest of any loan advance at the time of such advance notwithstanding that it did not act in the same manner as a third-party lender. As discussed above, there is no necessary reason why a parent corporation cannot be both a lender and a shareholder even if, as a lender, it does not conform in all respects to the standard of a third-party lender.

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Analysis of the Principal Considerations Relied Upon by the Objecting Parties

[239] I turn then to a consideration of the probative value of the general factors relied upon by the Objecting Parties in the analyses below of the Term Loan and the Revolver Loan. As set out above, the Objecting Parties say that the Term Loan Agreement and the Revolver Loan Agreement reflect arrangements under which USS intended at all times to return excess cash to USS when available and to write off the principal or interest in respect of the Loans to the extent that payments of either were due and sufficient cash was not available.

[240] In this section, I will address, in order, the extent to which the seven principal factors relied upon by the Objecting Parties are of assistance in the analysis of the Term Loan and the Revolver Loan in light of the conclusions reached above. The seven principal factors are the following: (1) the absence of any arm's length negotiation regarding the terms and conditions of the Term Loan or the Revolver Loan; (2) the deferred interest payment dates and the long maturity dates of both the Term Loan and the Revolver Loan; (3) the history of interest payments and waivers under the Term Loan; (4) the absence of any security; (5) the extent of USS' control over the business operations and financial performance of USSC; (6) the fact, as acknowledged by USS, that USSC would not have been able to obtain financing from a third-party bank or institutional lender in the amount and on the terms and conditions of either the Term Loan or the Revolver Loan; and (7) the view of the Objecting Parties that payments on account of the Term Loan and the Revolver Loan were effectively subordinated to payment of trade creditors.

[241] First, the Objecting Parties suggest that the lack of any negotiation between USS and ABULC regarding the Term Loan, and the absence of any substantive negotiations between USS and USSC regarding the Revolver Loan, suggest that the advances under the Loans were in the nature of equity injections rather than *bona fide* debt. I do not consider these circumstances to be of any value in addressing the issues on this motion. The limited negotiations between these parties is a reflection of the wholly-owned subsidiary relationship that is the starting point for such issues, but it is a neutral fact that does not bear in any way on the reasonableness of the expectations of USS regarding repayment with interest of the advances under the Term Loan and the Revolver Loan.

[242] Second, the Objecting Parties submit that the two-year interest payment provision in the Term Loan and the Revolver Loan, and the lengthy maturity dates for the Loans, suggest these arrangements were capital contributions. However, the terms and conditions of the Term Loan and the Revolver Loan make express provision for the payment of interest on fixed dates and the repayment of principal by a fixed maturity date. While these terms were acknowledged to be generous, the fact remains that each Loan fixed the maximum amount payable thereunder as interest and principal and provided fixed dates for the payment of accruing interest and the repayment of the principal amount of the Loans. In particular, the interest payment dates were time-limited. Setting aside any comparison with the terms expected in third-party lender

arrangements for the reasons set out above, there is nothing in the terms of the Loans, on their own, that would support an inference that USS did not expect to receive repayment with interest of all advances made under the Loans. In particular, the existence of a long maturity date and the absence of a schedule of repayments is not a basis for inferring that USS did not expect USSC to repay the Term Loan. The Term Loan did not prevent earlier repayment of principal. In addition, USS was in a position to require USSC to repay principal without a contractual schedule of repayments.

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[243] Accordingly, on their face, neither the Term Loan nor the Revolver Loan is more consistent with receipt of the residual cash flow and assets of USSC as the Objecting Parties suggest. Any such inference must be based on the actions of USS and USSC in the administration of the Loans.

[244] Third, accordingly, the Objecting Parties argue that the Court should infer from the manner in which interest payments were treated under the Term Loan that the Loans were intended to be capital contributions rather than debt, i.e., that there was never any expectation of repayment with interest of the Loans. There are two aspects of the interest payment history in respect of the Term Loan that will be addressed separately – the accelerated payment of interest in 2008 and the interest waivers commencing in 2010.

[245] The Objecting Parties argue that the acceleration of the interest payments under the Term Loan in 2008 evidences an intention to treat the Term Loan as a capital contribution. In making this argument, the Objecting Parties rely on the testimony of Dr. Finnerty who suggested that the payment of interest under the Term Loan in 2008 ahead of the due date in 2010 exhibited behavior that was more characteristic of the payment of dividends rather than interest.

[246] I accept that it is possible that the payment of interest could resemble a dividend in circumstances in which there is no reasonable explanation for the timing or amount of payments made outside the provisions of a loan agreement, for example, a payment in excess of accrued interest by way of an alleged pre-payment of interest. However, where the timing of interest payments is consistent with a legitimate business purpose and in accordance with the provisions of a loan agreement, the Court cannot disregard such circumstances in assessing the expectations of the parent corporation regarding the loan.

[247] In this case, the Term Loan permitted, but did not require, a deferral of interest payments for a period of time. The argument based on Dr. Finnerty's evidence proceeds on the unrealistic premise that, given such a provision in a loan agreement, a subsidiary would not pay interest to its parent corporation until the end of the permitted interest deferral period even if an earlier payment would be more efficient financially. In other words, the argument relies on a third-party lender standard which is rejected for the reasons discussed above. More generally, where there is a legitimate business reason for the flexibility provided in the loan agreement, I do not see any necessary connection between the availment of that flexibility and either the characterization of the payment as a dividend or the expectation of the parent corporation regarding repayment of the loan with interest.

[248] In the present circumstances, the accelerated interest payments reflected very favourable financial results of USSC during the first three quarters of 2008. There was no legitimate reason for USSC to defer payment of interest, which was compounding while outstanding, to the

interest payment date if it had cash available for such purpose. The Term Loan Agreement permitted a deferral of interest payments for a period of time to accommodate an adverse financial performance from time to time. However, it did not require such a deferral in the event of a favourable economic performance. The presence of this provision does not evidence an intention of USS and USSC that USSC would hold on to excess cash at its own cost in such circumstances.

[249] Accordingly, I am not persuaded that the acceleration of interest payments in 2008 is indicative of an intention on the part of USS to treat the Term Loan as a capital contribution rather than as a debt obligation.

[250] The Objecting Parties also argue that the interest payment waivers granted in favour of USSC commencing in 2010 evidence the absence of any expectation of repayment with interest of the Term Loan. Insofar as the Objecting Parties urge the Court to draw such an inference from the existence of the interest waivers without having regard to a third-party lender standard, this issue is addressed later in these Reasons.

[251] I note, however, that Dr. Finnerty's opinion was based on a somewhat different approach. He suggested that, from the perspective of financial economics, USS' actions in respect of the interest waivers reflected the behavior of a shareholder rather than a lender. The position of Dr. Finnerty and the Objecting Parties is that, in the circumstances of non-payment of interest, third-party lenders will obtain some value in negotiations with borrowers as a condition of granting such waivers. As evidence of an equity interest, they point to the absence of any enforcement proceedings on the part of USS to protect its interest as a lender, and of any negotiations to obtain a *quid pro quo* for, in particular, the grant of such waivers of interest.

[252] Given the finding above regarding the appropriateness of the third-party lender standard, the Court does not draw any inference from the absence of any enforcement proceedings or other actions on the part of USS in respect of the interest waivers. In this case, the application of such a standard also reflects an unrealistic premise upon which the argument for equity treatment is based. As mentioned above, in wholly-owned situations, enforcement proceedings are counter-productive so long as the parent corporation believes the subsidiary still has value. It is also axiomatic that the subsidiary cannot give the parent any additional value as a *quid pro quo* for obtaining a waiver of its interest obligations since the parent already owns all of the subsidiary's equity value. The probative value of the interest waivers is discussed further below.

[253] Fourth, the Objecting Parties submit that the absence of security for the Term Loan or the First Tranche Indebtedness is probative of the expectations of USS at the time it extended advances under the Loans. This argument also relies implicitly on a comparison with a third-party lender standard. If such a comparison is disregarded, I conclude that the absence of security is not indicative of a capital contribution for the following reasons.

[254] As discussed above, and as the history of the Revolver Loan demonstrates, as the sole shareholder of USSC, USS had no need to require security for its loans to USSC until it became concerned about the ability of USSC to repay any funds advanced to it. As such, the fact that USS required security for advances made after October 2013 is more significant as evidence of the expectations of USS in October 2013 than the absence of any security for advances made

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prior to that date. In short, the Objecting Parties have not demonstrated a necessary connection between an absence of security for the Term Loan or the First Tranche Indebtedness and an absence of any expectation of repayment with interest of the Term Loan or the First Tranche Indebtedness.

[255] Moreover, the implication of the position of the Objecting Parties is that, to protect itself in possible insolvency proceedings, a sole shareholder must lend on an asset-backed basis, i.e., take security on the assets of the enterprise, to avoid characterization of its loan as equity. This cannot have been the intention of the definition of "equity claims" under the CCAA insofar as such an implication would, among other things, encourage a parent corporation to take a priority over claims of trade creditors and thereby make a restructuring of an enterprise in an insolvency situation more difficult.

[256] Fifth, for the following reasons, I am not persuaded that the extent of USS' control of USSC is a factor to be taken into account in assessing whether the Term Loan and the Revolver Loan were, in substance, equity contributions by USS.

[257] As a polar case, I accept that there may be circumstances in which a parent corporation's expectation from the outset is that it will sacrifice a subsidiary's profitability over the long-term for the benefit of the consolidated enterprise. In such circumstances, a court could find that the parent corporation had no intention of causing the subsidiary to repay with interest any financing extended to the subsidiary or, more precisely, no expectation that the subsidiary would generate sufficient cash flow to enable it to make such payments based on the parent's anticipated business plan for it. In such circumstances, a court could also find that the entire amount of the financing extended by the parent corporation to the subsidiary was, in reality, an equity contribution.

[258] However, the Objecting Parties have expressly advised the Court that they do not take that position in this proceeding. In any event, the evidence is not sufficient to justify such a conclusion in the present circumstances. In particular, among other considerations, the history of the Term Loan and the Revolver Loan is too short, and the impact on the entire USS business of the recessionary environment after late 2008 was too significant, to enable the Court to draw such a conclusion.

[259] This leaves the question of whether control of a wholly-owned subsidiary that does not go so far as to render the profitability of the subsidiary a matter entirely in the sole discretion of the parent corporation can constitute a consideration to be taken into account in the analysis of whether loans made by the parent corporation are debt or are, instead, equity contributions. I accept that such control requires a court to take a "good hard look" at the substantive reality of any such loans, in this case being the advances under the Term Loan and the Revolver Loan. Beyond that, however, in this case, I think that USS' control is the point of departure, rather than an independent factor, for the following reasons.

[260] First, and foremost, as mentioned, there is no overriding authority in the CCAA to disregard entirely the manner in which parties, including related parties, have structured their affairs. As set out above, I think a court must give effect to such structure unless and until, in the case of a loan from a parent corporation to a subsidiary, there is other evidence establishing that the parent did not reasonably expect to receive repayment of the loan with interest at the time of

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the making of the loan. In other words, the existence of control is not a basis for such an inference on its own.

[261] Second, the submission of the Objecting Parties that USS' control is an independent factor demonstrating an equity contribution proceeds on the basis of a distinction between a lender's rights and a shareholder's rights that is untenable in the present circumstances. The Objecting Parties argue, in effect, that USS acted in its capacity as a shareholder, rather than as a lender, in causing USSC to repay monies to it and, therefore, such payments should be treated as dividends.

[262] This argument is based on a false dichotomy. No lender has a right to compel the repayment of principal or the payment of interest. The lender's rights are restricted to enforcement in the event of non-payment. The debtor alone decides whether to pay principal or interest. The implication of this argument is that a parent corporation must renounce its rights as a shareholder to cause payments under a loan agreement. This is not only unrealistic but also counter to the conclusion that a parent corporation can have regard to its rights as a shareholder while acting as a lender. Accordingly, the fact that USS instructed USSC with respect to the payments to be made cannot on that account result in a characterization of such payments as dividends, or of the Loans as capital contributions.

[263] Sixth, for the reasons set out above, I conclude that the fact that USSC could not have obtained financing from a third-party lender on the terms and in the amounts of the Loans is not an independent factor that assists in evaluating USS' expectations regarding repayment with interest of the advances under these Loans at the time that they were made.

[264] Seventh, the remaining consideration is the view of the Objecting Parties that USS effectively subordinated its position to the other creditors of USS by paying interest on the Term Loan and the Revolver Loan only after such other creditors were satisfied on an on-going basis. In doing so, the Objecting Parties say USS acted like a shareholder rather than a lender, thereby evidencing the absence of any expectation of repayment with interest of the Loans.

[265] As a factual matter, it is correct that USSC paid interest on the Term Loan and the Revolver Loan only after its arm's length creditors were satisfied on an on-going basis. From 2007 until shortly prior to the Filing Date, USS funded USSC with debt or equity in order to permit USSC to pay its trade creditors on an ongoing basis. Moreover, as mentioned, USS waived a significant amount of interest that accrued and became due under the Term Loan and made no interest payments on the remaining accrued interest.

[266] This raises the question of whether such evidence demonstrates that USS intended that the Term Loan and the Revolver Loan would be subordinated to payment of USSC's other obligations and, if so, whether such arrangements demonstrate that USS did not expect to receive repayment with interest of the Loans. There are a number of issues bound up in this argument that need to be separated.

[267] First, it is important to note that there is no suggestion that USS intended a legal subordination of its claims in respect of either the Term Loan or the Revolver Loan to claims of third party creditors of USSC. Indeed, after October 2013, all fresh advances under the Revolver Loan were secured and, therefore, ranked ahead of the trade creditors of USSC.

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[268] Second, in any event, subordinated debt is not synonymous with a capital contribution. For present purposes, subordinated debt remains debt, subject to demonstration that a borrower could not have obtained subordinated debt on any basis from external sources, that is, did not have the debt capacity to obtain external financing in the amount of the Term Loan or the amount of the First Tranche Indebtedness. In such event, such evidence would cast serious doubt on a parent corporation's expectation with respect to repayment with interest of the alleged subordinated debt. As discussed below, however, there is no such evidence in the present case.

[269] Third, I am not persuaded that the actions of USS and USSC described above are properly characterized as subordination for present purposes. In the face of a significantly changed economic and financial environment described above, USS chose to defer rather than subordinate the repayment of the principal of the Loans and the payment of interest, except to the extent of the waived interest. However, USS left its options open regarding the treatment of amounts outstanding under the Term Loan in the future.

[270] Fourth, and most important, there is no evidentiary connection between the factual circumstances which the Objecting Parties describe as effective subordination of the Term Loan and the Revolver Loan and the expectation of USS regarding repayment with interest of the Loans at the time the advances were made thereunder. As described elsewhere in these Reasons, the economic circumstances commencing in 2008 established a reason for the actions that USS and USSC took subsequently which the Objecting Parties say constituted effective subordination of the Loans. There is, however, no evidence of an intention to implement such actions or, more generally, to implement a principle of effective subordination, at the time of the advances under the Loans.

[271] Accordingly, I am not persuaded that the argument of alleged effective subordination of the Term Loan and the Revolver Loan supports the position of the Objecting Parties that USS did not expect to receive repayment with interest of advances under the Term Loan or the Revolver Loan.

Analysis and Conclusions Regarding the Re-characterization Claim in Respect of the Term Loan

[272] I propose to set out my analysis of the debt re-characterization claim of the Objecting Parties with respect to the Term Loan after first setting out the position of the Objecting Parties in their written submissions. I would note that, at the trial, the Objecting Parties concentrated on a subset of these considerations which are addressed in these Reasons.

Positions of the Parties

The Union

[273] The essence of the position of the Union with respect to both the Term Loan and the Revolver Loan is captured by the two paragraphs below which are taken from the supplementary written submissions of the Union:

> Critically, USS always expected and intended that USSC's repayment of amounts owing under both the Term Loan and the Revolver Loan was contingent on USSC's performance.

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> The evidence is clear that USS only expected to receive payments on account of interest and principal if and when USSC was able to make them, and not in accordance with the terms of the agreements. On discovery, Mr. Brockway's evidence was that USS "anticipated that the ability to repay that portion of the debt would be dependent on the success of Stelco's business going forward."

[274] The Objecting Parties do not merely assert that USS expected to disregard the timing requirements of the Term Loan Agreement and the Revolver Loan Agreement with respect to the movement of available cash from USSC to USS. Rather, they say that, from the outset of each of the Term Loan and the Revolver Loan, USS did not expect USSC to be able to repay the advances under such Loans, and the interest on such advances, and therefore expected to write off a significant portion of such obligations as they fell due.

[275] In its factum, the Union argues that the Term Loan should be re-characterized as equity based principally on the following seven *AutoStyle* factors: (1) the ability of USSC to obtain similar financing from outside lending institutions; (2) the source of repayments of the Term Loan; (3) the presence or absence of a fixed maturity date and schedule of payments; (4) the absence of security for advances under the Term Loan; (5) the absence of a sinking fund to provide for repayments; (6) the extent to which the advances under the Term Loan were effectively subordinated to the claims of outside creditors; and (7) the inadequacy of capitalization of ABULC at the date of the initial advance under the Term Loan.

[276] The Union also says that the lack of negotiation between USS and USSC regarding the Term Loan and the fact that the principal purpose of the initial advances under the Term Loan was the acquisition by USS of capital assets also support a finding of a contribution to capital rather than debt.

The Province

[277] The general approach of the Province with respect to both the Term Loan and the Revolver Loan is set out in the following excerpts from its factum:

> The context of the Term Loan is crucial for the characterization exercise. … Essentially, USSC operated as a division of the USS organization. This same context also applies to the Revolver….
>
> USS' attitude to the financing of USSC reflected what its attitude would be in funding one of its operating divisions – the money went where and when needed. There was no consideration or expectation that the funds would be treated other than equity – the investment would yield returns if, and only if, the business prospered. Advances were motivated by whether the global business would benefit from the allocation of resources to the facility, and not based upon any analysis of the profitability or credit-worthiness of the business unit….
>
> USS' loose approach to interest from USSC is understandable in the context of the complete control of USSC by USS discussed above. Whether USSC had the wherewithal at any point in time to pay interest was utterly dependent on the production USS assigned to it, the intercompany allocation of raw materials (and

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their cost) and USSC's personnel – all controlled by USS. Presumably, USS believed sending the money to USSC on a non-interest bearing basis allowed USS to earn a better return elsewhere in the global business.

[278] In its factum, the Province argues that the Term Loan should be re-characterized as equity based principally on the following three allegations: (i) there was no expectation that USSC would pay interest on the Term Loan advances; (ii) there was no expectation that USSC would repay the principal of the Term Loan advances; and (iii) the Term Loan was not provided by, nor available from, a third-party lender on commercial terms. I note that the first two considerations are not actually referred to in *AutoStyle*, although, as discussed above, I think that they are fundamental issues in respect of the re-characterization issue.

[279] The Province also suggested that the following four attributes of the Term Loan, which reflect factors referred to in *AutoStyle* and are included in the considerations upon which the Union relies, also demonstrate that it is, in substance, equity rather than debt: (1) the initial advances under the Term Loan were used to acquire a capital asset, being the outstanding shares of Stelco; (2) ABULC's capital structure was thinly or inadequately capitalised at the date of the Acquisition when the initial advances were made under the Term Loan, especially in light of Stelco's historical operating performance; (3) the failure to provide for security for the Term Loan; and (4) the failure to establish a sinking fund for repayment, particularly in view of the 30-year term of the Term Loan.

USS

[280] USS submits that a number of the *AutoStyle* factors considered by American courts refute, rather than support, the Objecting Parties' re-characterization argument, including: (1) the documents entered into between USS and USSC regarding the Term Loan on their face purport to evidence indebtedness and are titled "Loan Agreements"; (2) the parties intended to enter into a loan transaction; (3) the Term Loan has a fixed maturity date; (4) the Term Loan provides for a specified applicable interest rate; (5) under the Term Loan, USS has the right to enforce payment of interest and principal; (6) USS did not acquire any management control rights in exchange for the funds advanced under the Term Loan; (7) USS did not subordinate any amounts owing under the Term Loan to USSC's other creditors as a matter of law; and (8) a substantial portion of the funds advanced under the Term Loan were used to finance USSC's ongoing operations. In addition, USS relies on statements in a recent American decision, *In re Alternate Fuels Inc*., 789 F.3d 1139 (10th Cir. 2015), to the effect that the identity of interest between USS and USSC and any undercapitalization of ABULC should not be material considerations in the context of a loan from a parent to a wholly-owned subsidiary.

Analysis and Conclusions

[281] As set out above, the claim of the Objecting Parties that the Term Loan should be characterized as an "equity claim" requires addressing two matters: (1) the expectation of USS regarding repayment of principal and interest on the Term Loan out of cash flows of USSC over the term of the Term Loan; and (2) the reasonableness of such expectations. I note that, while these are discrete issues, the evidence referred to below that is relevant to the expectation of USS at the time of any particular advance can also be relevant to the reasonableness of such expectation.

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[282] As described above, most of the Term Loan advances were advanced to ABULC between October 31, 2007 and December 31, 2007. However, further advances in the aggregate principal amount of $211.2 million were made in 2009. It is therefore necessary to address the characterization of the Term Loan advances in these two periods of time separately. In each case, I will address the application of the general considerations discussed above to the USS expectation regarding repayment of the Term Loan with interest and will then consider certain additional arguments of the Objecting Parties specific to the Term Loan that have not already been addressed above.

Term Loan Advances at the Time of the Acquisition

[283] The advances made to USSC in respect of the Acquisition between October 31, 2007 and December 31, 2007 have been set out above. USS says that it expected to be repaid the principal of the Term Loan outstanding at December 31, 2007 with interest over the course of the Loan, even if it could not anticipate the timing of such payments given the cyclical nature of the steel industry.

[284] USS relies principally on the evidence of Brockway with respect to the facts pertaining to its expectations at the time of the Acquisition and the initial advances under the Term Loan. Brockway testified that USS based its decision to acquire Stelco on a financial model which was created by USS internally, but was reviewed by its financial advisor in the transaction and was relied upon by the USS board of directors in connection with their decision to make the Acquisition.

[285] The financial model contemplated stable sales of flat-rolled steel that would rise 1%-2% annually, which would generate earnings before interest, taxes and depreciation ("EBITDA") estimated to be U.S. $368 million in 2008 and projected to gradually rise over the next seven years. Brockway testified that, based on this financial model, USS anticipated that the Acquisition would generate sufficient free cash flow in USSC to pay the interest provided for under the Term Loan and to repay the principal over the 30-year term of the Term Loan. The financial model also included a discounted cash flow analysis. The extent to which this analysis is also supportive of the USS expectation is unclear. However, there is no evidence regarding this financial model that contradicts USS's expectation of repayment of the Term Loan with interest.

[286] The Objecting Parties do not dispute that USS made its decision to acquire USSC based on the financial model described above. However, the Objecting Parties argue that the constellation of factors described above pertaining to the terms of the Term Loan Agreement, and the manner in which USS administered the Term Loan, demonstrate that USS did not expect to be repaid the principal with interest of the initial advances under the Term Loan.

Did USS Expect to be Repaid the Term Loan With Interest?

[287] I do not propose to revisit the considerations that have been excluded for the reasons set out in the preceding section, including, in particular, the considerations that rely on a comparison with a third-party lender standard. Setting those considerations aside, the position of the Objecting Parties is based primarily on the following remaining factors which will be evaluated without regard to a third-party lender standard: (1) the terms of the Term Loan Agreement, in

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particular the deferred interest payment dates and the length of the term of the Term Loan; (2) the acceleration of interest payments in 2008; (3) the waivers of interest commencing in 2010; and (4) the view of the Objecting Parties that USS effectively subordinated payments on the Term Loan to payment of USSC's trade creditors. The Objecting Parties argue that, even considered without regard to the third-party lender standard, these factors, particularly the actions of USS after the advances were made, evidence the fact that USS did not expect to receive repayment of the principal with interest of the Term Loan. I will address each of these factors in turn and will then address the probative value of these factors considered collectively.

[288] First, as mentioned, the Term Loan Agreement provided USSC and USS with considerable latitude regarding the timing of both the payment of interest and the repayment of principal. There was a legitimate business reason for these terms of the Loans. They provided USS with some, but not complete, flexibility to align the payment of interest with the receipt of excess cash flow in a highly cyclical industry. They also provided a lengthy period of time over which to repay the Loans for the same reason. These terms were permissible under applicable tax legislation without losing the tax treatment for debt. For the reasons set out above, I do not think that the terms of the Term Loan Agreement, by themselves, are more consistent with a re-characterization of the Term Loan as a capital contribution. The mere existence of provisions providing flexibility in the timing of payment of interest and repayment of principal is not a basis for inferring that USS did not expect to receive repayment with interest of the Term Loan without further evidence at the time of the initial advances. There is no such evidence in this case. In particular, as noted above, there is no evidence regarding the financial model that establishes, on a balance of probabilities, that repayment of the Term Loan was not a realistic possibility over the life of the Loan.

[289] Second, the Objecting Parties suggest that the acceleration of interest payments in 2008 supports a finding that the payments were, in substance, dividend payments. For the reasons set out in the preceding section, I do not think that the two interest payments made in late 2008 are more properly characterized as dividends based on a third-party lender standard. I also do not think that the action of causing such payments in advance of their respective payment dates is, on its own, indicative of treatment of the Term Loan as a capital contribution. More generally, in the absence of any documentary or other evidence at the time of the payments suggesting otherwise, the fact that the payments were characterized as interest payments, that the payments did not exceed the amount of the accrued interest at the time, that the payments were permitted under the Term Loan Agreement, and that there was a legitimate business purpose for making interest payments in advance of their due date should be determinative.

[290] Third, the Objecting Parties' reliance on the interest waivers and failure to repay any interest in the seven years between the initial advances under the Term Loan and the Filing Date is understandable. It raises a legitimate question of whether USS ever intended USSC to pay principal or interest on the Term Loan, that is, whether it ever expected to be paid interest and/or repaid principal.

[291] There is some force to this argument in one respect. Insofar as USS waived, rather than continued to accrue, unpaid interest, it appears to have acted as a shareholder rather than a lender. The evidence before the Court established that it was not economic for USS to "round-trip" the payment of interest by USSC under the Term Loan. This explains why USS did not fund USSC to enable it to pay the accrued interest. However, it does not explain why it was

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appropriate to write off the interest that was waived in each of the relevant years, much less why only a portion of the interest was written off. Moreover, based on an internal email dated March 29, 2011 of USS, it is possible that, in or about late 2010 or early 2011, USS decided on a policy of waiving at least some interest at the end of each year to the extent USS was not in a position to pay the accrued interest payable in such year.

[292] However, the Objecting Parties suggest that the Court should infer from the interest waivers that USS did not expect to receive repayment with interest of the Term Loan at the time of the initial advances under the Term Loan. In the preceding section, I addressed the argument of Dr. Finnerty that the Court should draw such an inference from USS' failure to assert its rights as a lender in respect of the interest payment defaults that gave rise to the interest waivers. In this section, I address the alternative argument of the Objecting Parties that the granting of the interest waivers by themselves is sufficient to support the inference that USS never expected to receive repayment of the Term Loan with interest at the time that the initial advances were extended thereunder.

[293] I do not think a court can reasonably draw such inferences for a number of reasons. First, and most important, there is no other evidence supporting such an expectation at the time of the establishment of the Term Loan and the making of the initial advances under the Loan. Second, the payment of interest under the Term Loan in 2008 is inconsistent with an absence of any expectation of payment of interest from the outset of the Term Loan. Third, the intervening economic events are sufficient to establish radically different economic conditions which support the USS position of altered expectations. There is no evidence that USS contemplated the possibility of a recession of the depth and length experienced in the steel market since 2008 even though it put in place flexibility regarding interest payments and a long maturity date as discussed above. Fourth, notwithstanding the waivers in 2011, 2012 and 2013, there is no evidence that such repeated waivers of interest reflected a long-term policy of USS that existed from the outset of the Term Loan.

[294] Accordingly, the significant facts for this purpose are the lengthy period after the initial advances before the initial decision was made to waive interest coupled with the intervening occurrence of significantly adverse market conditions. These factors, together with the absence of any documentation or other evidence to the contrary at the time of the initial advances under the Term Loan, exclude an intention at the time of such advances to waive interest as and when it became payable under the terms of the Term Loan Agreement.

[295] Lastly, with respect to the argument of subordination, I have concluded for the reasons set out above that the evidence regarding the alleged effective subordination of the Loan does not evidence the absence of an expectation of USS of repayment with interest of the Term Loan or the Revolver Loan, except to the extent of the waived interest which has been addressed above. I would add that I do not consider that the evidence of Brockway, discussed below, constitutes evidence that USS implemented a policy of subordination of the Term Loan to trade creditors from the time of the initial advances as the Objecting Parties suggest.

[296] The Objecting Parties have raised one further argument that should be addressed pertaining to the use of the initial advances under the Term Loan. They suggest that both the use of the advances under the Term Loan to acquire capital assets, being the Stelco shares and other Stelco securities, and the circumstances surrounding the SHC Transaction, argue for a finding

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that the Term Loan constituted, in substance, a contribution to capital. I do not accept either submission for the following reasons.

[297] With respect to the significance of the acquisition of the Stelco shares and other securities, the Objecting Parties say that such use of the initial advances under the Term Loan demonstrates that the primary intention of USS was the acquisition of Stelco rather than the establishment of a debtor-creditor relationship between Canada LP and ABULC.

[298] This argument presumes that the purpose of debt is the provision of working capital and that the purpose of equity is the acquisition of capital assets. That is too narrow an approach. Term loans are regularly used to acquire capital assets and, indeed, are often secured on such capital assets in the case of third-party lenders. There is no necessary reason why the fact that advances under a term loan were used for the purpose of acquiring assets should be a consideration that demonstrates a capital contribution. In addition, as discussed above, there is no general principle that prevented USS from structuring a portion of its investment in USSC as a loan. Moreover, as described below, the portion of the Term Loan that reduced the Credit Corp Loan was effectively used to retire the third party debt of Stelco at the time of the Acquisition.

[299] With respect to the SHC Transaction, the Union argues that the fact that advances under the Term Loan were used to satisfy the Credit Corp Loan, which was incurred to refinance the Stelco debt at the USS level, is indicative of a view of the Term Loan as an equity contribution. I do not see the connection suggested by the Union.

[300] The SHC Transaction has been described above. The principal effect of the SHC Transaction was to effect a sale of SHC at its apparent fair market value by USSC and a reduction of the Credit Corp Loan in a like amount. If the SHC Transaction had not occurred, the Credit Corp Loan would have remained outstanding as of the Filing Date in the amount of such reduction and the amount of the Term Loan would have been correspondingly lower. From the point of view of the aggregate amount of outstanding debt of USSC, the SHC Transaction was therefore neutral. Moreover, the Credit Corp Loan was made for the purpose of repaying third-party debt of Stelco. To the extent that advances under the Term Loan in connection with the SHC Transaction were applied to reduce the Credit Corp Loan, such advances were therefore indirectly used to repay such third-party debt. I do not see any further significance to the SHC Transaction.

[301] It is therefore necessary to address the argument of the Objecting Parties that, while none of the foregoing factors or considerations may be sufficient on its own to support a conclusion that the Term Loan was, in substance, a capital contribution, the combination of factors should support such a conclusion. This argument effectively brings together all of the factors set out and discussed above and asserts that collectively they establish that it is more probable that USS did not expect to receive repayment with interest of the Term Loan than that USS had such an expectation.

[302] In considering this argument, I have looked more generally at which of the two scenarios proposed by the parties is more probable – the USS position that it expected to be repaid the principal with interest of the Term Loan at the time of the advances in 2007 or the Objecting Parties' position that, at the time of such advances, USS expected to receive only such cash flow and assets as were available after satisfaction of the obligations to third party creditors

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and to write off the principal or interest in respect of the Term Loan when cash was not available and such obligations fell due.

[303] In addition to the factors described above, the Objecting Parties rely on the evidence of Brockway referred to above and the evidence more particularly described in certain excerpts of Brockway's discovery in these proceedings set out at pages 8 and 9 of the Union's Compendium of Key Read-in Evidence. The Union submits that these excerpts establish that USS' expectation of repayment was "contingent on USSC's performance" or was "dependent on the success of Stelco's business going forward" and that "[USS] only expected to receive interest payments if USSC was successful." I note that this argument is similar to, but separate from, the argument that USS effectively subordinated repayment of the Term Loan, and payment of interest thereon, to the payment of USSC's third party creditors.

[304] I do not think that this submission accurately captures the evidence of Brockway and, accordingly, I think that the Objecting Parties rely on an interpretation of his evidence which it was not intended to carry.

[305] There is a difference between the investment risks of USS' investment in Stelco, considered as a whole, and the risk of repayment of the portion of the investment that was structured as debt of USSC. Reading the entirety of Brockway's evidence, I am satisfied that Brockway's statement was intended to acknowledge no more than that there could be no certainty that the aggregate investment in Stelco would be profitable. Brockway acknowledged no more than that the Acquisition entailed normal investment risks and that, to the extent that USS made a bad investment, there was a risk that it had made such a bad investment that USSC would be unable to repay not only its equity investment but also the Term Loan with interest. His evidence does not, however, constitute an acknowledgement that USS believed it had made an unprofitable investment in acquiring Stelco, much less an acknowledgement that USS therefore expected that USSC would be unable to repay the Term Loan with interest.

[306] The foregoing discussion highlights the fact that, at times, the position of the Objecting Parties approaches the issue of repayment of the Term Loan as part of the larger issue of the profitability of the entire investment of USS in USSC. This is reflected in the position of the Union, as excerpted above, which proceeds on the basis that USS treated both the Loans and the equity component as a single investment. In so doing, the Objecting Parties disregard the reality that the Term Loan was expressly structured and documented separately from the equity injections in order to function in the manner described above. I do not think that the separate existence of the Term Loan can be simply ignored in the absence of an explanation or reason for treating the USS investment on an aggregate basis. In doing so, this approach conflates the issues of repayment of the Term Loan and the profitability of USS' acquisition of Stelco, which are very different. The Court is only concerned with USS' expectation of repayment with interest of the Term Loan. Even an unsuccessful investment may nevertheless repay with interest the portion of the investment structured as a loan.

[307] Further, to the extent that Brockway was also acknowledging the existence of lending risks with respect to repayment of the Term Loan, the mere existence of lending risks is not a basis for an inference that there was no expectation of repayment of the debt portion of the USS' investment in USSC. The statement that USSC would not be able to repay the Term Loan with interest unless it was profitable is, on its own, a neutral statement. There is a considerable

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distance between an acknowledgement of the existence of normal lending risks and an acknowledgement that USS did not expect USSC to be able to repay the Term Loan with interest. I do not read Brockways' testimony as going to the latter statement.

[308] It is also necessary to address the position of the Province as excerpted above. The Province argues, in effect, that, having made the decision to acquire Stelco and to integrate it into the USS business as an operating division, USS paid no attention to the ability of USSC to repay the Term Loan over the thirty-year life of the Loan. It says that such action demonstrates that the Term Loan was, in effect, equity. By way of explanation for this approach, the Province suggests that USS considered the investment from a business-wide perspective. The Province suggests that USS was not concerned specifically with the profitability of USSC, and its ability to repay the Term Loan, given that USS considered that an increased profitability of other companies within the USS group would more than compensate for any losses in USSC.

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[309] At the time of the initial advances under the Term Loan, USS undoubtedly intended to integrate Stelco into its business as an operating division. That fact alone, however, does not support the conclusion that USS had no expectation that USSC would be unable to repay with interest the portion of the acquisition cost that was provided to it in the form of the Term Loan. More importantly, the evidence does not support the conclusion that USS paid no attention to the ability of USSC to repay the Term Loan in the manner suggested by the Province for the following reasons.

[310] First, as Brockway noted, it is incorrect to suggest that USS made no credit analysis of USSC in connection with the initial advances under the Term Loan. The financial model, upon which the decision to acquire Stelco was based, served the function of a credit analysis even if the principal purpose of the model was to address the financial impact of the entire investment. In its projections of cash flows of the post-acquisition Stelco, the financial model provided the basis for a conclusion regarding USSC's ability to service the Term Loan. As set out below, the evidence before the Court with respect to this financial model does not demonstrate that USS did not expect to receive repayment with interest of the initial advances under the Term Loan over the life of the Loan.

[311] Second, while the financial model did anticipate the realization of substantial synergies outside of USSC, it is not suggested that the quantum of such synergies was such that they would compensate for anticipated losses in USSC. More generally, there is no evidence that USS did not anticipate recovery of the majority of its investment in the form of profits from USSC, including the portion represented by the initial advances under the Term Loan which for this purpose is notionally senior to USS' equity investment.

[312] The Brockway evidence therefore does not constitute an acknowledgement or admission of USS that it had no expectation of repayment with interest of the initial advances under the Term Loan when they were made. For the reasons set out above, I am also not persuaded by the Province's argument that USS allocated its investment in Stelco between debt and equity with no regard to USSC's ability to repay the initial advances under the Term Loan. The probative value of the other considerations upon which the Objecting Parties rely has been discussed above. The element of USS' actions which most strongly raises a doubt regarding its expectation regarding repayment of the Term Loan is the experience of the interest waivers. The Objecting Parties also rely, among other considerations, on the long maturity date, the absence of

a schedule of repayments, and the alleged effective subordination. For the reasons set out above, however, none of this evidence is sufficient on its own to support a characterization of the Term Loan advances as equity. I am also not persuaded, for the reasons discussed above, that the experience of the interest waivers, together with the other considerations upon which the Objecting Parties rely, collectively demonstrate that USS did not expect to be repaid the initial advances under the Term Loan with interest as of the time such advances were made in 2007.

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[313] Accordingly, I find, on a balance of probabilities, that, at the time of the advances under the Term Loan in 2007, USS expected that USSC would repay interest on the Term Loan in accordance with the terms of the Term Loan Agreement and would repay principal on or prior to the maturity date of the Term Loan.

Was the USS Expectation Reasonable?

[314] This raises the issue of the reasonableness of the USS expectation.

[315] The Objecting Parties rely heavily on two factors which might suggest that such an expectation was unreasonable: (1) third party financing was not available to USSC on terms substantially similar to the terms of the financing provided by USS; and (2) the view of the Objecting Parties that ABULC was inadequately capitalized. I will address these issues in turn.

[316] As mentioned, the Province introduced the Hall Report as expert evidence demonstrating that a third party lender would not have provided ABULC/USSC with financing in the amount and on the terms of the Term Loan provided by USS.

[317] There is no actual dispute regarding this opinion in the Hall Report. However, for the reasons set out above, the standard addressed in the Hall Report — i.e., whether USSC could have obtained financing on the terms and in the amount of the Term Loan from a bank or other institutional lender — is too limited to establish that the USS expectation of repayment of the Term Loan was unreasonable. In this regard, it is noteworthy that both Mr. Hall and Dr. Finnerty, who relied on the Hall Report for the purpose of the opinion in the Finnerty Report on this issue, acknowledged that they were not expressing any opinion on the ability of USSC to have obtained financing other than from a third-party lender.

[318] The question remains whether the evidence regarding the ability of USSC to raise debt on a viable basis as of December 31, 2007 contradicts the reasonableness of the USS expectation. If the Objecting Parties were able to demonstrate, on a balance of probabilities, that USSC could not have obtained external financing in the amount of the Term Loan on any viable basis, I think a court could conclude that at least the excess of the Term Loan over the amount of financing that was obtainable from external sources represented an equity contribution.

[319] However, in the present circumstances, the evidence is not sufficient to establish that USSC lacked the capacity to raise an amount of debt equal to the outstanding amount of the Term Loan as of December 31, 2007, that is, that external financing would not have been available to USSC on a viable basis, although admittedly on a fully secured basis. Accordingly, the Objecting Parties cannot establish that the USS expectation in 2007 of repayment with interest of the Term Loan was unreasonable. In this regard, the following considerations are relevant.

[320] First, Stelco had total debt approximating $1.16 billion at the time of the Acquisition. As the Austin Smith Report suggests and Mr. Hall acknowledged, this would appear to put a floor on the debt capacity of USSC at the time of the Acquisition.

[321] Second, the historical financial results for Stelco (EBITDA and EBIT) prior to the Acquisition, when adjusted to remove non-recurring items, reflected an improving trend from 2006 to 2007 on a quarter-over-quarter comparison by year.

[322] Third, the outstanding balance of the Term Loan at December 31, 2007, being approximately $1.4 million including the outstanding loan from the Province, was not significantly higher than the amount of the Stelco debt prior to the Acquisition. This level of debt represented approximately 70% of the total acquisition cost to USS of Stelco. It is not inconsistent with Brockway's testimony that USS believed that the Term Loan could be repaid over the 30-year life of the Loan as Brockway suggested. It is true that the investment failed to generate the results contemplated by the USS financial model. By any estimation, in hindsight, the investment was a significant failure. However, there is no basis for retrospectively fixing USS with such knowledge at the time of the initial advances under the Term Loan.

[323] Fourth, the Hall Report bases its conclusions entirely on the historical performance of Stelco rather than on an analysis of the projected cash flow of USSC at the time of the Acquisition. However, as the Province's financial advisor in respect of the Acquisition, Ernst & Young Inc., recognized in a report dated August 22, 2007 to the Province, the Acquisition was likely to improve the financial strength of USSC relative to Stelco. The report identified a number of factors for consideration by the Province regarding the Acquisition. Purely from a cash-flow perspective, these factors would have been expected to result in an increased and more stable cash flow, other economic factors being equal. There is, therefore, a reasonable basis for concluding that the Acquisition increased USSC's debt capacity relative to Stelco's pre-Acquisition debt capacity. The fact that a third-party lender might not have been prepared to rely on USS' cash flow projections is not determinative of whether lenders in other capital markets were prepared to do so.

[324] Fifth, the limited metrics in evidence do not suggest that USSC lacked the ability to incur such external financing. As noted by Brockway, in 2007, Stelco incurred slightly less than $60 million in interest expense for the nine months ended September 30, 2007, or slightly less than $80 million on an annualized basis. The Term Loan interest for 2008 approximated $100 million, which was well within the estimated EBITDA for that year.

[325] Sixth, while the Acquisition was not a leveraged buyout transaction as that term is generally understood, USS, as a strategic purchaser, approached the purchase of Stelco with a similar philosophy and approach to capitalization, as the Austin Smith Report notes. In this regard, the financial metrics pertaining to aggregate debt and interest coverage, on a prospective basis, are consistent with leveraged buyout financing transactions in 2007 and are, therefore, suggestive of the availability of financing in the high-yield market.

[326] Given these factors, the evidence suggests a reasonable possibility of obtaining third-party financing in other capital markets, beyond the third-party lender market addressed in the Hall Report and the Finnerty Report, in particular, in the high-yield market. For the reasons discussed above, it is not relevant for present purposes that any such financing would have been

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on different terms and conditions from the Term Loan. The second issue raised by the Union in its Factum is the allegedly inadequate capitalization of ABULC/USSC at the time of the initial advances under the Term Loan.

[327] Insofar as the Union says that ABULC was inadequately capitalized, I think the issue is misdirected. While it is correct that ABULC had no prior operating performance and no revenues or profits of its own, that is irrelevant. At all times, ABULC was the direct parent corporation of USSC. Its financial performance on a consolidated basis was that of USSC. Accordingly, the extent to which ABULC was or was not undercapitalized was directly dependent on the extent to which USSC was or was not undercapitalized.

[328] Insofar as the Objecting Parties say that post-Acquisition USSC was inadequately capitalized, I think this issue engages the same issue as the preceding discussion of the availability of external financing. To the extent that the evidence fails to establish that USSC could not have obtained external financing on a viable basis in the amount of the Term Loan, it cannot reasonably be argued that USSC was inadequately capitalized.

[329] Based on the foregoing, I find that the Objecting Parties have not satisfied the onus of demonstrating that the USS expectation of repayment with interest of the principal of the Term Loan as of December 31, 2007 was unreasonable.

Term Loan Advances in 2009

[330] As mentioned, in 2009, USSC received additional advances totalling $211.2 million under the Term Loan from Canada LP. No interest or principal was paid during 2009. In addition, as set out in the table above, USS provided equity injections in the amount of $61 million during 2009.

[331] The Objecting Parties do not raise any arguments regarding these advances under the Term Loan in addition to those addressed above. The relevant facts are essentially the circumstances as of December 31, 2007 carried forward, subject to the interest payments in 2008 and the occurrence of the recession in 2009. Given the history of the steel market in the period 2004 to 2008, USS had a reasonable expectation that markets would improve that justified supporting USSC in 2009 with additional working capital advances. I note as well that the first interest waiver under the Term Loan occurred subsequent to the advances in 2009.

[332] Accordingly, I see no basis for reaching a different conclusion respecting the expectation of USS regarding repayment of these advances from the conclusion reached above regarding repayment of the initial advances under the Term Loan. The evidence before the Court establishes that USS expected that USSC would repay these advances with interest for the reasons set out above. Hindsight is always 20/20. There is, however, no evidence that, as of 2009 when such advances were made, USS or USSC anticipated the negative financial performance of USSC in the period 2009 to 2013 and therefore expected that USSC would be unable to repay these advances with interest. There is also no evidence before the Court that would demonstrate that the expectation of repayment with interest of these advances under the Term Loan was unreasonable.

Conclusion Regarding Characterization of the Term Loan

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[333] Based on the foregoing, I conclude that the outstanding Term Loan, being Claim #9, constitutes a debt claim rather than an "equity claim" for the purposes of this CCAA proceeding.

Analysis and Conclusions Regarding the Re-characterization Claim in Respect of the Revolver Loan

[334] I propose to set out my analysis of the debt re-characterization claim of the Objecting Parties with respect to the Revolver Loan after first setting out the position of the Objecting Parties in their written submissions. As in the case of the Term Loan, the Objecting Parties concentrated on a subset of these considerations at the trial, which are addressed in these Reasons.

Positions of the Parties

The Union

[335] The approach of the Union, as excerpted above from its written submissions, applies equally to the Term Loan and the Revolver Loan and therefore will not be repeated here. In its factum, the Union argues that the Revolver Loan should be re-characterized as equity based principally on the following seven *AutoStyle* factors: (1) the inability of USSC to obtain similar financing from outside lending institutions; (2) the source of repayments of the Revolver Loan; (3) the presence or absence of a fixed maturity date and schedule of payments; (4) the absence of security for advances under the Revolver Loan; (5) the absence of a sinking fund to provide for repayments; (6) the extent to which the advances under the Revolver Loan were effectively subordinated to the claims of outside creditors; and (7) the financial position of USSC, including an inadequate capitalization, at the date that the Revolver Loan was first put in place.

The Province

[336] The Province's approach, as excerpted above from its factum, also applies equally to the Term Loan and the Revolver Loan and therefore will not be repeated here. In its written submissions, the Province argues that the Revolver Loan should be re-characterized as equity based principally on two assertions also made in respect of the Term Loan, namely: (i) there was no expectation that USSC would repay the principal of the Revolver Loan advances; and (ii) the Revolver Loan was not provided by, nor available from, a third-party lender on commercial terms. The Province also suggests that the following three attributes of the Revolver Loan further demonstrate that it is, in substance, equity rather than debt: (1) the arrangements pertaining to interest including, in particular, determination of the interest rate based on tax requirements, the timing of interest payments in the loan agreements, and the reliance on equity injections to make interest payments under the Revolver Loan; (2) thin or inadequate capitalization of USSC at the date of the Revolver Loan Agreement and USSC's operating performance at the time; and (3) the failure to establish a sinking fund for repayment.

USS

[337] USS submits that the same *AutoStyle* factors upon which it relies in respect of the Term Loan also refute the Objecting Parties' re-characterization claim in respect of the Revolver Loan. Accordingly, I will not repeat them here.

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Analysis and Conclusions

[338] The claim of the Objecting Parties that the Revolver Loan should be characterized as an "equity claim" also requires addressing the two matters discussed above: (1) the expectation of USS regarding repayment of principal with interest on the Revolver Loan out of cash flows of USS over the term of the Revolver Loan; and (2) the reasonableness of such expectation. In the case of the Revolver Loan, it is necessary to address these issues separately in respect of each of the First Tranche Indebtedness and the Second Tranche Indebtedness. Accordingly, I will deal with each Tranche in order.

The First Tranche Indebtedness

Background

[339] As set out above, the amount of the First Tranche Indebtedness outstanding as of October 31, 2013 was U.S. $116,969,996. It is understood that no payments of either principal or interest were made in respect of the First Tranche Indebtedness after October 30, 2013. The history of advances and payments under the Revolver Loan to this date is important for the determinations herein. The Monitor's Seventh Report sets out all such advances and repayments in Exhibit "O" thereto, which is briefly summarized as follows.

[340] During 2010, USSC drew a total of U.S. $100,000,000 under the Revolver Loan and made no interest payments. In 2011, USSC drew U.S. $20,000,000 in June, repaid U.S. $18,339,563 in November and drew U.S. $25,223,983 in December. In the same year, USSC paid U.S. $6,660,437 of interest in November and U.S. $223,983 of interest in December. As of December 31, 2011, the amount outstanding under the Revolver Loan was U.S. $127,155,598.

[341] In 2012, USSC obtained advances totaling U.S. $307,366,090. Advances were made in each month, other than March and April when it repaid U.S. $33,866,386 and U.S. $9,568,279, respectively, and October when there was no activity. In addition, small amounts of interest were paid in each of January, March and April, being U.S. $366,090, U.S. $1,133,614 and U.S. $431,721, respectively. At the end of December 2012, the outstanding balance of the Revolver Loan was U.S. $496,702,434, which amount was increased by a draw of U.S. $10,000,000 in early January 2013 to bring the outstanding amount to U.S. $507,750,128.

[342] As Dr. Finnerty observed, with the qualification that money is fungible, it can be argued that the payments on account of principal and interest in the aggregate amount of U.S. $25,000,000 in November 2011, and a further interest payment of U.S. $223,983 in December 2011, were funded by an equity injection in October 2011. It can also be argued that the payments on account of principal and interest in March and April 2012 were funded by an advance under the Revolver Loan in February 2012.

[343] In 2013, as described above, USS implemented a decision to "de-lever" USSC by reducing the Revolver Loan. Accordingly, principal and interest payments totaling $383,845,848 and $11,154,152, respectively, were made in each of the months of February to July 2013 inclusive. By this means, the balance outstanding at October 31, 2013, prior to the execution of the Third Revolver Amendment and the October Security Agreement, had been reduced to the level set out above, being the amount of the First Tranche Indebtedness. Applying advances and

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repayments on a first-in, first-out basis, the advances outstanding under the First Tranche Indebtedness at the Filing Date were advances made in the course of 2012.

[344] It is necessary to overlay the economic performance of USS and USSC during these years. As described above, the evidence establishes that market conditions improved in the second quarter of 2010 and then weakened again in the second half of 2010. Similarly, market conditions improved in the second quarter and third quarter of each of 2011 and 2012 before weakening again in the fourth quarter of each year. Essentially, the evidence is that USS thought that the improvement in the markets in the first half of 2010 signalled the start of an improving market whereas, in retrospect, it heralded the beginning of several years of "mini-cycles" in each of 2010, 2011 and 2012. The evidence also indicates that a similar improvement did not occur in the first half of 2013.

[345] Exhibit "O" to the Monitor's Seventh Report sets out the equity injections made by USS during the period 2010 to October 2013 on a monthly basis, which is briefly summarized as follows. In 2010, USS made equity injections in each of June, July, September, October and December totaling $611,754,000. In 2011, USS made equity contributions in each of January, February, July, August, September and October totaling approximately U.S. $213 million. There were no equity injections in 2012. In 2013, as described above, in connection with its "de-leveraging" decision, USS contributed a total of $682,758,200 through equity injections in each month from February to and including September. It is not disputed that a significant portion of these equity injections in 2013 was used to pay interest owing, and to repay principal outstanding, on the Revolver Loan in connection with the "de-leveraging" exercise. A further $57,040,500 was injected in October 2013 prior to execution of the Third Revolver Amendment prompting a moratorium on further cash payments to USSC imposed by the new chief financial officer until security was provided.

Analysis and Conclusions

[346] The evidence indicates that USS established the Revolver Loan in May 2010 during a period of improvement in market conditions after the significant slowdown in business activity during the second half of 2008 and 2009. The funding under the Revolver Loan provided additional working capital required to respond to the recovery of the steel market that was anticipated at that time. As mentioned, the advances comprising the First Tranche Indebtedness were made in 2012 based on a first-in, first-out approach to advances and repayments under the Revolver Loan. Accordingly, such advances must be considered in the context of the economic environment in which they were made in 2012.

[347] USS says that it expected to be repaid all advances, with interest, when they were made under the Revolver Loan over the course of the Loan. As set out above, the principal argument of the Objecting Parties is that the terms of the Revolver Loan, as well as the manner in which the Loan was administered by USS, are more consistent with receipt of the residual cash flow and assets of the USSC, without any expectation of repayment with interest of the advances under the Revolver Loan.

[348] The Objecting Parties rely largely on the general considerations that were addressed in respect of characterization of the Term Loan. This is consistent with the fact that the Revolver Loan performed the same cash management function as the Term Loan. They also rely on certain

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other considerations that are specific to the circumstances in which the First Tranche Indebtedness was advanced. These include the following matters: (1) the losses of USSC since 2009; (2) the failure of USSC to pay any interest on the Term Loan after 2009; (3) the negative equity of USSC in 2012; (4) the removal of the solvency representation from the Revolver Loan; and (5) the use of equity injections to fund repayment of the Revolver Loan pursuant to the "de-leveraging" exercise described above in 2013.

[349] I will first address the application of the general considerations that the Objecting Parties suggest demonstrate the equity character of both the Term Loan and the Revolver Loan and then the additional considerations which they raise that are specific to the Revolver Loan.

[350] As mentioned, in the period from 2010 to 2012, that is, prior to the "de-leveraging" exercise discussed below, USS administered the Revolver Loan in the same manner as it had administered the Term Loan with the exception that: (1) in each of 2011 and 2012, USSC repaid some principal and paid some accruing interest out of available cash; and (2) USSC did not waive any interest that became payable during this period. There are no additional facts in respect of the administration of the Revolver Loan that render the combined effect of the general considerations upon which the Objecting Parties rely more compelling in the context of the Revolver Loan than the Term Loan.

[351] I therefore do not think that the terms of the Revolver Loan Agreement and the manner in which USS administered the Revolver Loan are sufficient to constitute the Revolver Loan, in substance, an equity contribution. There is nothing in these circumstances, considered on their own or collectively, that casts any doubt on the evidence that USS expected USSC to repay the principal with interest of the First Tranche Indebtedness over the life of the Loan.

[352] The next issue is therefore whether the financial status of USSC in 2012, when the advances comprising the First Tranche Indebtedness were made, affects this conclusion. The Objecting Parties say that the Court should infer from the four considerations set out above, which pertain to the financial state of USSC in the latter half of 2012, that USS did not expect to receive repayment with interest of the Revolver Loan. These factors raise a legitimate issue regarding both the expectation of USS and the reasonableness of that expectation at that time. I propose to address the issue of the removal of the solvency representation first and then the remaining considerations pertaining to USSC's financial state.

[353] The Objecting Parties place considerable reliance on the agreement of USS to remove the solvency representation from the Revolver Loan Agreement in 2012 as evidence that USS could not have expected USSC to be able to repay any advances under the Revolver Loan. The solvency representation was removed by the First Revolver Amendment in July 2012 at the request of Michael McQuade, the chief financial officer of USSC at the time ("McQuade").

[354] McQuade states in his affidavit sworn September 4, 2014 that, at the time of the execution of the First Revolver Amendment, he had a concern about USSC's solvency given its losses since 2009 and its reliance on USS for on-going liquidity and solvency. He testified at the hearing of this motion that he had a concern that USSC might become insolvent at some point over the remaining thirteen-year term of the Revolver Loan.

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[355] The Objecting Parties suggest the Court should draw the inference that USS was aware that USSC was insolvent in July 2012 and, from that inference, find that USS had no expectation of repayment with interest of the advances made in 2012 under the Revolver Loan. I do not think the evidence justifies such an inference or finding for the following reasons.

[356] First, there is no evidence regarding the intentions of either USS or USSC in removing the insolvency representation that supports such a finding. McQuade requested its removal. His evidence at the trial was that he approached the solvency representation as a continuing representation. McQuade's concern was prospective rather than immediate. He was concerned that USSC might breach the representation at some point in the future rather than that USSC was insolvent in July 2012. In addition, McQuade also testified that he believed that USSC had a continuing right under the Revolver Loan Agreement to draw funds as needed up to the maximum availability. It is not clear how he integrated these two apparently contradictory considerations. McQuade's view of the operation of the Revolver Loan Agreement does, however, reinforce the prospective nature of his concern. In addition, there is no evidence regarding why USS agreed to remove the solvency representation at the time.

[357] Second, it is not possible to draw any conclusion regarding the knowledge of USS and USSC from the terms of the Revolver Loan Agreement for the following reasons. As described elsewhere in these Reasons, I consider that the proper interpretation of the Revolver Loan Agreement is that a balance sheet solvency test remained in the form of the "unable to meet debts" event of default. In addition, a similar event of default remained in the Term Loan Agreement. I do not see any inconsistency in the removal of the solvency representation and the retention of a balance sheet event of default. Moreover, it is not clear whether the solvency representation was a continuing representation given at the time of each advance. Even if it was, which may be more likely, the net effect of the amendment was to remove the solvency test based on meeting liabilities as they fell due. As discussed above, there was no need for such an event of default in the context of a wholly-owned subsidiary relationship. It is therefore questionable whether the removal of the insolvency representation had any real practical significance from which it would be possible to draw an inference.

[358] Third, while USSC may not have been solvent on a book value basis in July 2012, there is no evidence to suggest that USS considered that USSC was insolvent on a market value basis at that time, which is the relevant issue both as a practical matter as well as a legal matter.

[359] I turn then to the remaining financial performance considerations upon which the Objecting Parties say that the Court should infer an absence of an expectation of repayment of the Revolver Loan on the part of USS in 2012. With hindsight, these considerations point in the direction of continuing financial problems of USSC which were identified in the autumn of 2013. With the benefit of that hindsight, it is also clear that USS had very lax controls over the provision of additional cash to USSC from 2010 until late October 2013 and perhaps poor planning processes. In practice, USSC's requests, as set out in its rolling thirteen-week cash forecasts, appear to have been satisfied on a regular basis without close scrutiny by the USS treasury department.

[360] However, such evidence, considered collectively with the other considerations relied upon by the Objecting Parties, is not sufficient to establish that USS actually expected that USSC would be unable to repay with interest the advances in 2012. The evidence is more consistent

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with a USS expectation that funding additional working capital in 2012 was appropriate given an anticipated improvement in the steel market, with a concomitant ability of USSC to repay such advances under the Revolver Loan as USSC returned to profitability.

[361] The advances under the Revolver Loan funded USSC with a view to increasing its working capital to take advantage of more favourable steel markets that were expected at the time. As described above, there were mini-cycles in each of 2010, 2011 and 2012. In each case, USS misread these mini-cycles as the start of a more broad-based improvement that did not occur. In the case of these advances, the evidence indicates a misplaced belief that the performance of USSC would improve in 2012 and 2013. There is, however, no evidence before the Court which suggests that USS did not hold these views. Nor is there any evidence that such views were unreasonable at the time.

[362] The Objecting Parties also raise the issue that the outstanding principal amount of the Revolver Loan was reduced from slightly in excess of U.S. $500,000,000 to the amount of U.S. $116,969,996 during 2013 pursuant to the "de-leveraging" exercise that was funded by equity injections from USS. They suggest that the source of funds is a factor indicating that the Revolver Loan was, in fact, an equity injection. There are three difficulties with this argument.

[363] First, USS had a legitimate business purpose in reducing the outstanding amount of the Revolver Loan that was not connected in any way to its expectation regarding the ability of USSC to repay the Revolver Loan. The "de-leveraging" exercise was undertaken to remove foreign currency fluctuations from the USSC financial statements and, thereby, to address an unnecessary complication in the USS consolidated financial statements.

[364] Second, in any event, I do not see any necessary connection between the use of the equity injections to reduce the outstanding balance of the Revolver Loan and the characterization of the remaining outstanding balance of the Loan. It may be that the use of equity injections reflected the fact that, in the course of 2013, USS concluded that USSC was no longer likely to be able to repay an amount of the Revolver Loan equal to the amount repaid by the equity injections. However, any determination to that effect would require evidence regarding the options available to USS to address the currency fluctuation issue, including the feasibility of conversion of such advances into another debt instrument rather than equity. Such evidence was not before the Court. In addition and in any event, the issue for the Court is whether USS expected repayment of an amount of the Revolver Loan equal to the remaining balance, being the First Tranche Indebtedness. The "de-leveraging" exercise does not demonstrate that USS also concluded that USSC would not be able to repay the amount of the Revolver Loan that it determined to leave outstanding.

[365] Third, there is a significant element of hindsight to this particular argument. The advances comprising the First Tranche Indebtedness were fully advanced before a decision to undertake the "de-leveraging" exercise was taken. In the absence of any documentary evidence of USS' decision-making in 2012, it is not possible to establish that the USS decision to convert a portion of the Revolver Loan to equity in 2013 reflected a determination made earlier in 2012 at the time of the advances under the Loan regarding the ability of USSC to repay such advances. More generally, there is no evidence that demonstrates that the use of equity injections to repay a portion or all of the Revolver Loan was contemplated at any time prior to late January 2013.

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[366] Accordingly, I do not see any demonstrable connection between the use of the equity injections to pay down the Revolver Loan and the expectation of USS regarding repayment with interest of the Loan when the Revolver Loan was established or when the advances comprising the First Tranche Indebtedness were made in 2012.

[367] Lastly, as mentioned, the Province argues that, in respect of the Revolver Loan, USS advanced monies to USSC as an operating division based on anticipated benefits to the overall USS business and without any expectation of the payment of interest or the repayment of principal of the advances. On this view, USS provided monies to USSC that would not earn interest or be repaid because it would earn sufficient additional profits elsewhere in the organization to justify the increased equity investment in USSC.

[368] While such a possibility cannot be wholly discounted, the evidence for such a conclusion is lacking, apart from the absence of any credit analysis by USS before establishing the Revolver Loan in 2010, upon which the Province relies. There is no evidence that the losses that USSC generated were compensated for by profits elsewhere within the USS companies between 2010 and 2012. Moreover, there also is no evidence that, by 2010, the synergies envisaged at the time of the Acquisition outside of USSC were being realized within the USS business. As discussed above, the evidence only goes as far as demonstrating lax controls and perhaps a poor planning process. Such evidence is insufficient to demonstrate an absence of an expectation of repayment with interest of the advances under the Term Loan.

[369] Based on the foregoing, I therefore find that the evidence demonstrates, on a balance of probabilities, that USS had an expectation of repayment with interest of the advances comprising the First Tranche Indebtedness at the time such advances were made.

[370] I turn then to the evidence regarding the reasonableness of such expectation.

[371] In this regard, the principal argument of the Objecting Parties is that USSC could not have obtained an operating loan from a third-party lender on the terms and conditions of the Revolver Loan. They argue that this fact demonstrates that the First Tranche Indebtedness was in substance an equity injection.

[372] There is no doubt that a third-party lender would not have made an operating line of credit available on the terms and conditions of the Revolver Loan. The Hall Report opines that a third-party lender would not have granted an unsecured credit facility in 2010 given the circumstances that USSC was unprofitable, was experiencing negative EBITDA, had a net worth deficit on a book value basis, and had an outstanding balance under the Term Loan of approximately $1.6 billion. On the other hand, there is no evidence before the Court that would support a conclusion that secured financing would not have been available on viable terms from an external source other than a third-party lender. Neither Mr. Hall nor Mr. Finnerty expressed any opinion on this matter.

[373] The more difficult question is whether any external financing would have been available given the amount outstanding under the Term Loan in 2012, that is, whether the total debt capacity of USSC would have been exceeded by the addition of a secured operating line. If it could be demonstrated that such financing would not have been available, a court could find

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that it was unreasonable to expect repayment of the advances of the First Tranche Indebtedness, being Claim #10, when they were made.

[374] However, there is no capital markets evidence before the Court that addresses this issue directly.

[375] The limited financial evidence referred to above is not sufficient to support any inference regarding the debt capacity of USSC at such time as it is limited to the availability of an unsecured revolver loan from a third-party lender. As the Objecting Parties bear the onus of proof, there is, therefore, no basis for a conclusion that USS' expectation of repayment was unreasonable on the basis that USSC lacked the aggregate debt capacity in 2012 to establish a revolving loan facility in the amount of the Revolver Loan.

[376] Based on the foregoing, I conclude that USS had a reasonable expectation of repayment with interest of the advances constituting the First Tranche Indebtedness at the time such advances were made. I therefore also conclude that the unsecured Claim in respect of the Term Loan, being Claim #10, constitutes a debt claim rather than an "equity claim" for the purpose of this CCAA proceeding.

The Second Tranche Indebtedness

[377] As set out above, Credit Corp advanced loans to USSC under the Revolver Loan totaling U.S. $71 million after the execution of the Third Revolver Amendment and the October Security Agreement on or about October 30, 2013. These advances were outstanding at the Filing Date. USS did not make any equity injection after October 30, 2013. As noted above, USSC acknowledges that USSC was insolvent on a balance sheet basis as of October 31, 2013, by which it is understood that USSC's liabilities exceeded the fair market value of its assets as of that date. The Objecting Parties argue that the Second Tranche Indebtedness was also an equity contribution.

[378] For clarity, I have approached the issue of characterization of the Second Tranche Indebtedness on the basis that such Indebtedness is secured by the security constituted by the October Security Agreement. Because USS required such security before advancing the Second Tranche Indebtedness, it is not realistic to address the characterization of such Indebtedness independently of such security. Accordingly, no conclusion is reached in these Reasons on the characterization of such Indebtedness to the extent that such security may be held to be void or unenforceable.

[379] I find the evidence supports the conclusion that USS expected to be repaid the Second Tranche Indebtedness as advanced under the Revolver Loan for the following reasons.

[380] First, there can be little doubt that USS expected to be repaid the advances made after October 30, 2013 with interest given the security over all the assets of USSC provided by the October Security Agreement. The existence of security for the Second Tranche Indebtedness overwhelms any argument that could be made for an absence of any expectation of repayment with interest based on the general considerations relied upon to seek to characterize the Term Loan and the First Tranche Indebtedness as capital contributions. The existence of security also

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precludes an argument based on the financial status of USSC at the time the advances comprising the Second Tranche Indebtedness were made.

[381] Second, the principal argument of the Objecting Parties is that USS was legally and practically obligated to continue funding USSC. The Objecting Parties say that, if USS had not funded through the Revolver Loan, it would have had to fund the same amounts by equity injections. They argue that therefore the Revolver Loan was effectively an equity contribution. There are two difficulties with this argument.

[382] First, I find that USS was not legally obligated to continue funding USSC under the Revolver Loan Agreement for the following reasons.

[383] The Objecting Parties submit that, as of October 31, 2013, USS was legally obligated to continue to make all advances requested by USSC up to the limit of the availability under the Revolver Loan Agreement, being U.S. $600 million. This position is based on the contractual interpretation set out in the Di Massa Report of the "unable to meet debts" event of default in section 11c of the Revolver Loan Agreement as of October 30, 2007.

[384] However, I have concluded above that the "unable to meet debts" event of default constituted a balance sheet insolvency event of default in the Revolver Loan Agreement. There is no dispute that USSC was insolvent on a balance sheet basis in October 2013. Accordingly, on this interpretation of the Revolver Loan Agreement, an event of default had occurred under the "unable to meet debts" event of default in the Agreement entitling USS to refuse to advance further funds to USSC thereunder.

[385] In addition, even assuming that USS was obligated practically to ensure financing for USSC, I do not think it is correct to say that USS was obligated to provide that financing by equity injections. This argument assumes that secured financing was not available from external sources on a viable basis in the amount of the Second Tranche Indebtedness. However, there is no reason to think that a revolving loan on a secured basis in the amount advanced during the remainder of 2013, being approximately $71 million, would not have been available to USS, although admittedly on terms and conditions which would have differed from those of the Revolver Loan.

[386] I note that the Objecting Parties acknowledged at the trial that, but for the foregoing argument, they would have no compelling argument for characterization of the Second Tranche Indebtedness as a capital contribution. In particular, they do not raise any argument to the effect that any expectation of USS of repayment of the Second Tranche Indebtedness as secured debt was unreasonable. The principal issue raised by the Objecting Parties in respect of the Second Tranche Indebtedness is the validity or enforceability of the security for such Indebtedness constituted by the October Security Agreement, which is discussed below.

[387] Based on the foregoing, I conclude that USS had a reasonable expectation of repayment with interest of the advances comprising the Second Tranche Indebtedness at the time such advances were made.

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The Validity of the Security for the Second Tranche Indebtedness

[388] The Objecting Parties submit that the security for the USS Secured Claims (being, collectively, Claims # 11, 11(a), 11(b), and 11(c)) should be invalidated. They make two principal arguments: (1) that the October Security Agreement and the November Security Agreement are unenforceable for lack of consideration at the time that they were executed and delivered by USSC; and (2) that the October Security Agreement and the November Security Agreement are void as constituting a fraudulent preference for the purposes of section 95(1)(b) of the BIA.

[389] In this section, I will address these issues in respect of the security for the Second Tranche Indebtedness, being the October Security Agreement. The security for the Remaining USS Secured Claims will be addressed in the last section of these Reasons.

Alleged Unenforceability of the October Security Agreement

[390] The Province and the Union argue that the October Security Agreement is unenforceable due to a lack of consideration at the time that it was executed and delivered by USSC and submit that, accordingly, the security constituted by such Agreement is invalid. On this basis, they argue that USS Claim #11, being the Second Tranche Indebtedness, should be declared to be an unsecured claim.

[391] USS says consideration was given for the October Security Agreement in the form of further advances under the Revolver Loan which would not have been granted without the provision of security for such advances, as referenced in the recital in the October Security Agreement cited above.

[392] The position of the Objecting Parties raises the following issues pertaining to the validity of security:

1. Is consideration for the October Security Agreement necessary for an enforceable security interest?

2. If so, did USS give consideration for the October Security Agreement in the form of an agreement to advance further funds under the Revolver Loan?

3. Alternatively, did USS give consideration for the October Security Agreement in the form of a forbearance or a waiver in respect of USS' rights to declare a default or take enforcement proceedings pursuant to the Revolver Loan Agreement or otherwise?

[393] I do not accept the position of the Objecting Parties that the October Security Agreement is unenforceable for want of consideration for the following reasons, which address each of these questions in turn.

[394] First, I do not think consideration is required for a grant of a security interest to be effective, although it will not be enforceable until such time as an obligation arises in favour of the grantee that is secured by the security interest. This result is a consequence of the fact that security is essentially a proprietary right. Consideration is not required to effect a pledge, or a

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charge on property. While a security interest is a statutory creation, I see nothing in the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (the "PPSA") that imposes a requirement for consideration as a condition of the effectiveness of a grant of a security interest.

[395] The Objecting Parties say that a requirement for consideration is found in the statutory provisions of the PPSA that require a security agreement between the parties. Given that any agreement requires consideration in favour of a party to the agreement to be enforceable against such party, the Objecting Parties say it necessarily follows that consideration is required for a party to enforce the grant of a security interest in its favour in a security agreement. I acknowledge that, in the absence of consideration, the other covenants in favour of a grantee of a security interest in a security agreement may not be enforceable. That is, however, a different issue. In such event, the rights of the grantee would be limited to its statutory rights under the PPSA, but the grant of the security interest would still be effective.

[396] Consistent with this approach, the PPSA expressly distinguishes between a security agreement and a security interest. A "security agreement" is defined in section 1(1) of the PPSA as "an agreement that creates or provides for a security interest and includes a document evidencing a security interest". I see no reason why a "document evidencing a security interest" cannot include a document or instrument containing a unilateral grant of a security interest by a grantor in favour of a grantee. Such a grant would be effective as between the parties regardless of whether consideration was given, provided the grantee could demonstrate that the grantor intended it to be delivered. It would also be effective in respect of the rights of third parties, subject to the other requirements of the PPSA regarding rights in the collateral and attachment. It is the extension of credit, and thereby the creation of an obligation in favour of the grantee that is secured by the security interest, that makes the security interest enforceable.

[397] Second, if consideration is required for the security interest granted in the October Security Agreement to be effective, I think this requirement was satisfied in three separate ways.

[398] First, the October Security Agreement recites that consideration was given, the receipt and sufficiency of which is acknowledged by both parties to the Agreement. It is an elementary principle that courts will not enter into an inquiry as to the adequacy of consideration: see John D. McCamus, *The Law of Contracts*, (Toronto: Irwin Law, 2005), at p. 222.

[399] Second, as a related matter, as stated above, the third recital to the October Security Agreement recites, in effect, that Credit Corp required the provision of security as a condition of continued advances under the Revolver Loan Agreement. This recital is consistent with the Court's conclusion above that an event of default had occurred under the Revolver Loan Agreement entitling Credit Corp to refuse to advance further monies under the Revolver Loan. On this basis, USS was therefore in a position to provide consideration in the form of a commitment to advance further funds under the Revolver Loan Agreement. Accordingly, the commitment to advance further funds on the part of Credit Corp referred to in the third recital accurately reflected the existence of consideration for the purposes of the October Security Agreement.

[400] Third, I am also of the opinion that any lack of consideration for the October Security Agreement was cured by the actual advances of monies under the Revolver Loan Agreement comprising the Second Tranche Indebtedness. If the execution of the October Security

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Agreement and the advance of monies had occurred concurrently, there would have been no issue regarding a lack of consideration. The advance of monies itself would have satisfied any requirement for consideration under the October Security Agreement. In other words, under such circumstances, it would have been unreasonable, and unnecessary, to require demonstration of an intermediate commitment to advance further funds. The result should not change merely because there was a period of time between the execution of the October Security Agreement and the subsequent advance of monies under the Revolver Loan. The significance of the lapse of time is that the security interest was not enforceable, in the sense that the security interest did not secure any outstanding obligation and therefore could be enforced, until such time as an advance occurred under the Revolver Loan. It did not, however, render the October Security Agreement void for lack of consideration.

[401] The Objecting Parties raise three arguments to the effect that USS did not give any consideration, even if an event of default had arisen under the Revolver Loan Agreement which would otherwise have permitted USS to refuse to advance further funds under the Revolver Loan Agreement.

[402] First, the Objecting Parties say that, notwithstanding the occurrence of an event of default, USS had waived its right to assert such an event of default by advancing funds prior to January 2013. They say this course of conduct constituted a waiver of USS' right to assert such an event of default in October 2013 or of USS' right to use the event of default to deny further advances under the Revolver Loan at that time.

[403] This argument is rejected for three reasons. First, as a practical matter, the last advance which could have given rise to such a waiver took place in early January 2013. There is no evidence that USS knew that USSC was insolvent, and therefore that an event of default had occurred, at or prior to the time of any such advances. Second, as a legal matter, the language of the Revolver Loan Agreement excluded the operation of a waiver in October 2013 based on previous conduct on two grounds. The provisions of section 7 of the Revolver Loan Agreement require that, to be effective, any waiver must be in writing, which would exclude entirely the possibility of an unwritten waiver based on a course of conduct. In addition, section 7 expressly negates the operation of a waiver based on the granting of a previous waiver. Third, in any event, as a practical matter, there can be no doubt that, as between USS and USSC, USSC would have understood that no course of conduct by USS could have given rise to a waiver of USS' rights to determine the availability of funding under the Revolver Loan Agreement, as described above.

[404] Second, the Objecting Parties submit that USSC did not, in fact, provide consideration in the form of a commitment to advance further funds under the Revolver Loan. They base this argument on the fact that McQuade testified that he was never expressly advised by any USS representative that USS would refrain from advancing funds unless the October Security Agreement was signed. They also rely upon the fact that USS did not declare an event of default in October 2013.

[405] I do not accept this argument for the following reasons. By acceding to USS' position with full knowledge that USS was taking the position that it was entitled to withhold future advances, USSC must be taken to have accepted USS' legal position. In this regard, it is clear that McQuade understood that execution of the October Security Agreement was a condition of the further advance of funds to USSC at the time he signed the Third Revolver Amendment and

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the October Security Agreement, notwithstanding the absence of any direct conversation on the matter with any USS representative. Further, McQuade's determination that execution of the October Security Agreement was in the best interests of USSC was expressly made on the basis of his understanding that USSC needed the advances to continue to meet its obligations and that USSC would only receive the further advances if it consented to the security.

[406] Accordingly, while McQuade says he believed that USS was obligated to fund under the Revolver Loan Agreement up to the limit of availability, he also knew that USS was taking the position that it was entitled to withhold funding under the Agreement until it received security for any further advances. McQuade did not challenge this legal position on behalf of USSC. Instead, USSC agreed to provide the security. In these circumstances, it was not necessary for USS to declare an event of default as a formal matter to assert its legal position. More importantly, in the absence of a determination at the time regarding the right of USS to withhold further advances, the decision of USSC to provide security must constitute acceptance of such legal right of USS.

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[407] Lastly, the Objecting Parties say that, as a practical matter, USS was never going to stop advancing funds in October 2013 for reasons relating to the operational impact on USS and USSC as well as the potential triggering of cross-default provisions on the USS public debt. Whether or not this is true, I do not think it demonstrates an absence of legal consideration for the following reasons. First, the absence of a legal obligation to advance further funds is by itself sufficient to give rise to consideration. Second, the grant of security by USSC forecloses this argument as it become entirely speculative. The position of the Objecting Parties requires the Court to make a determination that, in the hypothetical situation in which USSC refused to provide the required security, USS would necessarily have advanced the monies comprising the Second Tranche Indebtedness. I do not think the Court could make such a determination on the limited evidence before it. Among other things, in order to make such a determination, the Court would need to address the other options that would have been available to USS in such circumstances, including a filing under the CCAA and DIP financing, which was raised at the time by the financial advisors to USS.Based on the foregoing, I do not accept the position of the Objecting Parties that the security constituted by the October Security Agreement is unenforceable for lack of consideration.

[408] For completeness, USS also argues that it gave consideration in the form of a forbearance from declaring a default, accelerating the Revolver Loan or instituting insolvency proceedings. These arguments also turn, at least in part, on the Court's acceptance of the contractual interpretation of the "unable to meet debts" event of default proposed in the Di Massa Report. Given the determination herein regarding consideration for the October Security Agreement, it is not necessary to address these potential additional sources of consideration, and I therefore decline to make a finding on these issues.

Alleged Fraudulent Preference

[409] In the alternative, if the October Security Agreement is held to be enforceable, the Objecting Parties submit that the Agreement constituted a fraudulent preference for the purpose of section 95(1)(b) of the BIA, as incorporated into the CCAA by the provisions of section 36.1 thereof. It is not disputed that the Objecting Parties bear the onus of proof in respect of this Objection.

[410] The provisions of section 95 of the BIA have been set out above. To succeed in this proceeding, the Objecting Parties must demonstrate: (1) a non-arm's length relationship between USSC and USS at the time of entering into the October Security Agreement; (2) that USSC was insolvent at the time of entering into the October Security Agreement; (3) that the October Security Agreement was entered into within twelve months of the Filing Date; and (4) that the October Security Agreement had the effect of giving USS, or more particularly Credit Corp as the lender under the Revolver Loan, a preference over other unsecured creditors at the date of delivery of October Security Agreement. There is no dispute that Credit Corp was not dealing at arm's length with USSC, that USSC was insolvent on and after October 30, 2013, and that the grant of security in favour of Credit Corp occurred less than one year prior to the Filing Date.

[411] USS argues, however, that the granting of security in the October Security Agreement did not give rise to a preference over another creditor entitling the Objecting Parties to relief under section 95 of the BIA. It bases this argument on the fact that the security in favour of Credit Corp is only being asserted in respect of advances made under the Revolver Loan after October 30, 2013, that is, in respect of the Second Tranche Indebtedness. USS bases its argument on the principle that there is no preference under section 95 if, and to the extent that, security is granted by a debtor company in respect of fresh advances which are used in the ongoing operations of the debtor company: see *McAsphault Industries Ltd. v. Six Paws Investments Ltd.,* [1995] O.J. No. 2450 (C.A.), at para. 19.

[412] The Objecting Parties make two submissions.

[413] The principal submission of the Objecting Parties is that the October Security Agreement constituted a fraudulent preference because Credit Corp obtained security in circumstances in which it was obligated to advance monies under the Revolver Loan Agreement. They say that, if Credit Corp had an unqualified obligation to advance monies under the Revolver Loan as and when requested by USSC up to such limit, delivery of the October Security Agreement would have constituted a fraudulent preference on the basis that delivery of security in such circumstances would be similar to providing security for past debts. This argument turns on the question of the extent to which Credit Corp was legally obligated to advance funds to USSC up to the limit of availability under the Revolver Loan Agreement as and when requested by USSC. It is a novel argument that could only arise, as a practical matter, in a non-arm's length situation.

[414] I have reservations regarding the merits of this argument as a matter of law. However, it is not necessary to determine the issue the alleged fraudulent preference on this basis. I have concluded above, in the context of the determination that USS provided consideration for the grant of the October Security Agreement, that Credit Corp was not obligated to advance further funds under the Revolver Loan Agreement. On this basis, this argument of the Objecting Parties cannot succeed.

[415] The alternative argument of the Objecting Parties is that the security in favour of Credit Corp under the October Security Agreement must fail in its entirety to the extent that the October Security Agreement purports to secure a pre-existing debt. They rely on *Re Fulton* (No. 2), [1926] O.J. No. 115 (C.A.), at para. 7, for this proposition.

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[416] I accept that the granting of security for existing or past indebtedness constitutes a preference for the purpose of section 95 of the BIA. However, USS is not asserting a secured claim in respect of any such obligations in this proceeding, notwithstanding that the definition of "Secured Obligations" in the October Security Agreement extends to pre-existing indebtedness.

[417] In such circumstances, the Court of Appeal made it clear in *McAsphault*, at para. 19, that "a security may be bad in respect to some advances, but enforceable in respect to others, thus protecting payments made by an insolvent company which would otherwise be preferential." In that case, the evidence indicated that the fresh advances at issue were used in the on-going operations of the company. On that basis, the Court of Appeal held that the repayment of the advances did not constitute a fraudulent preference.

[418] In my opinion, the same principle operates in the present circumstances. There is no dispute that the advances comprising the Second Tranche Indebtedness were used in the on-going operations of USSC's business. The advances under the Revolver Loan after October 30, 2013 therefore benefitted the unsecured creditors as of the date of such advances. This factual context is sufficient under the case law to exclude a finding of a fraudulent preference under section 36.1 of the CCAA and section 95 of the BIA.

[419] The decision in *Fulton* does not assist the Objecting Parties for the reason that the circumstances in *Fulton* were qualitatively different from the present circumstances. *Fulton* involved advances under a chattel mortgage totaling $3,800, of which $2,200 represented a new advance after the date of the chattel mortgage. The mortgage purported to secure the existing obligation as well as the new advance. The security was declared invalid in respect of both advances. However, there was a significant issue with the new advance that explains the result in that decision. The Court of Appeal expressly held that there was "no doubt that the $2,200 did not in fact increase the assets of the estate in any tangible way." In fact, the court concluded that there was no evidence regarding what became of the $2,200. Accordingly, the security failed in its entirety because the new advance could not be demonstrated to have been used in the operations of the debtor, not because the mortgage also purported to secure a past advance.

[420] Based on the foregoing, I conclude that there is no basis for a finding that the delivery of the October Security Agreement constituted the grant of a fraudulent preference by USSC in favour of Credit Corp insofar as the security constituted thereby secured the Second Tranche Indebtedness.

Conclusion Regarding the Second Tranche Indebtedness

[421] Based on the foregoing, I conclude that Claim #11, being the claim in respect of the Second Tranche Indebtedness under the Revolver Loan, constitutes a debt claim, rather than an "equity claim", which is a Secured Claim for the purpose of this CCAA proceeding.

Remaining USS Secured Claims

[422] As mentioned, the Objecting Parties also submit that the security for the Remaining USS Claims (being Claims #11(a), 11(b) and 11(c)), should be invalidated on the grounds that the security for such Claims, being the November Security Agreement, is either unenforceable as a matter of contract law for lack of consideration at the time it was executed and delivered by USSC or void as constituting a fraudulent preference for the purposes of section 95(1)(b) of the

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BIA. The Objecting Parties do not dispute the quantum of any of these three Claims nor do they suggest that these Claims are "equity claims". For completeness, the Objecting Parties also submitted that the November Security Agreement cannot be an enforceable obligation to the extent that the Court were to find that the October Security Agreement was unenforceable. Given the determination above, it is not necessary to address this submission.

[423] I propose to address the issues pertaining to the Remaining USS Secured Claims in the following order. First, I will describe the nature of the November Security Agreement. Then I will address the issues pertaining to Claim #11(c) (Intercompany Goods & Services), which relates to the provision of goods and services by USS to USSC prior to the Initial Order. Lastly, I will address the issues pertaining to Claim #11(a) (the Cliffs Transaction) and Claim #11(b) (Credit Support Payments), which involve different considerations, as these claims arose after the Filing Date.

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The November Security Agreement

[424] On November 12, 2013, Credit Corp, USSC, USS, United States Steel International, Inc. and SHC executed a further amendment and restatement of the October Security Agreement that provided security to each of USS, United States Steel International, Inc. and SHC (collectively, the "USS Affiliates") in respect of the provision of intercompany goods and services on credit by any of them to USSC (as so amended, the "November Security Agreement") in addition to, and alongside, the security already provided to Credit Corp in respect of advances under the Revolver Loan pursuant to the October Security Agreement.

[425] The November Security Agreement contains recitals to the effect that each USS Affiliate sells "Goods" to USSC pursuant to arrangements and agreements, defined for such purposes as the "Sales Agreements", as between the USS Affiliates and USSC, that the USS Affiliates have determined that, in light of USSC's financial position and credit worthiness, they "no longer wish to sell Goods to the Debtor on terms other than cash in advance or cash on delivery, unless the Debtor provides acceptable financial accommodations" and that, "upon the Debtor's request, the [USS Affiliates] are willing to continue to sell Goods to the Debtor on credit…provided that the Debtor secures its obligations to pay for such Goods pursuant to the terms of the [November Security Agreement]". I would note that the definition of "Goods" for purposes of the November Security Agreement is "materials, goods and other products (including inventory and raw materials)".

[426] The extension of security to the USS Affiliates was implemented by adding the USS Affiliates as parties to the October Security Agreement, providing that such parties were "Secured Parties" for purposes of such Agreement, and amending the definition of "Secured Obligations" to read as follows:

> …all obligations, duties, indebtedness and liabilities of the Debtor from time to time owing by the Debtor to any Secured Party including, without limitation, obligations, duties, indebtedness and liabilities arising under, or in connection with: (i) the Loan Agreement; (ii) any amendment or restatement of the Loan Agreement, including any such amendment or restatement which increases or decreases the maximum amount of Loans and other obligations that may be made by Secured Party to Debtor thereunder; (iii) this Agreement; (iv) all obligations

> arising out of, in connection with or relating to the Sales Agreements or the sale of Goods by any USS Seller to the Debtor at any time and from time to time; and (v) any other document made, delivered or given in connection with any of the foregoing; in each case whether now existing or hereafter arising, whether evidenced by a note or other writing, whether allowed in any bankruptcy, insolvency, receivership or other similar proceedings, whether arising from an extension of credit, issuance of a letter of credit, acceptance, loan, guarantee, indemnification or otherwise, and whether direct or indirect, absolute or contingent, due or to become due, primary or secondary, or joint or several.

[427] By virtue of the definition of "Secured Obligations", therefore, all obligations owing by USSC to Credit Corp under the Revolver Loan Agreement, or to any of the USS Affiliates in respect of the sale of Goods, were entitled to the benefit of the general security interest granted by USSC in the Security Agreement, as amended and restated by the October Agreement and the November Security Agreement.

[428] I would also note that the first advance comprising the Second Tranche Indebtedness was made at the time that the October Security Agreement was in force and that the two later advances were apparently made after the November Security Agreement came into force. However, it is not disputed that the same security interest was continued under the November Security Agreement. I would also note that the parties addressed the validity of the security for the Second Tranche Indebtedness, and the existence of a fraudulent preference in respect of the granting of security for the Second Tranche Indebtedness, in the context of the October Security Agreement rather than the November Security Agreement. As the Objecting Parties have not raised any additional issues in respect of the Second Tranche Indebtedness pertaining to the November Security Agreement, I have proceeded on the basis that such Indebtedness is secured thereunder the extent that the security for the Second Tranche Indebtedness under the October Security Agreement is not invalidated for one of the reasons discussed above.

The Intercompany Trade Claim - Claim #11 (c)

[429] As mentioned, the Objecting Parties argue that the security for this Claim is either unenforceable for want of consideration from the USS Affiliates with respect to the November Security Agreement or void on the basis that the grant of the November Security Agreement constituted a fraudulent preference. I will address each issue in turn. I note that there is no issue regarding the fair market value of the goods and services relating to this Claim.

Alleged Unenforceability of the November Security Agreement

[430] The principles regarding the requirement for consideration in respect of the grant of a security interest in a security agreement have been addressed above in respect of the October Security Agreement. I do not propose to repeat that discussion in this section. As applied to the November Security Agreement, I reach the following conclusions.

[431] First, for the reasons set out above, I do not think that consideration is required for the grant of the security interest in the November Security Agreement.

[432] Further, to the extent that consideration is required to enforce the security constituted by the November Security Agreement, I find that consideration was given for the November

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Security Agreement, as verified in the recitals in the Agreement and acknowledged by all the parties. In particular, the recitals to the November Security Agreement reflect the grant of consideration from the USS Affiliates in the form of a commitment to continue to provide the goods and services that are the subject of this Claim. The position of the USS Affiliates was made clear to McQuade before he executed the November Security Agreement on behalf of USSC. There is no evidence before the Court that would indicate that the USS Affiliates lacked the legal right to refuse to provide such goods and services if USSC had refused to provide the security. Insofar as the Objecting Parties suggest that the USS Affiliates were not going to stop providing these services, as a practical matter, I consider that the reasoning and conclusions reached in respect of the comparable argument made regarding the security for the Second Tranche Indebtedness is equally applicable in this context.

[433] In addition, any lack of consideration was cured by the delivery and provision by the USS Affiliates of the goods and services in respect of Claim #11(c). I note that such delivery is the substantive equivalent of an advance of funds to be used in the operations of USSC to acquire such goods and services. If USS had advanced the purchase price of such goods and services to USSC under the Revolver Loan for the purpose of payment of such obligations, such advances would have been secured pursuant to the October Security Agreement based on the conclusion reached above. There is no principled reason why the result would differ because the USS Affiliates provided goods and services rather than advanced funds for such purposes.

[434] Accordingly, I conclude that the November Security Agreement is not unenforceable in respect of the amounts constituting Claim #11(c) for lack of consideration from the USS Affiliates to USSC.

Alleged Fraudulent Preference

[435] The principles regarding the operation of section 95(1)(b) of the BIA have also been set out above. As discussed above, there is no evidence before the Court that the USS Affiliates were legally obligated to continue to provide the goods and services that are the basis for this Claim. The security constituted by the November Security Agreement was given in respect of a the provision of additional goods and services that would not otherwise have been provided to USSC. Accordingly, for the reasons set out above, I conclude that the grant of the security under by the November Security Agreement in favour of the USS Affiliates did not constitute a fraudulent preference in their favour for the purposes of section 95.

[436] Further, as stated above, the delivery and provision of the goods and services in respect of Claim #11(c) represents the substantive equivalent of a fresh advance of funds to USSC to be used in the operation of its business. On this basis, the grant of security in respect of the delivery and provision of such goods and services did not prejudice the unsecured creditors of USSC as of the date of delivery of the November Security Agreement or the date of the delivery or provision of such goods and services and does not constitute a fraudulent preference.

[437] Based on the foregoing, I conclude there is no basis for a finding that the delivery of the November Security Agreement by the USS Affiliates in respect of Claim #11(c) constituted the grant of a fraudulent preference by USSC in favour of such parties.

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The Cliffs Transaction Claim and the Credit Support Payments Claim – Claims #11(a) and #(b)

[438] The claims for the Cliffs transaction and the credit support payments each arose after the Filing Date in the following circumstances.

[439] USSC took delivery from Cliffs of the iron ore that is the subject of the Cliffs transaction prior to the Filing Date. However, USS was not in a position to sell the iron ore to USSC until it had paid Cliffs. Because USS did not pay for the iron ore until after the Filing Date, its claim against USSC for payment of the iron ore arose after the Filing Date.

[440] USSC incurred the third-party obligations that are the basis of the credit support payments claim prior to the Filing Date but had not paid them as of that date. Because USS paid such claims pursuant to its guarantees in favour of such third parties after the Filing Date, its claim against USSC in respect of these payments also arose after the Filing Date.

[441] I will address each of these claims in turn.

The Cliffs Transaction – Claim #11(a)

[442] The Objecting Parties argue that the security for this Claim constituted by the November Security Agreement is either unenforceable or void as a fraudulent preference on the same grounds upon which they rely in respect of Claim #11(c). In addition, they argue that this claim is a pre-filing claim that is no different from all other trade creditor claims outstanding on the Filing Date. They argue that the effect of the November Security Agreement is to elevate improperly an unsecured pre-filing claim into a secured claim.

[443] This Claim involves the sale of goods by USS to USSC and is therefore similar as a factual matter to the circumstances in Claim #11(c). I conclude that the principles that governed the determinations with respect to Claim #11(c) regarding the issues of consideration for the November Security Agreement and the alleged fraudulent preference are equally applicable in the present situation, with the following additional consideration which reinforces the conclusions therein.

[444] In the case of this Claim, the Iron Ore Agreement specifically evidences fresh consideration for the grant of security pursuant to the November Security Agreement. While it is correct that USS was obligated to pay Cliffs under its agreement with Cliffs, as the Objecting Parties say, there is no evidence that USS was legally obligated to sell the iron ore to USSC once it acquired title to the ore. USS could have required that USSC deliver up possession of the iron ore to it. Instead, USS and USSC entered into a fresh agreement regarding the purchase by USSC of the iron ore at a time when USSC was independently represented. The Iron Ore Agreement provided that USSC's obligation to pay for such iron ore, when it arose, would be a "Secured Obligation" for purposes of the November Security Agreement, in return for USS' agreement effectively to sell USSC its interest in the iron ore and to pay Cliffs the purchase price of the ore on behalf of USSC.

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[445] Such circumstances are sufficient to satisfy any requirement for the demonstration of consideration for the grant of security pursuant to the November Security Agreement in respect of the purchase price obligation of USSC and to negate any fraudulent preference upon the grant of such security for such obligation.

[446] I would add that, in the case of this claim, USSC expressly agreed to the secured treatment of the purchase price obligation prior to such obligation coming into existence. As such, the circumstances do not involve the transformation of a pre-filing unsecured claim into a post-filing secured claim.

The Credit Support Payments Claim – Claim #11(b)

[447] As discussed above, USS paid these obligations pursuant to guarantees established in favour of the third-party creditors. It asserts Claim #11(b) against USSC pursuant to its rights of subrogation. USS submits that such rights of subrogation constitute "Secured Obligations" for the purposes of the November Security Agreement and, accordingly, rank ahead of all other trade creditors. If these credit support payments are secured, a consequence would be that the unsecured, pre-filing claims of the third party-creditors have become secured, post-filing claims of USS without any involvement of the Monitor or the Court pursuant to the provisions of section 10 of the Initial Order, which would otherwise govern the payment of pre-filing obligations.

[448] The Objecting Parties argue that the security for this Claim constituted by the November Security Agreement is either unenforceable or void as a fraudulent preference on the same grounds upon which they rely in respect of Claims #11(a) and #11(c).

[449] After a review of the documentation pertaining to this Claim, I think there is a threshold issue of whether the USS subrogation rights at issue qualify as "Secured Obligations" under the November Security Agreement. This issue was not, however, raised directly in the submissions of the parties. The parties should therefore be given an opportunity to make submissions regarding this threshold issue to the extent they wish to do so.

[450] Accordingly, I do not propose to address the determination of the issues pertaining to this Claim at this time. If the parties are unable to agree on a schedule for submissions on the threshold issue, they should contact the Court to arrange a telephone case conference at their convenience.

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Conclusions

[451] he USS Claims referenced as Claims #1-8 inclusive in the Monitor's Third Report are not disputed in this proceeding and are therefore confirmed as unsecured Claims under the Claims Process Order. Based on the foregoing, the USS Claims referenced in such Report as Claims #9 and #10 are also confirmed as unsecured Claims under the Claims Process Order and Claims #11, #11(a) and #11(c) are confirmed as Secured Claims. The USS Claim referenced in the Report as Claim #11(b) remains to be determined.

Wilton-Siegel J.

Date: February 29, 2016

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COURT OF APPEAL FOR ONTARIO

CITATION: U.S. Steel Canada Inc. (Re), 2016 ONCA 662
DATE: 20160909
DOCKET: C61331

2016 ONCA 662 (CanLII)

Strathy C.J.O., Lauwers and Benotto JJA.

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

And in the Matter of a Proposed Plan of Compromise or Arrangement with Respect to U.S. Steel Canada Inc.

Gordon Capern, Kristian Borg-Olivier and Denise Cooney, for the appellant United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (the "Union"), Appellant

Andrew Hatnay and Barbara Walancik, for SSPO and non-union retirees and active employees of U.S. Steel Canada Inc.

Tamryn Jacobson, for Her Majesty the Queen in Right of Ontario and the Superintendent of Financial Services (Ontario)

Michael E. Barrack, Jeff Galway and John Mather, for United States Steel Corporation, Respondent

Sharon Kour, for U.S. Steel Canada Inc.

Heard: March 17, 2016

On appeal from the order of Justice H. Wilton-Siegel of the Superior Court of Justice, dated August 13, 2015.

Strathy C.J.O.:

[1] U.S. Steel Canada Inc. (“USSC”) is in *CCAA*[1] protection. Its former employees claim that its American parent, United States Steel Corporation (“USS”), ran the company into insolvency to further its own interests. An issue arose in the court below as to whether the *CCAA* judge could apply an American legal doctrine called “equitable subordination” to subordinate USS’s claims to the appellant’s claims.

[2] The *CCAA* judge held he had no jurisdiction to do so. For reasons different than the ones he gave, I agree, and would dismiss the appeal.

FACTUAL BACKGROUND

[3] USS is one of the largest steel producers in North America. In 2007, it acquired Stelco, which was in *CCAA* protection at the time, and changed its name to USSC.

[4] Seven years later, on September 16, 2014, USSC was again granted *CCAA* protection by order of the Superior Court of Justice (Commercial List).

[5] The *CCAA* judge made a Claims Process Order on November 13, 2014, establishing a procedure for filing, reviewing and resolving creditors’ claims against USSC.

[1] *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

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[6] The order set out a separate procedure for resolving claims of approximately $2.2 billion by USS against USSC. Most of the claims arose from USS's acquisition and reorganization of Stelco and from advances of working capital. Those claims were to be determined by the court, rather than by the Monitor.

[7] USS filed its proofs of claims. The Monitor recommended they be approved and USS moved for court approval of the claims.

[8] Notices of Objection were filed by four parties: (a) the Province of Ontario and the Superintendent of Financial Services in his capacity as administrator of the Pension Benefits Guarantee Fund; (b) the United Steelworkers, Locals 8782 and 1005; (c) Representative Counsel to the Non-USW Active Salaried Employees and Non-USW Salaried Retirees; and (d) Robert Milbourne, a former president of Stelco, and his wife, Sharon Milbourne, both of whom are beneficiaries of a pension agreement with USSC.

[9] These objections overlapped to some extent. The *CCAA* judge had to develop a procedure to address the objections. He had to decide whether they should be dealt with within the *CCAA* process, outside it, or not at all.

[10] The Province made two allegations. The first was that loans by USS to USSC should be characterized as shareholders' equity, because of the circumstances in which they were made. They should therefore be subordinated to all other claims

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pursuant to s. 6(8) of the *CCAA*[2] (the “Debt/Equity Objection”). Second, the Province argued that the security for the loans should be invalidated pursuant to provincial and federal fraudulent assignment and fraudulent preference legislation (the “Security Objection”). USS disputed both allegations, but was content to have the issues determined under the Claims Process Order.

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[11] The Union made objections similar to the Province’s, but it added a third based on oppression and breach of fiduciary duty arising out of USS’s conduct in relation to the Canadian plants, pensioners, pension plan members and beneficiaries (the “Conduct Objections”).

[12] The *CCAA* judge described the Conduct Objections as allegations that USS caused USSC to underperform, thereby requiring it to incur significant debt and to be unable to meet its pension obligations. The Union sought, among other things, an order subordinating the USS claims in whole or in part to its claims.

[13] The Milbournes’ objections were based on USS’s alleged conduct and relied primarily on the doctrine of equitable subordination. They asked that the USS claims be dismissed entirely or subordinated to the claims of the other unsecured creditors.

[14] The *CCAA* judge scheduled a motion to establish a litigation plan for USS’s motion for approval of its claims against USSC. The parties agreed that the Security

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[2] 6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Objection and the Debt/Equity Objection could be determined pursuant to the Claims Process Order and within the *CCAA* proceedings.[3]

[15] The primary disagreement concerned the procedure and timing for the determination of the other objections. The Union argued that the Conduct Objections should be resolved as part of the Claims Process Order and that an evidentiary record was required to do so. USS and USSC took the position that the Conduct Objections should be litigated outside the *CCAA* claims process.

[16] The *CCAA* judge found that some of the claims of the Union and the Milbournes could be approached as third party claims against USS for oppression for the purpose of s. 241 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, and for breach of fiduciary duty. He found that neither the Claims Process Order nor the *CCAA* contemplated that such claims would be addressed by or would be relevant to a plan of arrangement or compromise under the *CCAA*. The third party claims fell outside the claims process unless specifically incorporated into the restructuring plan as approved by the parties or otherwise ordered.

[17] The *CCAA*, he said at para. 65, “is directed towards the creation, approval and implementation of a plan of arrangement or compromise proposed between a debtor company and its secured and unsecured creditors”. It did not contemplate

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3 In a subsequent ruling, *U.S. Steel Canada Inc., (Re)*, 2016 ONSC 569, the *CCAA* judge dismissed the Debt/Equity objection, finding that approximately $2 billion of USSC’s unsecured claims and $73 million in secured claims were properly characterized as debt rather than equity. He also dismissed the objection that approximately $118 million in secured claims should be invalidated due to lack of consideration or as a fraudulent preference.

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incorporation of inter-creditor claims into any plan of arrangement or compromise or into the voting process in respect of any proposed plan.

[18] He concluded, at para. 84, that under s. 11 the court had authority to order the remaining claims of the Union and the Milbournes, except the claim for equitable subordination, to be “determined by a process within the *CCAA* proceedings, other than the process contemplated by the Claims Process Order, if the Court is of the opinion that, on balance, such action is likely to further the remedial purpose of the *CCAA*.” He held that those claims could be determined within the *CCAA* proceedings, rather than in a separate action in the Superior Court, but not under the Claims Process Order. He noted that the court retained jurisdiction to order that the claims be continued outside the *CCAA* if it was determined that pursuing them within the process would no longer further the remedial process of the *CCAA.*

[19] He held, however, that he had no jurisdiction under the *CCAA* to apply the doctrine of equitable subordination. Before turning to his reasons, I will explain the doctrine of equitable subordination.

EQUITABLE SUBORDINATION

[20] Equitable subordination was developed as an equitable remedy in American insolvency law to subordinate a creditor’s claim based on its inequitable conduct. The principles were articulated in *Re Mobile Steel* (1977) 563 F. (2d) 692 (5th Cir.), which set out a three-part test:

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a. the claimant must have engaged in some type of inequitable conduct;

b. the misconduct must have resulted in injury to creditors of the bankrupt or conferred an unfair advantage on the claimant; and

c. equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

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[21] Paragraph 105(a) of the U.S. *Bankruptcy Code* authorizes bankruptcy courts to use equitable principles to alter the provisions of Title 11 or to prevent an abuse of process. One year after *Mobile Steel*, the *Code* was amended to give legislative effect to equitable subordination: *Bankruptcy Reform Act*, 11 U.S.C. §510(c)(1).

[22] The Supreme Court of Canada considered the doctrine on two occasions. In both, the court found it unnecessary to determine whether equitable subordination should be applied, because the underlying facts did not meet the test: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558, at p. 609; and *Sun Indalex Finance, LLC v. United Steelworkers,* 2013 SCC 6, [2013] 1 S.C.R. 271, at para. 77. This court also found it unnecessary to decide the issue in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 14 O.R. (3d) 1 (C.A.).

[23] The availability of the doctrine has been considered in various Canadian superior courts at the trial level, in various contexts and with inconclusive results: see *e.g. Harbert Distressed Investment Fund, L.P. v. General Chemical Canada Ltd.*, [2006] O.J. No. 3087 (S.C. [Commercial List]), (in the context of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3); *Christian Brothers of Ireland*

in Canada (Re) (2004), 69 O.R. (3d) 507, *(*in the context of the *Winding-up and Restructuring Act*, R.S.C. 1985, C. W-11, as amended).

[24] In *AEVO Co. v. D & A Macleod Co.* (1991), 4 O.R. (3d) 368 (Gen. Div.), Chadwick J. rejected the application of equitable subordination in Canadian law, observing, at p. 372, that to introduce the doctrine would create chaos and would lead to challenges to security agreements based on the conduct of the secured creditor. In *I. Waxman & Sons Ltd. (Re)* (2008), 89 O.R. (3d) 427 (S.C.), Pepall J. queried, at para. 33, whether statutory priorities should be upset by a doctrine "divorced from its legal home". This observation was followed, however, with the comment that "a vibrant legal system must be responsive to new developments in the law and the need for reform. Jurisprudence from other jurisdictions often provides the impetus or basis for much needed legal developments."

[25] On the other hand, the Newfoundland and Labrador Supreme Court (Trial Division) applied the doctrine in a bankruptcy case in *Oppenheim v. J.J. Lacey Insurance Limited*, 2009 NLTD 148, 291 Nfld. & P.E.I.R. 149.

[26] The Supreme Court of Canada's silence on the issue of equitable subordination in *CDIC* and *Indalex* cannot be taken, as the *CCAA* judge appears to have thought, as an outright rejection of the doctrine. In my view, the Supreme Court simply left the issue for another day.

[27] It is unnecessary to decide that issue in order to resolve this appeal. The only issue is whether the *CCAA* judge was right in deciding that he had no jurisdiction to

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grant equitable subordination under the *CCAA*, assuming the remedy is available in Canadian law.

SUBMISSIONS AND ANALYSIS

A. PROCEDURAL OBJECTION

[28] The appellant's first submission is procedural. It claims that it was unnecessary for the *CCAA* judge to determine whether he had jurisdiction to grant equitable subordination. The Union essentially says it was blindsided. It says it made no submissions on the doctrine of equitable subordination and the *CCAA* judge did not indicate that he was going to address the issue in the context of the scheduling motion. It was inappropriate and unnecessary for the court to shut the door on a novel and controversial remedy without a full factual record.

[29] The respondent acknowledges that equitable subordination was not a central issue in the oral submissions before the *CCAA* judge, but points out that it was raised in some of the factums and memoranda filed before and after the hearing. The *CCAA* judge was required to determine what conduct-based inter-creditor claims would be litigated, either under the Claims Process Order or under the *CCAA.* He was entitled to determine whether he had jurisdiction to grant equitable subordination within the *CCAA*.

[30] I do not accept the appellant's submission. The issue of equitable subordination was plainly before the *CCAA* judge in submissions made before and after the hearing. The Milbournes' factum made extensive submissions on equitable

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subordination and argued that it, along with fiduciary duty and oppression, were "live issues which should be the subject matter of a robust evidentiary record and subject to a fair and thorough due process in this court". The Union's factum suggested that some of USS's unsecured claim could be subordinated to the claims of other creditors "on account of a breach of fiduciary duty, a finding of oppression, or otherwise." USSC's factum argued that the Union's claim for equitable subordination should be rejected and that suitable remedies were available outside the Claims Process. In supplementary written submissions, the Union argued, in response to USSC's submissions, that the determination of the issue of equitable subordination should await an evidentiary record.

[31] Moreover, the issue before the *CCAA* judge was not simply scheduling. The motion sought directions on the extent and nature of production and discovery with respect to the various objections. The Union argued that the objections had to be resolved before there could be approval of a plan of restructuring, a sale process or a distribution to creditors. The allegations that USS's claims should be re-characterized, invalidated, disallowed or subordinated had to be resolved and the *CCAA* judge had to determine a process for their resolution. Some might be dealt with under the Claims Process Order and some might be dealt with outside that Order but nevertheless in the *CCAA* proceedings. Some might not be dealt with under the *CCAA* at all.

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[32] The *CCAA* judge was plainly aware that a determination of the inter-creditor claims could have implications for the approval of any subsequent reorganization, sale of the business or credit bid. It was appropriate for him to consider whether the court had jurisdiction to address those claims and, if so, how and when.

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[33] An evidentiary record was unnecessary. The *CCAA* judge was not deciding whether equitable subordination applied on the facts of this case. The issue was whether he had jurisdiction to grant equitable subordination under the *CCAA*.

[34] I turn now to the question whether the *CCAA* judge correctly held that he had no jurisdiction under the *CCAA* to order equitable subordination of USS's claims.

B. JURISDICTION TO ORDER EQUITABLE SUBORDINATION

[35] I will begin by summarizing the *CCAA* judge's reasons on this issue. I will then set out the submissions of the parties, identify the standard of review, describe the methodology I will use and apply that methodology to the legislation.

(1) The *CCAA* judge's reasons

[36] The *CCAA* judge noted that although the *CCAA* gives authority to re-characterize debt as equity and to invalidate a preference or assignment, there is no express provision conferring jurisdiction to grant equitable subordination. He was of the view that any jurisdiction to do so would have to be found in s. 11, which provides that "the court … may, subject to the restrictions set out in this Act … make any order that it considers appropriate in the circumstances."

[37] He observed that there is no Canadian case law supporting that authority and, when given the occasion to confirm the existence of equitable subordination on two occasions, the Supreme Court of Canada had declined to do so: *Canada Deposit Insurance Corp.*; and *Indalex*. He suggested that one might infer from this that the Supreme Court had rejected the principle of equitable subordination.

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[38] He found, however, that to the extent the issue remained open, the *CCAA* evidenced an intention to exclude equitable subordination. When Parliament amended the legislation in 2009, it gave authority under s. 6(8) to subordinate debt as being in substance equity, but it did not enact any provision to subordinate a claim based on the conduct of the creditor. Nor had it drafted s. 36.1, which permitted the court to invalidate preferences and assignments, broadly enough to permit the court to make an order for equitable subordination. These provisions, he said, were "restrictions set out in this Act", limiting the court's broad discretion under s. 11. Parliament's failure to include equitable subordination in the remedies introduced in 2009 must be taken as indicative of an intention to exclude the operation of the doctrine under the *CCAA*. This, he said, was a policy decision the court must respect.

(2) The submissions of the parties

[39] The appellant submits the *CCAA* judge had jurisdiction to grant equitable subordination pursuant to s. 11 of the *CCAA* in the absence of express "restrictions"

on that jurisdiction. He erred in implying restrictions based on Parliament's failure to amend the legislation.

[40] The respondent submits that Canadian courts have all the tools they need to assess, review and, where necessary, subordinate or invalidate creditors' claims in a manner consistent with the underlying legislation, without the need for equitable subordination. Some of these tools are the result of the 2009 amendments to the *BIA* and the *CCAA*. Parliament might have expanded those amendments to incorporate equitable subordination or some other conduct-based remedy, but declined to do so. The court should not invoke a controversial doctrine that Parliament declined to adopt when it had the opportunity to do so.

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(3) The standard of review

[41] The parties agree that the applicable standard of review is correctness: *Housen v. Nikolaisen*, 2002 SCC 33, at para. 8; and *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.)*, 2008 ONCA 587, 92 O.R. (3d) 513, at para. 40.

(4) Framework for analysis

[42] In *Century Services v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379, at paras. 65ff., the Supreme Court of Canada gave guidance on the approach to the scope of statutory remedies under the *CCAA,* and, if need be, under related sources of judicial authority. The court adopted the analysis proposed by Justice Georgina R. Jackson of the Court of Appeal for Saskatchewan and

Professor Janis Sarra in an article entitled, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Toronto: Thomson Carswell, 2007), at p. 41. Blair J.A. also approved of this approach in *Metcalfe & Mansfield*, at paras. 48-49.

[43] Jackson and Sarra note that the *CCAA* is skeletal legislation and advocate a transparent and consistent methodology as judges define the scope of their jurisdiction under the statute. They propose that the courts should take a hierarchical view of the powers at their disposal, adopting a broad, liberal and purposive interpretation of the statute and applying the principles of statutory interpretation before turning to other tools such as the common law or the exercise of inherent jurisdiction.

[44] At para. 66 of *Century Services*, the Supreme Court held that in most cases, the search for jurisdiction under the *CCAA* should be an exercise in statutory interpretation. The starting point is the "big picture" principles of statutory interpretation.

[45] Driedger's modern principle is the crucial tool for construing skeletal legislation such as the *CCAA*. A court must go beyond an examination of the wording of the statute and consider the scheme of the Act, its object or the intention of the legislature and the context of the words in issue:

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> 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.

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See: Jackson and Sarra, at p. 47; Elmer A. Driedger, *The Construction of Statutes*, 2d ed (Toronto: Butterworths, 1983) at p. 87, cited in *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559, at para. 26. See also: *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at paras. 23, 40.

[46] With this in mind, I will apply the framework in *Century Services* to the search for jurisdiction. I turn first to a consideration of the purpose and scheme of the *CCAA*, before considering the language of the statute.

(5) Application of the framework

(i)The purpose of the CCAA

[47] There is no dispute about the purpose of the *CCAA*. It describes itself as "An Act to facilitate compromises and arrangements between companies and their creditors". Its purpose is to avoid the devastating social and economic effects of commercial bankruptcies. It permits the debtor to continue to carry on business and allows the court to preserve the status quo while "attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all": *Century Services*, at para. 77.

[48] The *CCAA* has proven to be a flexible and successful tool to enable businesses to avoid bankruptcy. As Professor Sarra notes, "[i]t has been the statute

of choice for debtor corporations in every major Canadian restructuring in the past quarter century, including national airlines, major steel and forestry companies, telecommunications companies, major retail chains, real estate and development groups, and the national blood delivery system": Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2d ed. (Toronto: Carswell, 2013), at p. 1.

[49] The *CCAA* achieves its goals through a summary procedure for the compromise or arrangement of creditors' claims against the company. It was described in *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (C.A.), at para. 36, as:

> 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.

[50] The process has been effective because it is summary, it is practical, it is supervised by an independent expert monitor and it is managed in real time by an experienced commercial judge.

[51] *Century Services* is a good example of how the purpose of the *CCAA* informs the exercise of the court's authority. At issue in that case were the reconciliation of another federal statute with the *CCAA* and the scope of a *CCAA* judge's discretion. At para. 70, the orders of the *CCAA* judge were considered squarely within the context of the purpose of the Act:

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> The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit. [emphasis added]

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[52] The Supreme Court concluded, at para. 75, that the order advanced the underlying purpose of the *CCAA.*

(ii)The scheme of the CCAA

[53] The *CCAA* has been described as “skeletal” or “under-inclusive” legislation, (Jackson and Sarra at p. 48) which grants broad powers to the courts in general terms.

[54] The Act has five parts. Part I, entitled “Compromises and Arrangements” permits the court to sanction a compromise or arrangement between a company and its secured or unsecured creditors, or both.

[55] The powers of the court are found in Part II, entitled “Jurisdiction of Courts”. The statute gives the court jurisdiction to receive applications, order stays, approve debtor-in-possession financing and appoint a monitor, among other things.

Proceedings are commenced by an application to the Superior Court. The court generally grants an initial stay, appoints a monitor with authority to repudiate leases and other agreements and authorizes debtor in possession financing. A process is established for the identification and review of creditors' claims by the monitor and to deal with disputed claims, with the ultimate purpose of establishing classes of creditors who will vote, by class, on the compromise or arrangement.

[56] One possible outcome is the preparation of a plan of arrangement. Creditors vote by class on the plan at a meeting called for that purpose. A majority by number of creditors in each class, together with two-thirds of the creditors in that class by dollar value, must approve the plan. If a class of creditors approves the plan, it is binding on all creditors within the class, subject to the court's approval of the plan. If all classes of creditors approve the plan, the court must then approve the plan as a final step.

[57] Part III, entitled "General", deals with such issues as the determination of the amount of creditors' claims, classes of creditors, the duties of monitors, the disclaimer of agreements between the company and third parties and preferences and transfers at undervalue.

[58] Section 19 identifies "claims" that may be dealt with in a compromise or arrangement. Those are claims provable in bankruptcy that relate to debts or

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liabilities, present or future, to which the debtor company is subject or may become subject before the compromise or arrangement is sanctioned.[4]

[59] The significance of this definition is that the focus of the plan of arrangement is claims against the debtor company that are provable in bankruptcy. The *CCAA* judge identified this significance at para. 59 of his reasons, where he noted that s. 19(1) of the *CCAA* provides, effectively, "that a plan of compromise or arrangement may only deal with claims that relate to debts or liabilities to which a debtor company is subject at the time of commencement of proceedings under the *CCAA*". At para. 61, he noted that neither the Claims Process Order nor the *CCAA* contemplated that inter-creditor claims would be addressed by or be relevant to a plan of arrangement.

[60] Section 20 sets out the method for determining the amount of the claim of any secured or unsecured creditors. In most cases, it will be the amount "determined by the court on summary application by the company or by the creditor".

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[4] *CCAA*, s. 2(1): "*claim* means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*." Section 121 of the *BIA* states that claims provable in bankruptcy are those to which the bankrupt is subject: "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."

[61] Section 22 provides for the establishment of classes of creditors for the purpose of voting on a compromise or arrangement, based on, among other things, the nature of their claims, the nature of the security in respect of their claims and the remedies available to them in relation to their claims. Creditors may be included in the same class "if their interests or rights are sufficiently similar to give them a commonality of interest".

[62] Part IV deals with Cross-Border Insolvencies. Its stated purposes are to give mechanisms to provide for the fair and efficient administration of such insolvencies, to promote cooperation with courts of other jurisdictions, to promote "the rescue of financially troubled businesses to protect investment and preserve employment" and to protect the interests of creditors, of other interested persons and of the debtor company. Part V deals with Administration.

[63] The *CCAA* was amended in 2009. The amendments were the product of extensive discussion of the *BIA* and the *CCAA* in the Standing Senate Committee on Banking, Trade and Commerce. The Committee recommended amendments to the legislation, including an expanded power to review, invalidate or subordinate creditors' claims under the *CCAA*.

[64] These recommendations were reflected in the 2009 amendments in two respects. First, s. 6(8) provides that a compromise or arrangement will not be approved unless it provides that all other claims are to be paid in full before an equity claim is paid.

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[65] This provision, coupled with the definition of “equity interest”[5] and “equity claim”[6] in s. 2(1), permits the court to determine whether a creditor’s claim is in substance a share, warrant or option. This is the underpinning of the Debt/Equity Objection, an objection based on a disagreement as to the proper characterization of the disputed claims.

[66] Section 22.1, also added in 2009, provides that all creditors with equity claims are to be in the same class unless the court otherwise orders, and may not, as members of that class, vote at any meeting unless the court otherwise orders.

[67] Second, the 2009 amendments harmonized the rules of reviewable transactions under the *BIA* and the *CCAA*. Creditors in a *CCAA* proceeding are now entitled to invoke the provisions of the *BIA* to invalidate security granted by a debtor corporation to a creditor where a fraudulent preference or transfer at undervalue is established. Section 36.1 of the *CCAA* provides that ss. 38 and 95 to 101 of the *BIA* apply, with any required modifications, in respect of a compromise or arrangement, unless the compromise or arrangement provides otherwise.

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[5] “*Equity interest* means (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt.”

[6] “*Equity claim* means a claim that is in respect of an equity interest, including a claim for, among others, (a) a dividend or similar payment, (b) a return of capital, (c) a redemption or retraction obligation, (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d).”

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[68] USS says that the 2009 amendments reflected Parliament's decision concerning the extent of the court's jurisdiction over "reviewable transactions" in *CCAA* proceedings and the extent to which a creditor's claim can be subordinated to other claims as a result of its conduct. It says Parliament might have included jurisdiction to rearrange priorities between creditors, for example through equitable subordination, but it declined to do so.

[69] The scheme of the *CCAA* focuses on the determination of the validity of claims of creditors against the company and the determination of classes of claims for the purpose of voting on a compromise or arrangement. Except as contemplated by ss. 2(1), 6(8), 22.1 and 36.1, the statute does not address either conflicts between creditors or the order of priorities of creditors. Priorities are, however, part of the background against which the plan of compromise or arrangement is negotiated.

[70] There is nothing in the record before us to indicate that the issue of equitable subordination was given serious consideration at the time of the 2009 amendments or that those amendments were intended to import other remedies.

(iii) Interpreting the particular provisions before the court

[71] I now turn to the words of the statute itself, considered in context and having regard to the scheme of the *CCAA*, the object of the act and the intentions of Parliament.

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[72] As Blair J.A. put it when deciding whether the *CCAA* granted the court the power to sanction the disputed order in *Metcalfe & Mansfield*, at para. 58, "[w]here in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases?" The question before us is "where (if at all) in the words of the statute is the court (implicitly or explicitly) clothed with authority to make an order for equitable subordination of the USS claims?"

(a) Section 11: "The engine that drives the statutory scheme"

[73] The parties focussed their arguments on whether the powers granted by s. 11 include the power to grant the remedy of equitable subordination. In order to inform the scope of s. 11, they urge us to consider the treatment of "equity" claims in s. 6(8) of the *CCAA* and the remedies available under s. 36.1.

[74] In *Stelco*, at para. 36, Blair J.A. described s. 11 as "the engine that drives this broad and flexible statutory scheme". Section 11 states, in full:

> Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, <u>subject to the restrictions set out in this Act</u>, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances. [Emphasis added.]

[75] Prior to amendment in 2005 (S.C. 2005, c. 47, s. 128), the underlined portion above had read "subject to this Act". In *Century Services*, the Supreme Court, at

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paras. 67-68, interpreted this amendment as being an endorsement of the broad reading of *CCAA* jurisdiction that had been developed in the jurisprudence.

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[76] The jurisdiction under s. 11 has two express limitations. First, the court must find that the order is "appropriate in the circumstances". Second, even if the court considers the order appropriate in the circumstances, it must consider whether there are "restrictions set out in" the *CCAA* that preclude it.

[77] As I have noted, the *CCAA* judge held that s. 11 did not confer jurisdiction to apply the doctrine of equitable subordination. The statute could have provided the authority to subordinate claims on this basis, as it did with equity claims, but it did not. He also held that the definition of "equity claim" and the option to bring proceedings under s. 36.1 were "restrictions" within the meaning of s. 11.

[78] In my view, the interpretative process should start with the scope of s. 11 before the restrictions are considered in the analysis. The broad powers exercised by *CCAA* judges evolved in the jurisprudence before the concept of "restrictions" was legislated.

[79] Moreover, it is inconsistent with the anatomy and history of the *CCAA* to maintain that if Parliament had intended that a *CCAA* judge would have the authority to make a certain type of order, it would have said so. The Supreme Court has made it clear that "[t]he general language of the *CCAA* should not be read as being restricted by the availability of more specific orders": *Century Services*, at para. 70.

[80] What is apparent from the many creative orders that have been made, before and since the 2009 amendments, is that such orders are made squarely in furtherance of the legislature's objectives. In *Century Services*, at para. 59, the Supreme Court observed that "[j]udicial discretion must of course be exercised in furtherance of the *CCAA*'s purposes", to avoid the devastating social and economic effects of bankruptcy while an attempt is made to organize the affairs of the debtor under court supervision.

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[81] The words "may … make any order it considers appropriate in the circumstances" in s. 11 must, in my view, be read as "may … <u>in furtherance of the purposes of this act</u>, make any order it considers appropriate in the circumstances."

[82] There is no support for the concept that the phrase "any order" in s. 11 provides an at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors. The orders reflected in the case law have addressed the business at hand: the compromise or arrangement.

[83] I turn to the second limit on the court's jurisdiction under s. 11, the "restrictions set out in this Act". The first question is whether such restrictions must be express or can be implied.

[84] It bears noting that there are numerous express restrictions on the court's jurisdiction contained within the *CCAA* itself. Some are contained in Part II (Jurisdiction of Courts) and some are actually preceded by the heading "Restriction". In *North American Tungsten Corp. v. Global Tungsten and Powders*

Corp., 2015 BCCA 426, 81 B.C.L.R. (5th) 102, at para. 34, the British Columbia Court of Appeal observed that “where other provisions of the statute are intended to restrict the powers under ss. 11 and 11.02 of the statute, they do so in unequivocal terms.”

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[85] The *CCAA* judge found that there were “restrictions set out” in the *CCAA* that prevented the court from applying equitable subordination, namely the definition of “equity claim” in s. 2(1) and the provisions of s. 36.1. Essentially, he found that Parliament could have introduced equitable subordination into the *CCAA* when it amended the legislation in 2009, but declined to do so. “The court must respect that policy decision”, he said at para. 53. The respondent supports this interpretation.

[86] I agree with the appellant that “equity claim” is not a restriction at all, but a definition. Together with s. 6(8), it codifies what was essentially the law before the 2009 amendments. The purpose of this involvement in the priority of claims is to remove shareholders from the process of arriving at a compromise or arrangement, absent permission of the court. It has nothing to do with any wrongdoing by the person with the equity interest. The only “restriction”, if any, would be the lack of flexibility to reverse this statutory subordination, as Pepall J. pointed out in *Nelson Financial Group Ltd. (Re)*, 2010 ONSC 6229, 75 B.L.R. (4th) 302, at para. 34. However, this has to do only with subordination flowing from the characterization of a claim and not equitable subordination.

[87] I also agree that the plain meaning of the words “subject to the restrictions set out in this Act” refers to express restrictions, of which there are a number.

(b) Subsection 6(8): Subordination of “equity claims”

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[88] In the court below, and in the appellant’s submissions in this court, there was a blurring of the distinction between the separate concepts of “equity claim” and the doctrine of “equitable subordination”. The *CCAA* judge’s reasons referred at times to the “subordination claims” of the Union and the Milbournes as including the equitable subordination claims and the claims for oppression and breach of fiduciary duty.

[89] As explained earlier, s. 6(8) of the *CCAA* effectively subordinates “equity claims”, as defined, to the claims of all other creditors. No compromise or arrangement can be approved unless it provides for other claims to be paid, in full, before equity claims are paid.

[90] With the exception of environmental claims, ss. 6(8) and 22.1 are the only provisions of the *CCAA* to deal expressly with priorities between creditors.[7] There is a clear rationale for these provisions. In E. Patrick Shea, *BIA, CCAA & WEPPA: A Guide to the New Bankruptcy & Insolvency Regime* (Markham: LexisNexis Group, 2009), at p. 89, the author explains that “[t]he intention of these amendments is to

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[7] Subsection 11.8(8) gives the federal and provincial Crowns priorities for environmental claims against the debtor.

remove the shareholder/creditor from the reorganization process, unless the court orders that they have a seat at the table."

[91] "Equitable subordination", on the other hand, refers to the doctrine at issue here: a form of equitable relief to subordinate the claim of a creditor who has engaged in inequitable conduct. Such a claim is not an "equity claim", as defined. If it were, it would be subordinated without the need for intervention by the court.

[92] Pepall J. dealt with these different principles and distinguished them clearly in *I. Waxman & Sons Ltd.*, a Commercial List decision that predated the 2009 amendments. There, a trustee in bankruptcy brought a motion for advice and directions as to whether a judgment creditor's claim should be allowed. Other creditors argued that his claim was rooted in equity and was not a debt claim. In the alternative, they argued that even if it was a debt claim, it should be subordinated to their claims pursuant to the doctrine of equitable subordination.

[93] Pepall J. addressed the argument that the judgment creditor's claim was an equity claim under the heading "Characterization" (paras. 18-26), because the issue was whether his claim was properly characterized as one of equity or debt, with the attendant priority consequences. Next she considered whether, even though she had found that the claim was a debt claim, it should be subordinated pursuant to the doctrine of equitable subordination (paras. 27-35). She noted, at para. 27, that "[a]s its name suggests, the basis for development of the doctrine is the equitable

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jurisdiction of the court”. She held that even if it applied in Canada, which was not established, there was no evidence on which to apply it in that case.

[94] By contrast, the *CCAA* judge in this case disposed of these issues under one heading, “The Authority of the Court to Adjudicate Claims for Debt Re-Characterization and for Equitable Subordination”, at paras. 38-53. He found, at para. 51, that the absence of any provision in the *CCAA* that would permit the application of equitable subordination was indicative of an intention to exclude the operation of the doctrine.

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[95] The *CCAA* judge appears to have treated equitable subordination as akin to equity claims as defined in s. 2(1), the subordination of equity claims in s. 6(8) and the remedies under s. 36.1. He found that because equitable subordination is not mentioned in the context of these remedies, Parliament must have intended to exclude it.

[96] The distinction between these terms undermines the argument that equitable subordination does not exist because it was not included as part of the definition of (or together with the subordination of) equity claims. Equity claims are subordinated in order to keep shareholders away from the table while the claims of other creditors are being sorted out. Even prior to being explicitly subordinated by statute in 2009, they generally ranked lower than general creditors: *Sino-Forest Corp. (Re)*, 2012 ONCA 816, 114 O.R. (3d) 304, at para. 30. The purpose of the 2009 amendments appears to have been to confirm and clarify the law: see The Report

of the Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa, November 2003), at p. 158-59.

(c) Section 36.1: Preferences and Assignments

[97] Section 36.1, which was part of the 2009 amendments, incorporates by reference provisions of the *BIA* permitting the court to invalidate prior fraudulent preferences or fraudulent assignments.

> 36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

[98] The respondent argues that the inclusion of these express provisions implies that no other form of equitable remedy was contemplated. Its argument is that, had Parliament wished to invalidate or subordinate claims of creditors who had engaged in inequitable conduct in relation to other creditors, it could have expressly included that remedy.

[99] I would not read anything into s. 36.1, one way or the other. Nor would I regard it as a "restriction" set out in the Act within the meaning of s. 11.

(6) Summary

[100] The appellant requested "a declaration that the *CCAA* contains no restrictions within the meaning of s. 11 on the court's ability to apply the doctrine of equitable

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subordination." In my view, this is the wrong inquiry and this is why I reach the same result as the *CCAA* judge, but for different reasons.

[101] I would not grant the relief sought because, applying the principles of statutory interpretation, nowhere in the words of the *CCAA* is there authority, express or implied, to apply the doctrine of equitable subordination. Nor does it fall within the scheme of the statute, which focuses on the implementation of a plan of arrangement or compromise. The *CCAA* does not legislate a scheme of priorities or distribution, because these are to be worked out in each plan of compromise or arrangement. The subordination of "equity claims" is directed towards a specific group, shareholders, or those with similar claims. It also has a specific function, consistent with the purpose of the *CCAA*: to facilitate the arrangement or compromise without shareholders' involvement.

[102] The success of the *CCAA* in fulfilling its statutory purpose has been in large measure due to the ability of judges to fashion creative solutions, for which there is no express authority, through the exercise of their jurisdiction under s. 11. As Blair J.A. noted in *Metcalfe and Mansfield*, however, the court's powers are not limitless. They are shaped by the purpose and scheme of the *CCAA.* The appellant has not identified how equitable subordination would further the remedial purpose of the *CCAA*.

[103] At this stage of the analysis, I am mindful of the Supreme Court's observation in *Century Services* that in most cases the court's jurisdiction in *CCAA* matters will

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be found through statutory interpretation. I am also mindful of its observation in *Indalex*, at para. 82, that courts should not use an equitable remedy to do what they wish Parliament had done through legislation. In my view, there is no “gap” in the legislative scheme to be filled by equitable subordination through the exercise of discretion, the common law, the court’s inherent jurisdiction or by equitable principles.

[104] There is no provision in the *CCAA* equivalent to s. 183 of the *BIA* or §105(a) of the U.S. *Bankruptcy Code.* Section 183 invests the bankruptcy court with “such jurisdiction at law and in equity” as will enable it to exercise its bankruptcy jurisdiction. This is significant, because if equitable subordination is to become a part of Canadian law, it would appear that the *BIA* gives the bankruptcy court explicit jurisdiction as a court of equity to ground such a remedy and a legislative purpose that is more relevant to the potential reordering of priorities.

CONCLUSION

[105] For these reasons, I would dismiss the appeal. I would order that counsel may make written submissions as to costs, not to exceed five pages in length, excluding costs outlines. I would assume counsel can agree on a timetable for delivery of all costs submissions within 30 days of the release of these reasons.

“George R. Strathy C.J.O.”
“I agree P. Lauwers J.A.”
“I agree M.L. Benotto J.A.”

Released: “GRS” September 09, 2016

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TAB 3

In the Matter of a Plan of Compromise or Arrangement of Sino-Forest Corporation

[Indexed as: Sino-Forest Corp. (Re)]

114 O.R. (3d) 304

2012 ONCA 816

Court of Appeal for Ontario,
Goudge, Hoy and Pepall JJ.A.
November 23, 2012

Debtor and creditor -- Arrangements -- Shareholders of company commencing class actions against company, underwriters and auditors for misrepresentation -- Plaintiffs alleging that misrepresentations artificially inflated price of company's shares -- Company successfully seeking protection under Companies' Creditors Arrangement Act ("CCAA") -- Underwriters and auditors filing proofs of claim against company seeking contribution and indemnity for any amounts they might be ordered to pay as damages in class actions -- Supervising judge not erring in finding that those claims were equity claims within meaning of s. 2(1) of CCAA despite fact that underwriters and auditors were not holders of an equity interest -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2(1).

The appellant underwriters provided underwriting services in connection with three S Co. equity offerings and four S Co. note offerings. The appellant auditors served as S Co.'s auditors at the relevant time. Shareholders of S Co. brought

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proposed class actions against S Co. and, among others, the underwriters and auditors, alleging that S Co. repeatedly misrepresented its assets and financial situation and its compliance with generally accepted accounting principles in its public disclosure, that the auditors and underwriters failed to detect those misrepresentations, and that the auditors misrepresented that their audit reports [page305] were prepared in accordance with generally accepted auditing standards. They claimed that the misrepresentations artificially inflated the price of S Co.'s shares and that proposed class members suffered damages when the shares fell after the truth was revealed. S Co. successfully sought protection pursuant to the provisions of the Companies' Creditors Arrangement Act ("CCAA"). The auditors and underwriters filed proofs of claim seeking contribution and indemnity for, among other things, any amounts that they were ordered to pay as damages to the plaintiffs in the class actions. S Co. applied for an order that the claims against it arising from the ownership, purchase or sale of an equity interest in the company, including shareholder claims, and any indemnification claim against it related to or arising from the shareholder claims, including the claims for contribution or indemnity, were equity claims under the CCAA. The application was granted. The underwriters and auditors appealed.

Held, the appeal should be dismissed.

The definition of equity claim in s. 2(1) of the CCAA focuses on the nature of the claim, and not the identity of the claimant. The appellants' claims for contribution and indemnity were clearly equity claims, despite the fact that the appellants did not have an equity interest in S Co. Parliament adopted expansive language in defining "equity claim". Parliament employed the phrase "in respect of" twice in defining equity claim: in the opening portion of the definition, it refers to an equity claim as a "claim that is in respect of an equity interest", and in para. (e) it refers to "contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)". The Supreme Court of Canada has repeatedly held that the words "in respect of" are of the widest possible scope, conveying some link or connection

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between two related subjects. It was conceded that the shareholder claims against S Co. were claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest", within the meaning of para. (d) of the definition of "equity claim". There was an obvious link between the appellants' claims against S Co. for contribution and indemnity and the shareholders' claims against S Co. Parliament also defined equity claim as "including a claim for, among others", the claims described in paras. (a) to (e). The Supreme Court has held that the phrase "including" indicates that the preceding words -- "a claim that is in respect of an equity interest" -- should be given an expansive interpretation, and include matters which might not otherwise be within the meaning of the term. Accordingly, the appellants' claims, which clearly fell within para. (e), were included within the meaning of the phrase "claim that is in respect of an equity interest". Parliament chose not to include language in s. 2(1) restricting claims for contribution or indemnity to those made by shareholders. If only a person with an equity interest could assert an equity claim, para. (e) would be rendered meaningless. No legislative provision should be interpreted so as to render it mere surplusage. Looking at s. 2(1) as a whole, it appeared that the remedies available to shareholders were all addressed by s. 2(1)(a) to (d). The logic of s. 2(1)(a) to (e) therefore also supported the notion that para. (e) referred to claims for contribution and indemnity not by shareholders, but by others. The definition of "equity claim" was sufficiently clear to alter the pre-existing common law.

Cases referred to

Blue Range Resource Corp. (Re), [2000] A.J. No. 14, 2000 ABQB 4, [2000] 4 W.W.R. 738, 76 Alta. L.R. (3d) 338, 259 A.R. 30, 15 C.B.R. (4th) 169, 94 A.C.W.S. (3d) 223; CanadianOxy Chemicals Ltd. v. Canada (Attorney General), [1999] 1 S.C.R. 743, [1998] S.C.J. No. 87, 171 D.L.R. (4th) 733, 237 N.R. 373, J.E. 99-861, 122 B.C.A.C. 1, 133 C.C.C. (3d) 426, 29 C.E.L.R. (N.S.) 1, 23 C.R. (5th) 259, 41 W.C.B. (2d) 411; [page306] Central Capital Corp. (Re) (1996), 27 O.R. (3d) 494, [1996] O.J. No. 359, 132 D.L.R. (4th) 223, 88 O.A.C. 161, 26 B.L.R. (2d) 88, 38 C.B.R. (3d) 1, 61 A.C.W.S. (3d) 18 (C.A.); EarthFirst Canada Inc. (Re), [2009] A.J. No. 749, 2009 ABQB 316, 56 C.B.R. (5th) 102; Goodyear Tire & Rubber

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Co. of Canada v. T. Eaton Co., [1956] S.C.R. 610, [1956] S.C.J. No. 37, 4 D.L.R. (2d) 1, 28 C.P.R. 25, 56 D.T.C. 1060; In Re: Mid-American Waste Systems, Inc., 228 B.R. 816 (Bankr. Del. 1999); Markevich v. Canada, [2003] 1 S.C.R. 94, [2003] S.C.J. No. 8, 2003 SCC 9, 239 F.T.R. 159, 223 D.L.R. (4th) 17, 300 N.R. 321, J.E. 2003-506, 2003 D.T.C. 5185, 120 A.C.W.S. (3d) 532; National Bank of Canada v. Merit Energy Ltd., [2002] A.J. No. 6, 2002 ABCA 5, [2002] 3 W.W.R. 215, 317 A.R. 319, affg [2001] A.J. No. 918, 2001 ABQB 583, [2001] 10 W.W.R. 305, 95 Alta. L.R. (3d) 166, 294 A.R. 15, 28 C.B.R. (4th) 228, 107 A.C.W.S. (3d) 182 (Q.B.); National Bank of Greece (Canada) v. Katsikonouris, [1990] 2 S.C.R. 1029, [1990] S.C.J. No. 95, 74 D.L.R. (4th) 197, 115 N.R. 42, J.E. 90-1410, 32 Q.A.C. 250, 50 C.C.L.I. 1, [1990] I.L.R. 1-2663 at 10478, 23 A.C.W.S. (3d) 74; Nelson Financial Group Ltd. (Re), [2010] O.J. No. 4903, 2010 ONSC 6229, 75 B.L.R. (4th) 302, 71 C.B.R. (5th) 153 (S.C.J.); Parry Sound (District) Social Services Administration Board v. Ontario Public Service Employees Union, Local 324, [2003] 2 S.C.R. 157, [2003] S.C.J. No. 42, 2003 SCC 42, 230 D.L.R. (4th) 257, 308 N.R. 271, 177 O.A.C. 235, J.E. 2003-1790, 7 Admin. L.R. (4th) 177, 31 C.C.E.L. (3d) 1, [2003] CLLC 220-062, 125 A.C.W.S. (3d) 85; R. v. Nowegijick, [1983] 1 S.C.R. 29, [1983] S.C.J. No. 5, 144 D.L.R. (3d) 193, 46 N.R. 41, [1983] 2 C.N.L.R. 89, [1983] C.T.C. 20, 83 D.T.C. 5041, 18 A.C.W.S. (2d) 2; R. v. Proulx, [2000] 1 S.C.R. 61, [2000] S.C.J. No. 6, 2000 SCC 5, 182 D.L.R. (4th) 1, 249 N.R. 201, [2000] 4 W.W.R. 21, J.E. 2000-264, 142 Man. R. (2d) 161, 140 C.C.C. (3d) 449, 30 C.R. (5th) 1, 49 M.V.R. (3d) 163, 44 W.C.B. (2d) 479; Return on Innovation Capital Ltd. v. Gandi Innovations Ltd., [2011] O.J. No. 3827, 2011 ONSC 5018, 83 C.B.R. (5th) 123, 206 A.C.W.S. (3d) 464 (S.C.J.) [Leave to appeal refused [2012] O.J. No. 31, 2012 ONCA 10, 90 C.B.R. (5th) 141, 211 A.C.W.S. (3d) 264]; Stelco Inc. (Re), [2006] O.J. No. 276, 14 B.L.R. (4th) 260, 17 C.B.R. (5th) 78, 145 A.C.W.S. (3d) 194 (S.C.J.)

Statutes referred to

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 2 [as am.], 121 [as am.]

Bankruptcy Code, 11 U.S.C.S. 502(e)(1)(B)

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

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am.], ss. 2(1) [as am], (a)-(e), 6(8), 22.1 [as am.]
Negligence Act, R.S.O. 1990, c. N.1 [as am.], s. 2
Securities Act, R.S.A. 2000, c. S-4, s. 203(1) [as am.], (10)
Securities Act, R.S.B.C. 1996, c. 418, s. 131(1) [as am.], (11)
Securities Act, R.S.N.L. 1990, c. S-13, s. 130(1), (8)
Securities Act, R.S.N.S. 1989, c. 418, s. 137(1), (8)
Securities Act, R.S.O. 1990, c. S.5, s. 130(1) [as am.], (8)
Securities Act, R.S.P.E.I. 1988, c. S-3.1, s. 111(1), (12)
Securities Act, R.S.Q., c. V-1.1, ss. 218 [as am.], 219, 221 [as am.]
Securities Act, S.N.B. 2004, c. S-5.5, s. 149(1), (9)
Securities Act, S.N.W.T. 2008, c. 10, s. 111(1), (12)
Securities Act, S.Nu. 2008, c. 12, s. 111(1), (12)
Securities Act, S.Y. 2007, c. 16, s. 111(1), (13)
The Securities Act, C.C.S.M. c. S50, s. 141(1), (11)
The Securities Act, 1988, S.S. 1988-89, c. S-42.2, s. 137(1), (9)

Authorities referred to

Driedger, Elmer A., Construction of Statutes, 2nd ed. (Toronto: Butterworths, 1983) [page307]

APPEAL from the order of Morawetz J., [2012] O.J. No. 3627, 2012 ONSC 4377 (S.C.J.) declaring that the appellants' claims were equity claims within the meaning of the Companies' Creditors Arrangement Act.

Peter H. Griffin, Peter J. Osborne and Shara Roy, for appellant Ernst & Young LLP.

Sheila Block and David Bish, for appellants Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC.

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Kenneth Dekker, for appellant BDO Limited.

Robert W. Staley, Derek J. Bell and Jonathan Bell, for respondent Sino-Forest Corporation.

Benjamin Zarnett, Robert Chadwick and Julie Rosenthal, for respondent Ad Hoc Committee of Noteholders.

Clifton Prophet, for monitor FTI Consulting Canada Inc.

Kirk M. Baert, A. Dimitri Lascaris and Massimo Starnino, for respondent Ad Hoc Committee of Purchasers.

Emily Cole, for respondent Allen Chan.

Erin Pleet, for respondent David Horsley.

David Gadsden, for respondent Pyry (Beijing).

Larry Lowenstein and Edward A. Sellers, for respondent board of directors.

BY THE COURT: --

I Overview

[1] In 2009, the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended ("CCAA"), was amended to expressly provide that general creditors are to be paid in full before an equity claim is paid.

[2] This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor, Sino-Forest Corporation ("Sino-Forest"), for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation. [page308]

[3] The appellants argue that the supervising judge erred in concluding that the claims at issue are equity claims within

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the meaning of the CCAA and in determining the issue before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

[4] For the reasons that follow, we conclude that the supervising judge did not err and accordingly dismiss this appeal.

II The Background

(a) The parties

[5] Sino-Forest is a Canadian public holding company that holds the shares of numerous subsidiaries, which in turn own, directly or indirectly, forestry assets located principally in the People's Republic of China. Its common shares are listed on the Toronto Stock Exchange. Sino-Forest also issued approximately $1.8 billion of unsecured notes, in four series. Trading in Sino-Forest shares ceased on August 26, 2011, as a result of a cease-trade order made by the Ontario Securities Commission.

[6] The appellant underwriters [See Note 1 below] provided underwriting services in connection with three separate Sino-Forest equity offerings in June 2007, June 2009 and December 2009, and four separate Sino-Forest note offerings in July 2008, June 2009, December 2009 and October 2010. Certain underwriters entered into agreements with Sino-Forest in which Sino-Forest agreed to indemnify the underwriters in connection with an array of matters that could arise from their participation in these offerings.

[7] The appellant BDO Limited ("BDO") is a Hong Kong-based accounting firm that served as Sino-Forest's auditor between 2005 and August 2007, and audited its annual financial statements for the years ended December 31, 2005 and December 31, 2006.

[8] The engagement agreements governing BDO's audits of Sino-Forest provided that the company's management bore the primary responsibility for preparing its financial statements in accordance with generally accepted accounting principles ("GAAP") [page309] and implementing internal controls to

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prevent and detect fraud and error in relation to its financial reporting.

[9] BDO's audit report for 2006 was incorporated by reference into a June 2007 prospectus issued by Sino-Forest regarding the offering of its shares to the public. This use by Sino-Forest was governed by an engagement agreement dated May 23, 2007 in which Sino-Forest agreed to indemnify BDO in respect of any claims by the underwriters or any third party that arose as a result of the further steps taken by BDO in relation to the issuance of the June 2007 prospectus.

[10] The appellant Ernst & Young LLP ("E&Y") served as Sino-Forest's auditor for the years 2007 to 2012, and delivered auditors' reports with respect to the consolidated financial statements of Sino-Forest for fiscal years ended December 31, 2007 to 2010, inclusive. In each year for which it prepared a report, E&Y entered into an audit engagement letter with Sino-Forest in which Sino-Forest undertook to prepare its financial statements in accordance with GAAP, design and implement internal controls to prevent and detect fraud and error, and provide E&Y with its complete financial records and related information. Some of these letters contained an indemnity in favour of E&Y.

[11] The respondent Ad Hoc Committee of Noteholders consists of noteholders owning approximately one-half of Sino-Forest's total noteholder debt. [See Note 2 below] They are creditors who have debt claims against Sino-Forest; they are not equity claimants.

[12] Sino-Forest has insufficient assets to satisfy all the claims against it. To the extent that the appellants' claims are accepted and are treated as debt claims rather than equity claims, the noteholders' recovery will be diminished.

(b) The class actions

[13] In 2011 and January of 2012, proposed class actions were commenced in Ontario, Quebec, Saskatchewan and New York State against, amongst others, Sino-Forest, certain of its officers, directors and employees, BDO, E&Y and the underwriters. Sino-

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Forest is sued in all actions. [See Note 3 below] [page310]

[14] The proposed representative plaintiffs in the class actions are shareholders of Sino-Forest. They allege that Sino-Forest repeatedly misrepresented its assets and financial situation and its compliance with GAAP in its public disclosure; the appellant auditors and underwriters failed to detect these misrepresentations; and the appellant auditors misrepresented that their audit reports were prepared in accordance with generally accepted auditing standards ("GAAS"). The representative plaintiffs claim that these misrepresentations artificially inflated the price of Sino-Forest's shares and that proposed class members suffered damages when the shares fell after the truth was revealed in 2011.

[15] The representative plaintiffs in the Ontario class action seek approximately $9.2 billion in damages. The Quebec, Saskatchewan and New York class actions do not specify the quantum of damages sought.

[16] To date, none of the proposed class actions has been certified.

(c) CCAA protection and proofs of claim

[17] On March 30, 2012, Sino-Forest sought protection pursuant to the provisions of the CCAA. Morawetz J. granted the initial order which, among other things, appointed FTI Consulting Canada Inc. as the monitor and stayed the class actions as against Sino-Forest. Since that time, Morawetz J. has been the supervising judge of the CCAA proceedings. The initial stay of the class actions was extended and broadened by order dated May 8, 2012.

[18] On May 14, 2012, the supervising judge granted an unopposed claims procedure order which established a procedure to file and determine claims against Sino-Forest.

[19] Thereafter, all of the appellants filed individual proofs of claim against Sino-Forest seeking contribution and indemnity for, among other things, any amounts that they are

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ordered to pay as damages to the plaintiffs in the class actions. Their proofs of claim advance several different legal bases for Sino-Forest's alleged obligation of contribution and indemnity, including breach of contract, contractual terms of indemnity, negligent and fraudulent misrepresentation in tort, and the provisions of the Negligence Act, R.S.O. 1990, c. N.1.

(d) Order under appeal

[20] Sino-Forest then applied for an order that the following claims are equity claims under the CCAA: claims against Sino-Forest arising from the ownership, purchase or sale of an equity [page311] interest in the company, including shareholder claims ("shareholder claims"); and any indemnification claims against Sino-Forest related to or arising from the shareholder claims, including the appellants' claims for contribution or indemnity ("related indemnity claims").

[21] The motion was supported by the Ad Hoc Committee of Noteholders.

[22] On July 27, 2012, the supervising judge granted the order sought by Sino-Forest and released a comprehensive endorsement.

[23] He concluded that it was not premature to determine the equity claims issue. It had been clear from the outset of Sino-Forest's CCAA proceedings that this issue would have to be decided and that the expected proceeds arising from any sales process would be insufficient to satisfy the claims of creditors. Furthermore, the issue could be determined independently of the claims procedure and without prejudice being suffered by any party.

[24] He also concluded that both the shareholder claims and the related indemnity claims should be characterized as equity claims. In summary, he reasoned that

-- the characterization of claims for indemnity turns on the characterization of the underlying primary claims. The shareholder claims are clearly equity claims and they led to and underlie the related indemnity claims;
-- the plain language of the CCAA, which focuses on the nature

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of the claim rather than the identity of the claimant, dictates that both shareholder claims and related indemnity claims constitute equity claims;

-- the definition of "equity claim" added to the CCAA in 2009 broadened the scope of equity claims established by pre-amendment jurisprudence;

-- this holding is consistent with the analysis in Return on Innovation Capital Ltd. v. Gandi Innovations Ltd., [2011] O.J. No. 3827, 2011 ONSC 5018, 83 C.B.R. (5th) 123 (S.C.J.), which dealt with contractual indemnification claims of officers and directors. Leave to appeal was denied by this court, [2012] O.J. No. 31, 2012 ONCA 10, 90 C.B.R. (5th) 141; and

-- "[i]t would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the underwriters, through a claim for indemnification, to be treated as creditors [page312] when the underlying actions of shareholders cannot achieve the same status" (para. 82). To hold otherwise would run counter to the scheme established by the CCAA and would permit an indirect remedy to the shareholders when a direct remedy is unavailable.

[25] The supervising judge did not characterize the full amount of the claims of the auditors and underwriters as equity claims. He excluded the claims for defence costs on the basis that while it was arguable that they constituted claims for indemnity, they were not necessarily in respect of an equity claim. That determination is not appealed.

III Interpretation of "Equity Claim"

(a) Relevant statutory provisions

[26] As part of a broad reform of Canadian insolvency legislation, various amendments to the CCAA were proclaimed in force as of September 18, 2009.

[27] They included the addition of s. 6(8):

> 6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

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Section 22.1, which provides that creditors with equity claims may not vote at any meeting unless the court orders otherwise, was also added.

[28] Related definitions of "claim", "equity claim" and "equity interest" were added to s. 2(1) of the CCAA:

2(1) In this Act,

. . . . .

"claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the Bankruptcy and Insolvency Act;

. . . . .

"equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,
(b) a return of capital,
(c) a redemption or retraction obligation, [page313]
(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

"equity interest" means

(a) in the case of a company other than an income trust, a share in the company -- or a warrant or option or another right to acquire a share in the company -- other than one that is derived from a convertible debt, and
(b) in the case of an income trust, a unit in the income trust -- or a warrant or option or another right to acquire a unit in the income trust -- other than one that is derived from a convertible debt[.]

(Emphasis added)

[29] Section 2 of the Bankruptcy and Insolvency Act, R.S.C.

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1985, c. B-3 ("BIA") defines a "claim provable in bankruptcy". Section 121 of the BIA in turn specifies that claims provable in bankruptcy are those to which the bankrupt is subject.

> 2. "claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;
>
> . . . . .
>
> 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.

(Emphasis added)

(b) The legal framework before the 2009 amendments

[30] Even before the 2009 amendments to the CCAA codified the treatment of equity claims, the courts subordinated shareholder equity claims to general creditors' claims in an insolvency. As the supervising judge described [at paras. 23-25]:

> Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise.
>
> The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential. [page314]
>
> As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement.

(Citations omitted) [See Note 4 below]

(c) The appellants' submissions

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[31] The appellants essentially advance three arguments.

[32] First, they argue that on a plain reading of s. 2(1), their claims are excluded. They focus on the opening words of the definition of "equity claim" and argue that their claims against Sino-Forest are not claims that are "in respect of an equity interest" because they do not have an equity interest in Sino-Forest. Their relationships with Sino-Forest were purely contractual and they were arm's-length creditors, not shareholders with the risks and rewards attendant to that position. The policy rationale behind ranking shareholders below creditors is not furthered by characterizing the appellants' claims as equity claims. They were service providers with a contractual right to an indemnity from Sino-Forest.

[33] Second, the appellants focus on the term "claim" in para. (e) of the definition of "equity claim", and argue that the claims in respect of which they seek contribution and indemnity are the shareholders' claims against them in court proceedings for damages, which are not "claims" against Sino-Forest provable within the meaning of the BIA and, therefore, not "claims" within s. 2(1). They submit that the supervising judge erred in focusing on the characterization of the underlying primary claims.

[34] Third, the appellants submit that the definition of "equity claim" is not sufficiently clear to have changed the existing law. It is assumed that the legislature does not intend to change the common law without "expressing its intentions to do so with irresistible clearness": Parry Sound (District) Social Services Administration Board v. Ontario Public Service Employees Union, Local 324, [2003] 2 S.C.R. 157, [2003] S.C.J. No. 42, 2003 SCC 42, at para. 39, citing Goodyear Tire & Rubber Co. of Canada v. T. Eaton Co., [1956] S.C.R. 610, [1956] S.C.J. No. 37, at p. 614 S.C.R. The appellants argue that the supervising judge's interpretation of "equity claim" dramatically alters the common [page315] law as reflected in National Bank of Canada v. Merit Energy Ltd., [2001] A.J. No. 918, 2001 ABQB 583, 294 A.R. 15, affd [2002] A.J. No. 6, 2002 ABCA 5, 317 A.R. 319. There, the court

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determined that in an insolvency, claims of auditors and underwriters for indemnification are not to be treated in the same manner as claims by shareholders. Furthermore, the Senate debates that preceded the enactment of the amendments did not specifically comment on the effect of the amendments on claims by auditors and underwriters. The amendments should be interpreted as codifying the pre-existing common law as reflected in National Bank of Canada v. Merit Energy Ltd.

[35] The appellants argue that the decision of Return on Innovation Capital Ltd. v. Gandi Innovations Ltd. is distinguishable because it dealt with the characterization of claims for damages by an equity investor against officers and directors, and it predated the 2009 amendments. In any event, this court confirmed that its decision denying leave to appeal should not be read as a judicial precedent for the interpretation of the meaning of "equity claim" in s. 2(1) of the CCAA.

(d) Analysis

(i) Introduction

[36] The exercise before this court is one of statutory interpretation. We are therefore guided by the following oft-cited principle from Elmer A. Driedger, Construction of Statutes, 2nd ed. (Toronto: Butterworths, 1983), at p. 87:

> [T]he 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.

[37] We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

[38] The appellants' arguments do not give effect to the expansive language adopted by Parliament in defining "equity claim" and read in language not incorporated by Parliament. Their interpretation would render para. (e) of the definition meaningless and defies the logic of the section.

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(ii) The expansive language used

[39] The definition incorporates two expansive terms.

[40] First, Parliament employed the phrase "in respect of" twice in defining equity claim: in the opening portion of the definition, it refers to an equity claim as a "claim that is in respect of [page316] an equity interest", and in para. (e) it refers to "contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)" (emphasis added).

[41] The Supreme Court of Canada has repeatedly held that the words "in respect of" are "of the widest possible scope", conveying some link or connection between two related subjects. In CanadianOxy Chemicals Ltd. v. Canada (Attorney General), [1999] 1 S.C.R. 743, [1998] S.C.J. No. 87, at para. 16, citing R. v. Nowegijick, [1983] 1 S.C.R. 29, [1983] S.C.J. No. 5, at p. 39 S.C.R., the Supreme Court held as follows:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.

(Emphasis added in CanadianOxy)

That court also stated as follows in Markevich v. Canada, [2003] 1 S.C.R. 94, [2003] S.C.J. No. 8, 2003 SCC 9, at para. 26:

> The words "in respect of" have been held by this Court to be words of the broadest scope that convey some link between two subject matters.

(Citations omitted)

[42] It is conceded that the shareholder claims against Sino-Forest are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest", within the meaning of para. (d) of the definition of "equity claim". There is an obvious link between the appellants' claims against Sino-Forest for contribution and indemnity and the shareholders'

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claims against Sino-Forest. The legal proceedings brought by the shareholders asserted their claims against Sino-Forest together with their claims against the appellants, which gave rise to these claims for contribution and indemnity. The causes of action asserted depend largely on common facts and seek recovery of the same loss.

[43] The appellants' claims for contribution or indemnity against Sino-Forest are therefore clearly connected to or "in respect of" a claim referred to in para. (d), namely, the shareholders' claims against Sino-Forest. They are claims in respect of equity claims by shareholders and are provable in bankruptcy against Sino-Forest.

[44] Second, Parliament also defined equity claim as "including a claim for, among others", the claims described in paras. (a) to (e). The Supreme Court has held that this phrase "including" indicates that the preceding words -- "a claim that is in respect of an equity interest" -- should be given an expansive [page317] interpretation, and include matters which might not otherwise be within the meaning of the term, as stated in National Bank of Greece (Canada) v. Katsikonouris, [1990] 2 S.C.R. 1029, [1990] S.C.J. No. 95, at p. 1041 S.C.R.:

> [T]hese words are terms of extension, designed to enlarge the meaning of preceding words, and not to limit them.
>
> [T]he natural inference is that the drafter will provide a specific illustration of a subset of a given category of things in order to make it clear that that category extends to things that might otherwise be expected to fall outside it.

[45] Accordingly, the appellants' claims, which clearly fall within para. (e), are included within the meaning of the phrase a "claim that is in respect of an equity interest".

(iii) What Parliament did not say

[46] "Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of

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an equity interest. Parliament could have, but did not, include language in para. (e) restricting claims for contribution or indemnity to those made by shareholders.

(iv) An interpretation that avoids surplusage

[47] A claim for contribution arises when the claimant for contribution has been sued. Section 2 of the Negligence Act provides that a tortfeasor may recover contribution or indemnity from any other tortfeasor who is, or would if sued have been, liable in respect of the damage to any person suffering damage as a result of a tort. The securities legislation of the various provinces provides that an issuer, its underwriters and, if they consented to the disclosure of information in the prospectus, its auditors, among others, are jointly and severally liable for a misrepresentation in the prospectus, and provides for rights of contribution. [See Note 5 below] [page318]

[48] Counsel for the appellants were unable to provide a satisfactory example of when a holder of an equity interest in a debtor company would seek contribution under para. (e) against the debtor in respect of a claim referred to in any of paras. (a) to (d). In our view, this indicates that para. (e) was drafted with claims for contribution or indemnity by non-shareholders rather than shareholders in mind.

[49] If the appellants' interpretation prevailed, and only a person with an equity interest could assert such a claim, para. (e) would be rendered meaningless, and as Lamer C.J.C. wrote in R. v. Proulx, [2000] 1 S.C.R. 61, [2000] S.C.J. No. 6, 2000 SCC 5, at para. 28:

> It is a well accepted principle of statutory interpretation that no legislative provision should be interpreted so as to render it mere surplusage.

(v) The scheme and logic of the section

[50] Moreover, looking at s. 2(1) as a whole, it would appear that the remedies available to shareholders are all addressed by s. 2(1)(a) to (d). The logic of s. 2(1)(a) to (e) therefore also supports the notion that para. (e) refers to claims for

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contribution or indemnity not by shareholders, but by others.

(vi) The legislative history of the 2009 amendments

[51] The appellants and the respondents each argue that the legislative history of the amendments supports their respective interpretation of the term "equity claim". We have carefully considered the legislative history. The limited commentary is brief and imprecise. The clause-by-clause analysis of Bill C-12 comments that "[a]n equity claim is defined to include any claim that is related to an equity interest". [See Note 6 below] While, as the appellants submit, there was no specific reference to the position of auditors and underwriters, the desirability of greater conformity with United States insolvency law to avoid forum shopping by debtors was highlighted in 2003, some four years before the definition of "equity claim" was included in Bill C-12.

[52] In this instance, the legislative history ultimately provided very little insight into the intended meaning of the amendments. We have been guided by the plain words used by Parliament in reaching our conclusion. [page319]

(vii) Intent to change the common law

[53] In our view, the definition of "equity claim" is sufficiently clear to alter the pre-existing common law. National Bank of Canada v. Merit Energy Ltd., an Alberta decision, was the single case referred to by the appellants that addressed the treatment of auditors' and underwriters' claims for contribution and indemnity in an insolvency before the definition was enacted. As the supervising judge noted, in a more recent decision, Return on Innovation Capital Ltd. v. Gandi Innovations Ltd., the courts of this province adopted a more expansive approach, holding that contractual indemnification claims of directors and officers were equity claims.

[54] We are not persuaded that the practical effect of the change to the law implemented by the enactment of the definition of "equity claim" is as dramatic as the appellants suggest. The operations of many auditors and underwriters extend to the United States, where contingent claims for

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reimbursement or contribution by entities "liable with the debtor" are disallowed pursuant to 502(e)(1)(B) of the U.S. Bankruptcy Code, 11 U.S.C.S. [See Note 7 below]

(viii) The purpose of the legislation

[55] The supervising judge indicated that if the claims of auditors and underwriters for contribution and indemnity were not included within the meaning of "equity claim", the CCAA would permit an indirect remedy to the shareholders when a direct remedy is not available. We would express this concept differently.

[56] In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest not diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity. [page320]

IV Prematurity

[57] We are not persuaded that the supervising judge erred by determining that the appellants' claims were equity claims before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

[58] The supervising judge noted, at para. 7 of his endorsement, that from the outset, Sino-Forest, supported by the monitor, had taken the position that it was important that these proceedings be completed as soon as possible. The need to address the characterization of the appellants' claims had also been clear from the outset. The appellants have not identified any prejudice that arises from the determination of the issue at this stage. There was no additional information that the appellants have identified that was not before the supervising judge. The monitor, a court-appointed officer, supported the motion procedure. The supervising judge was well positioned to

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determine whether the procedure proposed was premature and, in our view, there is no basis on which to interfere with the exercise of his discretion.

V Summary

[59] In conclusion, we agree with the supervising judge that the appellants' claims for contribution or indemnity are equity claims within s. 2(1)(e) of the CCAA.

[60] We reach this conclusion because of what we have said about the expansive language used by Parliament, the language Parliament did not use, the avoidance of surplusage, the logic of the section and what, from the foregoing, we conclude is the purpose of the 2009 amendments as they relate to these proceedings.

[61] We see no basis to interfere with the supervising judge's decision to consider whether the appellants' claims were equity claims before the completion of the claims procedure.

VI Disposition

[62] This appeal is accordingly dismissed. As agreed, there will be no costs.

Appeal dismissed.

Notes

Note 1: Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC.

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Note 2: Noteholders holding in excess of $1.296 billion, or 72 per cent, of Sino-Forest's approximately $1.8 billion in noteholders' debt have executed written support agreements in favour of the Sino-Forest CCAA plan as of March 30, 2012. These include noteholders represented by the Ad Hoc Committee of Noteholders.

Note 3: None of the appellants are sued in Saskatchewan and all are sued in Ontario. E&Y is also sued in Quebec and New York and the appellant underwriters are also sued in New York.

Note 4: The supervising judge cited the following cases as authority for these propositions: Blue Range Resource Corp., (Re), [2000] A.J. No. 14, 2000 ABQB 4, 259 A.R. 30; Stelco Inc. (Re), [2006] O.J. No. 276, 17 C.B.R. (5th) 78 (S.C.J.); Central Capital Corp. (Re) (1996), 27 O.R. (3d) 494, [1996] O.J. No. 359 (C.A.); Nelson Financial Group Ltd. (Re), [2010] O.J. No. 4903, 2010 ONSC 6229, 71 C.B.R. (5th) 153 (S.C.J.); EarthFirst Canada Inc. (Re), [2009] A.J. No. 749, 2009 ABQB 316, 56 C.B.R. (5th) 102.

Note 5: Securities Act, R.S.O. 1990, c. S.5, s. 130(1), (8); Securities Act, R.S.A. 2000, c. S-4, s. 203(1), (10); Securities Act, R.S.B.C. 1996, c. 418, s. 131(1), (11); The Securities Act, C.C.S.M. c. S50, s. 141(1), (11); Securities Act, S.N.B. 2004, c. S-5.5, s. 149(1), (9); Securities Act, R.S.N.L. 1990, c. S-13, s. 130(1), (8); Securities Act, R.S.N.S. 1989, c. 418, s. 137(1), (8); Securities Act, S.Nu. 2008, c. 12, s. 111(1), (12); Securities Act, S.N.W.T. 2008, c. 10, s. 111(1), (12); Securities Act, R.S.P.E.I. 1988, c. S-3.1, s. 111(1), (12); Securities Act, R.S.Q., c. V-1.1, ss. 218, 219, 221; The Securities Act, 1988, S.S. 1988-89, c. S-42.2, s. 137(1), (9); Securities Act, S.Y. 2007, c. 16, s. 111(1), (13).

Note 6: We understand that this analysis was before the Standing Senate Committee on Banking, Trade and Commerce in 2007.

Note 7: The United States Bankruptcy Court for the District of Delaware in In Re: Mid-American Waste Systems, Inc., 228 B.R. 816 (Bankr. Del. 1999) indicated that this provision

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applies to underwriters' claims, and reflects the policy rationale that such stakeholders are in a better position to evaluate the risks associated with the issuance of stock than are general creditors.

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TAB 4

Court of Queen's Bench of Alberta

Citation: Alberta Energy Regulator v Lexin Resources Ltd, 2018 ABQB 590

2018 ABQB 590 (CanLII)

Date: 20180808
Docket: 1701 03460
Registry: Calgary

Between:

Alberta Energy Regulator

Applicant

- and -

Lexin Resources Ltd., 1051393 B.C. Ltd., 0989 Resource Partnership, LR Processing Ltd., and LR Processing Partnership

Respondents

Decision
of the
Honourable Madam Justice B.E. Romaine

I. Introduction

[1] This is an application by the Receiver of Lexin Resources Ltd, 1051393 BC Ltd, 0989 Resource Partnership, LR Processing Ltd and LR Processing Partnership (the Lexin Group) seeking advice and direction respecting the characterization of funds indirectly advanced by MFC Energy Finance Inc to the 0989 partnership, a member of the Lexin Group, on June 30, 2015. The original amount of the advance was $37,570,500 (the Finance Advance). Finance advances a secured claim in the receivership against 0989 in the amount of $15,058,116.08, which it alleges is the remaining amount of the Finance Advance.

[2] For the reasons set out in this decision, I find that the Finance Advance is more properly characterized as equity rather than debt. In the alternative, I find that the Finance Advance should be postponed to the claims of other creditors pursuant to section 137 of *the Bankruptcy and Insolvency Act*, RSC 1985, C. B-3, as it is not a proper transaction.

II. Facts

[3] The relevant facts are as follows:

[4] MFC Bancorp Ltd (Bancorp) is a merchant banking company that invests in distressed businesses. In 2012, a subsidiary of Bancorp acquired the shares of Lexin Resources Inc, and in effect assumed or paid down Lexin's existing debt. At the time it did so, another of Bancorp's subsidiaries, MFC Energy Holding Austria Gmbh (MFC Austria) entered into two loan facility agreements with Austrian banks.

[5] Debt under these facilities was incurred in order to aid in the restructuring of Lexin, and used by the subsidiary to acquire a TD bank loan facility that had been used by Lexin's predecessor. The subsidiary and Lexin were then amalgamated, thus extinguishing Lexin's debt.

[6] While Finance submits that the intention was that the facility loans would be repaid from Lexin's cash flow, no loan agreement or other debt obligation has ever been put in place between MFC Austria and Lexin. Any payments by Lexin to MFC Austria have been made by way of a return of share capital.

[7] In 2013, Lexin's assets were transferred to the 0989 partnership, in which Lexin and Bancorp are partners. Again, there is no loan agreement between MFC Austria and 0989. The outstanding balance of the Finance Advance was reduced from time to time, and Finance now submits that the current balance is $15,058,116.08.

[8] In June, 2015, approximately $10.2 million in payments under the Austrian facilities became due.

[9] At this point in time, Bancorp held 100% of the shares of M Financial Corp (M Financial) and MFC Austria, which was wholly-owned by Bancorp, owned all the shares of Lexin. Lexin and Bancorp were partners of 0989, Lexin as to 66 2/3% and Bancorp as to 33.68%.

[10] Finance was incorporated on June 26, 2015 as a wholly-owned subsidiary of M Financial. Thus, each of Finance, M Financial, MFC Austria and Lexin were wholly –owned subsidiaries of Bancorp.

[11] Michael Smith was a director of Bancorp, M Financial, Finance, MFC Austria and Lexin and a member of the management committee of 0989.

[12] The following transactions all occurred on the same day, June 30, 2015:

(a) the directors of Finance resolved to issue 37,570,500 shares in Finance to M Financial for consideration of $37,570,500 and to grant a loan to 0989 in the same amount. Mr. Smith and Samuel Morrow, a director of Finance, MFC Austria and Bancorp, signed the directors' resolution. At the time, Finance had no other business or assets;
(b) 0989 received a wire transfer of $37,570,500 directly from M Financial;

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[13] Finance and 0989 entered into a demand loan agreement dated June 30, 2015 which states that Finance was providing a loan to 0989 in the amount of $37,570,500. As security for the loan, 0989 and Lexin executed a general security agreement and 0989 executed a demand promissory note payable to Finance in the amount of the advance, all dated June 30, 2015. Before this, neither 0989 nor Lexin had any debt.

[14] All of the documentation with respect to the Finance Advance was signed or co-signed by Mr. Smith on behalf of both Finance and 0989.

[15] The loan agreement between Finance and 0989, provides, among other things, that:

(a) the Finance Advance is to be payable by 0989 only upon demand of Finance. There is no schedule for repayment;
(b) interest will only accrue if 0989 commits an event of default;
(c) 0989 is prohibited from selling assets of a value of more than $100,000 in any 12 month period, other than usual course sales of assets;
(d) 0989 may only make a payment on account of redemption or a distribution or return of capital if Finance consents to such a payment; and
(e) Finance is free to assign its rights and obligations under the agreement.

[16] Prior to the receivership of 0989 and Lexin, only two variable payments were made by 06989 to Finance, and no interest was ever charged.

[17] 0989 did not record receiving $37,570,500 in its accounting records in June, 2015 or any other date, but instead recorded an account payable of $37,570,500 to M Financial and a corresponding reduction in the share capital account of 0989 and Lexin.

[18] On the same day, June 30, 2015, the management committee of the 0989 partnership resolved to issue distributions to its two partners, Lexin and Bancorp, in the total amount of $37,570,500. At the time the Finance Advance was made, Finance was aware of this resolution.

[19] 0989's bank records show that on June 30, 2015, $12,653.744.40 was transferred to Bancorp and $24,916,755.60 was transferred to Lexin, resulting in no net change in 0989's bank accounts. Again on the same day, Lexin transferred the $24,916,755.60 to MFC Austria, resulting in no net change in Lexin's bank accounts. Given the over lapping nature of Finance and Lexin's directors, it is reasonable to infer that Finance was aware of these transfers.

[20] On June 30, 2015, MFC Austria paid down the Austrian bank facilities in the amount of $10,200,000 and transferred the remaining approximately $15,000,000 back to M Financial, the originator of the funds, as repayment for a 2013 loan made by the M Financial to MFC Austria.

[21] In summary, the Finance Advance was received by 0989, not from Finance but from M Financial directly, on June 30, 2015, and the whole advance was withdrawn from 0989's account on the same day and transferred to each of Lexin and Bancorp. Bancorp received and kept $12,653,744.40. On the same day, Lexin transferred the entirety of the amounts it had received to MFC Austria, MFC Austria then paid part of the amount to reduce bank debt and the rest, about $15 million, to M Financial, the originator of the funds for the Finance Advance. 0989 and Lexin only served as conduits though which the money flowed.

[22] In December, 2015, Finance transferred a portion of Lexin and 0989's assets to itself in partial settlement of the Finance Advance, at a time when Lexin's liabilities to creditors had started to accrue.

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III. Position of the Parties

[23] Finance submits that the Finance Advance is a debt incurred for purposes of recapitalizing Lexin Resources Ltd. and 0989 with some additional "local" leverage to reduce their costs of capital.

[24] The Receiver, however, submits that, when considering the Finance Advance in light of all the surrounding circumstances at the time it was advanced, including the economic reality of 0989 and Lexin and the manner in which the advance was used, the Finance Advance should properly be characterized as an equity contribution made by Finance to 0989. Thus, the Receiver seeks an order declaring that 0989 is not indebted to Finance by reason of the Finance Advance, and that any claim that Finance has against 0989 or Lexin as a result of the Finance Advance is an "equity claim" as that term is defined under the *BIA*.

[25] In the alternative, if the Finance Advance is determined to be debt, the Receiver submits it is appropriate to postpone the Finance Advance to the claims of all of Lexin and 0989's other creditors pursuant to section 137 of the *BIA*, as an improper transaction between the debtors and a non-arm's length party. Further in the alternative, the Receiver submits that the Finance Advance should be postponed pursuant to the doctrine of equitable subordination.

IV. Preliminary Issues

A. Procedural Unfairness

[26] Finance complains that the Receiver has acted unfairly in this application, in that contrary to the procedural order, it not only addressed the validity of the Finance Advance, but also its priority. I do not agree that the Receiver was limited in its submissions on these issues by the procedural order or that issues of priory and equitable subordination do not fall within the broad issue of the reasons for the Receiver's denial of the claim, or that the Receiver was not clear in its reasons for its denial of the claim, which were set out in its letter of November 29, 2017. Without agreeing that there was any unfairness, however, I allowed Finance to tender a late affidavit, and a few additional days to respond to the Receiver's submissions on equitable subordination. Finance was also given the opportunity of filing a supplemental brief.

B. Brown v Dunn

[27] Finance submits that, as the Receiver did not comply with ***Brown v Dunn*** by questioning Mr. Morrow on whether it was Finance's intention to create an equity claim, his evidence that the intention was to re-leverage 0989 with some debt should be accepted as contradicted. However, as noted by the Receiver, in the absence of an arm's length relationship, it is not the stated intention of the parties that is determinative of the character of the advance, but rather all of the surrounding circumstances. I agree that the issue is whether the substance of the transaction is different from what the parties expressed it to be: ***Re U.S. Steel Ltd***, 2016 ONSC 569, upheld 2016 ONCA 662m at para 140.

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V. Analysis

A. Should the Finance Advance be characterized as an investment of capital in 0989 by Finance or as a loan by Finance to 0989?

[28] If the Finance Advance is characterized as an equity contribution, Finance's secured claim will be subordinated to the claims of all other "creditors by the operation of s. 140.1 of the *BIA*, which states that a creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity claims have been satisfied".

1. Onus

[29] In the normal course in an insolvency, the onus is on a creditor to prove its claim.

[30] While Finance concedes that it has the "initial" burden to prove that the Finance Advance is a secured claim in the receivership, it submits that it does not have the burden of disproving that the Finance Advance is equity, or that it ought to be subordinated. By this, Finance means that, once it has proved that there is a contract, pursuant to which one person delivers money, and the other person agrees to repay the borrowed amount. Finance has met its burden and the onus proving that the advance is equity shifts to the Receiver. Finance relies in this respect on comments made by the Court in ***U.S Steel***.

[31] Those comments were made in context of a contest between competing creditors, and not an application by a receiver for advice and directions with respect to its findings on the validity of a claim. The Receiver has made its objections to the claim clear: the transaction bears the characteristics of a claim in equity and not in debt. Thus, the normal rule that the creditor bears the onus of establishing otherwise should apply. In any event, even if the burden shifts to the Receiver, the Receiver has met the burden in this case.

2. Analysis

[32] The issue of: supra particular claim is to be treated as debt or equity is a matter of statutory interpretation: ***supra*** at para 152.

[33] An "equity claim" is defined in the *BIA* as a claim that is in respect of an equity interest, including a claim for a return of capital or a contribution in respect of such a claim. An "equity interest" is defined as a share in the corporation, or another right to acquire a share in the corporation, other than one that is derived from a convertible debt. As noted by Wilton-Seigel, J. in ***U.S. Steel***, this type of situation can be distinguished from the situation in ***Canada Deposit Insurance Corp v Canadian Commercial Bank***, [1992] 3 SCR 558, where the transaction was arm's length.

[34] In ***U.S. Steel***, the Court held at para 155-156 that the definition of "equity claim" can extend to a contribution to capital by a sole shareholder unaccompanied by a further issuance of shares. Further, the reference to "a return of capital" need not be limited to a claim in respect of express contribution to capital, and a transaction can be a contribution of capital in substance even if it is expressed otherwise.

[35] Both the Receiver and Finance rely on the decision of U.S. Steel, as the Court in that case considered the specific circumstances of the characterization of the claim, such as this one, involving wholly-owned subsidiaries engaged in non-arm's length transaction.

[36] As noted at para 154 of ***U.S. Steel***:

> In the circumstances of a sole shareholder, there is no practical difference...... between a shareholding of a single share and a shareholding of multiple shares. Accordingly, for the purposes of the definition of an "equity claim", there should be no difference between a payment to a debtor company on account of the issuance of new shares and a payment to a debtor company by way of a contribution to capital in respect of the existing shares.

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[37] Thus, as was the case in ***U.S. Steel,*** the determination of whether Finance's claim is to be treated as debt or equity must address, not just the expressed intentions of the parties as reflected in the transaction documentation but also the manner in which the transaction was implemented and the economic reality of the surrounding circumstances. The form of the documentation is merely the "point of departure": ***supra*** at para 149.

[38] The issue in situations where the parties are not arm's length is not what the parties say they intended regarding the substance of the transaction but the "underlying substantive reality of the transaction": ***supra*** para 167. As actually implemented, is the substance of the transaction different from what was expressed in the transaction documentation?

[39] It is not as simple as submitted by Finance. The approach to characterization is not merely a narrow "rubber-stamping" of the form of transaction chosen by the sole shareholder: ***supra*** para 168.

[40] While the characterization of the claim must be analyzed at the date of advance, subsequent behavior, rather than subsequent stated intention, may be relevant if it illuminates the intentions of the parties at the date of advance although it cannot on its own justify a re-characterization of such advance: ***U.S. Steel*** at para 195; ***Canadian Deposit Insurance*** at para 52. The determination is not based on inequitable behaviour, but on the underlying substantive reality of the transaction.

[41] ***U.S. Steel*** sets out a helpful two-part test in to be followed in situations involving parent-subsidiary relationships at paras 186-190:

(a) subjectively, did the alleged lender actually expect to be repaid the principle amount of the loan with interest out of the cashflows of the alleged borrower; and
(b) objectively, was the expectation reasonable under the circumstances?

[42] The Court in ***U.S. Steel*** referred to various factors used by American courts to aid in determining appropriate characterization, including the following:

(a) the names given to the instruments, if any, evidencing the indebtedness;
(b) the presence or absence of a fixed maturity date and schedule of payments. The American cases suggest that the absence of a fixed maturity date and a fixed obligation to repay is an indication that the advances were capital contributions and not loans;
(c) the presence or absence of a fixed rate of interest and interest payments. Again, it is suggested that the absence of a fixed rate of interest and interest payments is a strong indication that the advances were capital contributions rather than loans;
(d) the source of repayments. If the expectation of repayment depends solely on the success of the borrower's business, the cases suggest that the transaction has the appearance of a capital contribution;

(e) the adequacy or inadequacy of capitalization. Thin or inadequate capitalization is strong evidence that the advances are capital contributions rather than loans;
(f) the identity of interest between the creditor and the shareholder. If shareholders make advances in proportion to their respective stock ownership, an equity contribution is indicated;
(g) the security, if any, for advances;
(h) the corporation's ability to obtain financing from outside lending institutions. When there is no evidence of other outside financing, some cases indicate that the fact no reasonable creditor would have acted in the same manner is strong evidence that the advances were capital contributions rather than loans;
(i) the extent to which the advances were subordinated to the claims of outside creditors;
(j) the extent to which the advances were used to acquire capital assets. The use of the advance to meet the daily operating needs for the corporation, rather than to purchase capital assets, is arguably indicative of bona fide indebtedness; and
(k) the presence or absence of a sinking fund to provide repayments.

[43] However, these and other factors are no more than an aid in determining substantive reality and should not be used in a "score-card" manner: supra para 181.

[44] However, the Receiver submits that these factors overwhelmingly point to the Finance Advance being in reality equity and not debt, particular factors b), c), e), f) and j).

[45] While there is formal documentation in this case, it does not include a schedule for repayment and there is no obligation to pay interest until default. Since it is characterized as a demand loan, there is no fixed maturity date. Thus, it would be possible, and in fact has been the case, that no demand for repayment has been made. Although there is evidence indicating the commencement of enforcement proceedings by various creditors, and thus default, Finance has issued no formal notice of default and no interest is alleged to be payable.

[46] Payments made under the Finance Advance were sporadic and the first payment made was in the form of an actual transfer of assets to Finance and its subsidiaries. Two variable cash repayments were made in 2016.

[47] It is relevant that the Finance Advance was not available for use by 0989 for daily operations or the acquisition of assets, but was immediately flowed through to its partners as distributions.

[48] It is also relevant that Bancorp was a guarantor of the Austrian bank debt, and that the transaction allowed that debt to be paid down, to the advantage of the parent company.

[49] The Receiver submits that this series of transactions was a plan to save the consolidated Bancorp enterprise at the expense of Lexin, 0989 and their stakeholders and, in effect, to secure ties to equity distributions for themselves against the Lexin Group's assets. Thus, it submits, referring back to the first part of the two-part test, there was no subjective intention for the Finance Advance to have ever been repaid.

[50] As noted at para 257 of ***U.S. Steel***:

> As a polar case, I accept that there may be circumstances in which a parent corporation is expectation from the outset is that it will sacrifice a subsidiary's profitability over the long-term for the benefit of the consolidated enterprise. In

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> such circumstances, a court could find that the parent corporation had no intentions of causing the subsidiary to repay with interest any financing extended to the subsidiary or, more precisely, no expectation that the subsidiary would generate sufficient cash flow to enable it to make such payments based on the parent's anticipated business plan for it. In such circumstances, a court could also find that the entire amount of the financing extended by the parent corporation to the subsidiary was, in reality, an equity contribution.

[51] Finance submits that there are valid responses to all of these factors. It submits that the fact that the Finance Advance is a demand loan is responsive to the lack of maturity date. As noted in ***U.S. Steel*** ,a lack of maturity date and the absence of a schedule for the principal payment may only indicate the desire for flexibility to align payments of principal with 0989's economic performance against the back drop of a cyclical industry: ***supra*** at para 224.

[52] Despite submissions by both parties, I am unable on the basis of the evidence before me to determine whether undercapitalization is an issue.

[53] However, for Finance, the lack of any interest provision except on default is more problematic. Mr. Morrow alleges that withholding tax issues are the reasons for the advance being non-interest bearing. While there is nothing improper about this, this lacks of interest implies equity disguised as debt. Business choices on structure, while otherwise entirely proper, can have consequences for characterization.

[54] The Receiver submits that the restructuring of 0989 and Lexin as of June 30, 2015 with additional debt at a time when these entities had no debt does not make commercial sense. I accept the Receiver's view, particularly as none of the funds remained with 0989 or Lexin, and $15 million went full-circle back to M Financial, as Finance was clearly aware was the plan.

[55] Finance states that the commercial propose of the Finance Advance was (i) to fund the repayment of the MFC Austria loans, and (ii) to recapitalize Lexin and 0989 with some additional leverage, with one advantage being to add a "modest amount of local leverage to reduce Lexin and 0989's cost of capital".

[56] However, there was no debt obligation between MCF Austria and Lexin or 0989 at any point in time.

[57] In addition, the explanation that a modest amount of local leverage would reduce 0989 and Lexin's costs of capital is inconsistent with the fact that, as early as December, 2014, Bancorp was pursing the disposition of some of the Lexin properties. The commercially unusual aspects of the Finance Advance, including its nature as a demand loan, the fact that it was payable only upon default and that it included restrictions on redemption, distribution and return of capital without Finance's consent, could hardly be considered to be attractive to a prospective purchaser, even if the loan did not bear interest until default. If a cash and debt offer was more attractive to a purchaser, it could be negotiated at the time of the sale.

[58] However, I am not able to decide the issue of the credibility of Mr. Morrow's assertions with respect to Finance's subjective expectations despite these contradictory indicators without the benefit of viva voce evidence. Thus, given the circumstances in which this application was heard, I must accept that Finance has met the first part of the two-part test.

[59] However, was that expectation reasonable in the circumstances? The surrounding economic circumstances provide context to this question.

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[60] While Finance asserts that the Austrian bank loans were intended to be repaid from Lexin's cash flow, in 2013, when the loans were made, Finance provided funds to MFC Austria to repay the principal and interest installments due under the loans, as neither 0989 nor Lexin generated sufficient returns to make equity distributions.

[61] In 2014, Lexin did make payments to MFC Austria, but it was by way of a return of capital. Finance states that MFC Austria used these funds to reduce the MFC Austria loans and to partially repay M Financial for the amounts it had advanced to MFC Austria in 2013.

[62] The funds distributed to Lexin and Bancorp by 0989 on June 30, 2015 are characterized by Finance as distributions to 0989's partners. The funds distributed by Lexin to MFC Austria the same day are characterized by Finance as a return of capital to Lexin's sole shareholder, MFC Austria, by way of a reduction of share capital pursuant to Section 74 of the British Columbia *Business Corporations Act*, SBC 2002 c 57. This raises the issue of why the flow-through of funds to 0989 was structured as a loan.

[63] Finance's answer is that the benefit of this leverage was in reducing 0989 and Lexin's cost of capital. However, Finance also submits that purpose of the loan was to facilitate a future sale.

[64] Finance's counsel included in its brief a hypothetical example that purported to demonstrate this increased saleability. However, the hypothetical example did not adequately take into account the effect of the Finance Loan. The Receiver revised the example, incorporating both the advance and actual data from the June 30, 2015 Lexin financial statements. This revision shows that the result would be the opposite of what Finance suggested would be increased saleability and that the advance would make a sale less attractive. As noted previously, the uncommon aspects of the debt would more likely make the existence of the Finance Advance a negative, rather than a positive, despite the lack of interest prior to default.

[65] Between July and September of 2015, the Bancorp board approved a plan to sell all of Lexin's assets, and in Bancorp's consolidated financial statements dated December 31, 2015, Bancorp referred to declining prices for oil and gas beginning in December 2014 and further declining by September 2015, leading to impairment assessments on its hydrocarbon properties in each of 2013 and 2014. In those financial statements, Bancorp indicates that on December 30th, 2015, it sold a 95 percent interest in certain hydrocarbon assets to a third party for nominal and contingent consideration, and that the contingent consideration was valued at nil.

[66] Even though the June 30, 2015 transactions occurred prior to these financial statements, and thus, some of these records are dated after the date of the Finance Advance, subsequent events are sometimes relevant to the extent they illuminate the intentions of the parties at the time of the advance. In this case, the subsequent events followed within weeks and months of the advance. In any event, Bancorp knew of declining commodity prices in 2013 and 2014, thus, it cannot have had any objectively reasonable expectation that 0989 would be able to pay the principle amount of the Finance Advance out of cashflow, even without interest.

[67] The Receiver submits that it is clear that 0989 and Lexin were underperforming at the time of the Finance Advance, but Mr. Morrow alleges that Lexin was profitable, and that he was not aware of any creditor that was outstanding as of June 30, 2015 or the rest of 2015 that was not paid in full. However, affidavits filed by the municipalities of Willow Creek and Vulcan indicate that Lexin had failed to pay property taxes levied by the counties since 2015, resulting in

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liens and seizures beginning in November, 2015. Mr. Morrow also relied on the GLG reserve reports for the period, but failed to mention that the report assumes that the company would have to incur costs of development much higher than expected cash flowed in 2017 in order to earn such cash flows. The unaudited consolidated financial statements, without notes, do not aid in the determination of whether the expectation of repayment was objectively reasonable.

[68] In conclusion, I find that the expectation that the Finance Advance would be repaid by the borrower from cashflow was not objectively reasonable, and that the Finance Advance is properly characterized as an equity contribution.

[69] In the event I am wrong in this determination, I have considered whether it is appropriate to postpone the Finance Advance to all of Lexin and 0989's other creditors.

B. Should the Finance Advance be postponed pursuant to section 137 of the *BIA*?

[70] Section 137 of the *BIA* provides that a non-arm's length creditor that entered into a transaction with the debtor before bankruptcy is not entitled to payment of its claim arising from that transaction "until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the...court a proper transaction."

[71] It is clear that the Finance Advance was a transaction entered into with a non-arm's length party before bankruptcy. Thus, section 137 would postpone Finance's claim to the claims of other creditors unless this Court finds that the Finance Advance was a "proper transaction".

1. Onus

[72] When a debt claim is being advanced by a non-arm's length party, the claimant has the onus of proving that the transaction is a proper claim if it hopes to avoid having the claim subordinated pursuant to section 137 of the *BIA*: ***Re Tudor Sales Ltd***, 2017 BCSC 119 at para 48. However, even if I am wrong in this regard, the Receiver has satisfied the onus of establishing that the Finance Advance is not a proper transaction for the purpose of section 137.

2. Analysis

[73] Finance submits that, if the Finance Advance is debt, the Court cannot find that it is not a proper transaction under s. 137, relying on ***Stone Mountain Resource Holdings Ltd v Stone Mountain Resources Ltd***, 2012 ABQ 534. That is not what the Court in ***Stone Mountain*** establishes. Kent, J, found that the transaction in that case was for a proper purpose because a) there was no preference, and b) there was an injection of new money from an arm's length creditor to the debtor's parent company, and a subsequent loan of that money to the debtor subsidiary as a direct contribution to the debtor company's working capital, in accordance with a development plan: ***supra*** paras 31, 39-43.

[74] The facts in this case are different from those in ***Stone Mountain***. In this case, the funds advanced were flowed through 0989 as distributions to its partners, leaving 0989 without additional operating funds or working capital but only debt.

[75] In addition, there is nothing in the plain language of section 137 that would prevent it from applying to a transaction that is structured as debt. Indeed, the postponement created by the section would not be necessary if it applied merely to equity.

[76] The Receiver references ***Tudor Sales*** as a case that considered issues similar to the ones that arise here.

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[77] In ***Tudor***, the applicant was an unsecured creditor of the bankrupt Tudor, seeking an order under section 135(5) of the *BIA* that the claim of a shareholder of Tudor with respect to shareholder loans be expunged or subordinated to the claims of other creditors.

[78] There was no written documentation of the shareholder loans, no fixed interest rate and no schedule for repayment. The advances were secured by a GSA. The interest rate that the company paid to the shareholder each year fluctuated with the fortunes of the company.

[79] The Court first considered whether the shareholder loans should be characterized a debt or equity, and found them to be equity, not because of the lack of a schedule for repayment or the absence of loan documentation, but because of the variable nature of the interest payments and the circumstances surrounding the advances at the time they were made. The Court considered events that took place shortly after the dates of the advances, noting that the "very close proximity in time" between the advances and these subsequent events "strongly implies that [the] advances were in substance consideration paid for [the shareholder's] ownership stake." Saunders, J. thus found the purported shareholder loans to be equity claims. The Court also considered whether the claim would fail by reason of section 137(1), and was satisfied that there was "simply no justification for allowing [the shareholder] the luxury of securing his investment in [another venture] through the mechanism of the GSA... and thereby defeating the legitimate interests of creditors": para 47.

[80] The Receiver submits that the Finance Advance was not made for the purpose of Lexin or 0989's ongoing operating expenses, or for their benefit at all, rather it was made for the sole purpose of enabling 0989 to issue partnership distributions which were ultimately return to Bancorp, MFC Austria and M Financial the originator of the funds, on the same day they were received.

[81] As previously noted, Finance claims that the purpose underlying the Finance Advance was to "recapitalize Lexin and 0989 with some additional leverage" and "reduce Lexin and 0989's costs of capital. This assertions is inconsistent with certain of Finance's other evidence, including the fact that at the time the Finance Advance was made, neither Lexin or 0989 had any debt. I accept that the substantive reality of the transactions was that, through the Finance Advance, Bancorp and its subsidiaries, including Finance, made equity distributions to themselves with their own funds, and secured such distributions against the assets of Lexin and 0989, both of whom previously had no debt.

[82] Mr. Morrow's evidence is that the purpose of the Finance Advance was to "facilitate a potential sale of the company at some point in the future through a deal that could include as part of the consideration an acquisitions of debt as opposed to a purely cash sale." Finance submits that this is evidence of a legitimate business purpose, and a benefit to 0989 and Lexin. As noted previously, a cash and debt sale could also be accomplished thought negotiation at the time of sale, and the hypothetical submitted through on Finances behalf does not support this theory.

[83] Finance also suggests that a benefit accrued to 0989 and Lexin in that MFC Austria used the proceeds of the MFC Austria loans to satisfy Lexin's pre-acquisition secured debt. However, 0989 and Lexin have no liability for that debt.

[84] Finance submits that, by retiring the debt, it freed up Lexin's cash flow but it is clear that in 2013 and 2014, cash flow was insufficient to warrant distributions sufficient to cover the Austrian loan. The Finance Advance occurred two and a half years after the alleged benefit, after

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numerous inter-corporate distributions, and in a climate of acknowledged declines in commodity prices. I find that there was no appreciable benefit to 0989 and Lexin in imposing debt as part of the 2015 transactions.

[85] I agree that the purpose and result of the Finance Advance was to leverage 0989 and Lexin for the benefit of Bancorp, which was at risk as a guarantor of the MFC Austria loan, and to benefit MFC Austria.

[86] As noted in ***U.S. Steel*** at para 257, there may be circumstances in which a parent corporation will sacrifice a subsidiary's profitability over the long-term for the benefit of the consolidated enterprise. This is that type of case. It does not fall within the exception set out in section 37 as a proper transaction.

C. Should the Finance Advance be postponed pursuant to the doctrine of equitable subordination?

[87] It is not necessary in this case to resort to the doctrine of equitable subordination, given that I have found the Finance Advance to be in substance equity rather than debt, and, in the alternative, debt that must be subordinated claims of the other creditors under s. 137 of the *BIA*.

[88] Application of the doctrine by the courts in Canada has been inconsistent. Most recently, the Ontario Court of Appeal in ***Re U.S. Steel***, 2016 ONCA 662 declined to grant a declaration that the *CCAA* contains no restrictions within the meaning of s. 11 on the court's ability to apply the doctrine of equitable subordination, noting that "this is the wrong inquiry": para 100. The Court instead declined to grant the relief sought because there was no specific authority within the *CCAA* to apply the doctrine, and the appellant had not identified how the doctrine would further the remedial purpose of the *CCAA*: para 102.

[89] The Receiver describes the elements of the American doctrine in the terms set out by the Supreme Court in Canada in the 1992 case of ***Canada Deposit Insurance***. However, as noted in ***Re Blue Range Resource Corp***, 2000 ABQB 4 at para 50, and in ***Re I. Waxman & Sons Limited***, [2008] OJ No 885 at para 29, the doctrine as interpreted in American cases is not static, and appears to have evolved over time to the point that it no longer requires inequitable conduct by the creditors but rather depends on considerations of fairness on a case-by-case basis. This illustrates the danger of "taking a doctrine divorced from its legal home and applying it to Canada's statutory bankruptcy regime unencumbered with deep knowledge of the origin, development and legal system from which it originated": ***Waxman*** at para 33.

[90] At any rate, this case does not require consideration of the doctrine of equitable subordination; since the provisions set out in the *BIA* at sections 140.1and 137 are sufficient to determine the issue.

Dated at the City of Calgary, Alberta this 08th day of August, 2018.

2018 ABQB 590 (CanLII)

B.E. Romaine
J.C.Q.B.A.

Appearances:

Robin Gurofksy and Jessica L. Cameron
for the Receiver Grant Thorton

Douglas A. McGillivray, Q.C., David LeGeyt and David A. de Groot
for MFC Energy Finance Inc.

Keely R. Cameron
for the Alberta Energy Regulator

Chris D. Simard
for Exxon Mobil Energy Canada

Gregory C. Plester and Megan Van Huizen
for the Municipal District of Willow Creek No. 26 and Vulcan County

Mary Buttery
for Energy Leasing Partners Ltd.

Richard Billington, Q.C.
for Young Energy Services Inc.

Karen Fellows
for MNP Ltd.

David Girard
for MD of Foothills Ranchland

2018 ABQB 590 (CanLII)

TAB 5

Most Negative Treatment: Distinguished
Most Recent Distinguished: Joy Estate v. 1156653 Ontario Ltd. | 2007 CarswellOnt 3762, 159 A.C.W.S. (3d) 212, [2007] O.J. No. 2315, 38 B.L.R. (4th) 69 | (Ont. S.C.J., Jun 11, 2007)

1992 CarswellAlta 298
Supreme Court of Canada

Canada Deposit Insurance Corp. v. Canadian Commercial Bank

1992 CarswellAlta 298, 1992 CarswellAlta 790, [1992] 3 S.C.R. 558, [1992] S.C.J. No. 96, [1993] A.W.L.D. 003, 131 A.R. 321, 143 N.R. 321, 16 C.B.R. (3d) 14, 16 C.B.R. (3d) 154, 25 W.A.C. 321, 36 A.C.W.S. (3d) 731, 5 Alta. L.R. (3d) 193, 7 B.L.R. (2d) 113, 97 D.L.R. (4th) 385, J.E. 92-1742, EYB 1992-66961

Re Winding-up Act, R.S.C. 1970, c. W-10, as amended; Re Winding-up of CANADIAN COMMERCIAL BANK; PRICE WATERHOUSE LIMITED (Liquidator of CANADIAN COMMERCIAL BANK) v. R. IN RIGHT OF ALBERTA, ROYAL BANK OF CANADA, BANK OF MONTREAL, TORONTO-DOMINION BANK, BANK OF NOVA SCOTIA, CANADIAN IMPERIAL BANK OF COMMERCE and NATIONAL BANK OF CANADA

La Forest, L'Heureux-Dubé, Gonthier, Cory, McLachlin, Stevenson * and Iacobucci JJ.

Heard: April 2, 1992
Judgment: November 19, 1992
Docket: Doc./n° 22084

Counsel: *Charles P. Russell*, for liquidator
Earl A. Cherniak, Q.C., and *Robert J. Morris*, for general body of creditors of estate of Canadian Commercial Bank
James Rout, Q.C., for respondent R. in Right of Alberta.
Colin L. Campbell, Q.C., for respondents Royal Bank of Canada, Bank of Montreal, Toronto-Dominion Bank, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and National Bank of Canada

Subject: Corporate and Commercial; Insolvency
Related Abridgment Classifications
Business associations
IV Powers, rights and liabilities
  IV.6 Partnership accounting
    IV.6.b Upon dissolution
Financial institutions
III Termination of business by bank
  III.3 On insolvency of bank
    III.3.g Priority of claims against bank assets
Financial institutions
V Powers and capacities
  V.2 Permitted behaviour
Headnote
Banking and Banks --- Termination of business by bank — On insolvency of bank — Priority of claims against bank assets

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Partnership --- Accounting — Upon dissolution

Corporations — Winding-up — Several parties advancing funds in attempt to save chartered bank from insolvency — Attempt failing and bank ordered wound up — Funds advanced being characterized as loan and not capital investment — Group of lenders being entitled to rank equally with bank's unsecured creditors.

When a chartered bank found itself in financial difficulty, an arrangement to provide emergency financial assistance to the bank was entered into by the governments of Canada and of Alberta, six major Canadian financial institutions, the Canada Deposit Insurance Corporation ("CDIC") and the bank. Under the arrangement $255 million was advanced to the bank by way of a purchase of participation in a portfolio of assets held by the bank. The portfolio of assets consisted of loans and related security having a nominal value on the bank's books of over $500 million. The participation interest of each participant was proportional to its financial contribution. The bank undertook to indemnify the participants against any loss experienced under the support programme up to the amount paid by each of them to the bank. It was agreed that in the event of the insolvency or winding-up of the bank any amount remaining unpaid "shall constitute indebtedness of [the bank] to the members of the Support Group." Despite this infusion of money, the bank became insolvent and was ordered to be wound up under the *Winding-up Act* in September 1985. A liquidator was appointed.

By August 1987, the liquidator had recovered approximately $112 million on account from the bank's portfolio assets, $5 million of which was attributable to the portion of the assets beneficially owned by the participants. The liquidator brought an application for the advice and direction of the court as to the interpretation of the support agreements. A judge of the Queen's Bench determined that the participants were entitled to the repayment of the $5 million recovered by the liquidator, but were otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. The injection of funds by the participants was found to have been a capital investment.

The participants, apart from the Government of Canada and CDIC, successfully appealed the part of the judgment characterizing the funds as a capital investment. The Court of Appeal characterized the advance of $255 million as a loan and concluded that the participants were entitled to rank equally with the bank's unsecured creditors for all moneys advanced to the bank.

The liquidator applied for leave to appeal from the judgment of the Court of Appeal. Leave was granted. On the appeal, the Supreme Court of Canada considered (1) whether the $255 million advance was a loan: (2) if so, whether it was a loan coming within the postponement provision in s. 4 of the *Partnerships Act* (Ont.); and (3) if that Act did not apply, whether the claim of the six financial institutions and the Government of Alberta should be postponed to the claims of the general body of the bank's unsecured creditors, other than the participants, based on the United States doctrine of equitable subordination.

Held:

The appeal was dismissed.

The words chosen by the participants in the agreements covering the advance of the $255 million clearly supported the Court of Appeal's conclusion that the assistance programme involved a loan and not a capital investment. There was nothing in the surrounding circumstances that would alter this characterization. Although the transaction had some "investment features", they were incidental to the debt features of the arrangement and did not alter the substance of the debtor-creditor relationship created by the advance of the $255 million.

The loan did not fall within the ambit of the *Partnerships Act* as the participants were to receive neither a "rate of interest varying with the profits" of the bank, nor a "share of the profits arising from carrying on the business" of the bank. Therefore, the Court of Appeal did not err in declining to postpone the participants' claims under s. 4 of the Act. The participants were not to receive a rate of interest varying with the bank's profits in return for the advance of $255 million. The rate of interest was fixed according to the prime rate and was made contingent on whether or not an equity agreement could be carried out. Further, a lender does not share in profits within the meaning of ss. 3(3)(*d*) and 4 of the Act unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. While the repayment was to be made from the pre-tax income of the bank, there was no direct link between the success of the bank and the overall quantum of the amount due to or payable to the participants.

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The principles of equitable subordination had no application to the facts of the case. In order to make a successful claim for equitable subordination (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statutes. The evidence adduced disclosed neither inequitable conduct on the part of the participants nor injury to the ordinary creditors of the bank as a result of the alleged misconduct.

. . . . .

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British Eagle International Airlines Ltd. v. Compagnie Nationale Air France, [1975] 1 W.L.R. 758, [1975] 2 All E.R. 390 (H.L.) — *referred to*
Cox v. Hickman (1860), 8 H.L.C. 268, 11 E.R. 431 — *distinguished*
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Young, Re; Ex parte Jones, [1896] 2 Q.B. 484 — *distinguished*

Statutes considered:

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s. 132

s. 173

s. 174

s. 277

Bankruptcy Act, R.S.C. 1985, c. B-3 —

s. 139

Partnership Act, 1890 (U.K.), 53 & 54 Vict., c. 39 —

s. 2(3)(d)

s. 3

Partnership Act, R.S.O. 1990, c. P.5 —

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s. 3(3)(a)

s. 3(3)(b)

s. 3(3)(d)

s. 4

Partnership, 1865, Act to Amend the Law of (U.K.), 28 & 29 Vict., c. 86.

Winding-up Act, R.S.C. 1970, c. W-10.

Winding-up Act, R.S.C. 1985, c. W-11 —

s. 93

s. 94

s. 95

Appeal from judgment reported at (1990), 74 Alta. L.R. (2d) 69, 69 D.L.R. (4th) 1, 107 A.R. 199 (C.A.), allowing appeal from (1987), 67 C.B.R. (N.S.) 136, 56 Alta. L.R. (2d) 244, 46 D.L.R. (4th) 518, 83 A.R. 122 (Q.B.).

The judgment of the court was delivered by *Iacobucci J.*:

1 In September 1985 the Canadian public witnessed what fortunately has been an infrequent occurrence in Canadian banking. Early that month, a chartered bank known as the Canadian Commercial Bank ("C.C.B.") became insolvent and was ordered to be wound up pursuant to the provisions of the *Winding-up Act*, R.S.C. 1985, c. W-11 (formerly R.S.C. 1970, c. W-10). This appeal [from (1990), 74 Alta. L.R. (2d) 69, 69 D.L.R. (4th) 1, 107 A.R. 199, reversing (1987), 56 Alta. L.R. (2d) 244, 67 C.B.R. (N.S.) 136, 46 D.L.R. (4th) 518, 83 A.R. 122] concerns the characterization of the unique and complex financial arrangement entered into by the governments of Canada and of Alberta, six major Canadian financial institutions, the Canadian Deposit Insurance Corporation ("C.D.I.C.") and C.C.B. in the spring of 1985 in an attempt to prevent its winding-up. The main issue is whether, in substance, the $255 million advanced to C.C.B. under this arrangement was in the nature of a loan, in which case the "lenders" thereof would rank pari passu with the other unsecured creditors of C.C.B., or whether it was in the nature of a capital investment in the business of C.C.B., in which case such unsecured creditors would have priority over the "investors." If the former characterization is adopted, as I believe it should be, subsidiary issues concerning the postponement of claims under s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5, and the doctrine of equitable subordination are also raised.

I. Facts

2 Although they are relatively uncomplicated, the facts of this case are rather extensive and warrant a full review. C.C.B. was a chartered bank involved primarily in commercial lending. In early 1985 C.C.B. faced a solvency crisis owing to a sharp deterioration in its loan portfolio. Many of its outstanding loans had become non-performing. On March 14, 1985 C.C.B.'s chief executive officer reported this crisis to the Office of the Inspector General of Banks and announced the inability of C.C.B. to continue in operation without outside assistance. At the request of the governor of the Bank of Canada, a government and banking industry funded support initiative was undertaken to assist C.C.B. and to avoid the loss of public confidence in Canada's banking system.

3 On March 24, 1985 a support group comprising Her Majesty in right of Canada ("Canada"), Her Majesty in right of Alberta ("Alberta"), C.D.I.C. and what I shall sometimes refer to as the "bank group," consisting of the Royal Bank of Canada, the Bank of Montreal, the Toronto-Dominion Bank, the Bank of Nova Scotia, the

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Canadian Imperial Bank of Commerce, and the National Bank of Canada, entered into a memorandum of intent to provide the "emergency financial assistance" requested by C.C.B. "on certain terms."

4 In essence, Canada, Alberta, C.D.I.C. and the bank group, collectively referred to as the "participants," agreed to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in a portfolio of assets held by C.C.B. consisting of loans and related security having a nominal value, on the books of C.C.B., of over $500 million ("portfolio assets"). The participation interest of each participant was proportional to its own financial contribution and was to be evidenced by participation certificates issued by C.C.B. The parties also agreed in principle that the participants would receive from C.C.B. on a proportionate basis, and until such a time as the participants received the amount they paid for their participation certificates, a portion of the money received on account of each portfolio asset as well as 50 per cent of C.C.B.'s pre-tax income, or alternatively 100 per cent of C.C.B.'s pre-tax income plus interest. In other words, it was agreed that the $255 million advanced by the participants would be repaid by C.C.B. After repayment, the payments from the portfolio assets and from C.C.B.'s pre-tax income would cease.

5 Under the memorandum of intent, C.C.B. undertook to indemnify each participant against any loss experienced under the support program up to the amount paid by them to C.C.B. It was agreed that in the event of the insolvency or winding-up of C.C.B., any amount remaining unpaid "shall constitute indebtedness of C.C.B. to the members of the Support Group." Finally, the parties agreed in principle that each participant would receive from C.C.B., on a proportionate basis, transferable rights or warrants to purchase common shares of C.C.B. at a price of $0.25 per share. The warrants were to expire ten years after the day that C.C.B. had repaid the full amount advanced for the participation certificates.

6 On March 25, 1985 the Department of Finance issued a press release announcing a joint agreement involving "an infusion of capital with repayment provisions ... designed to provide the Canadian Commercial Bank with sufficient funds to ensure solvency following a recent and sharp deterioration in its U.S. loan portfolio." The agreement was described as resulting in the "purchase by the support group of a package of nonperforming loans," leaving C.C.B. "in a strong position of solvency in order to support its deposit base." After setting out the general terms of the support program, the Minister of State (Finance) said she had "full confidence" that this program "involving Canada's largest chartered banks and the two Governments will permit the Canadian Commercial Bank to continue its active and important role in the growing economy of Western Canada." The minister concluded that the support program represented "a strong collective vote of confidence in the health of the economy of Western Canada."

7 In order to carry out the letter and spirit of the memorandum of intent, the participants and C.C.B. were to execute, among other documents, a "participation agreement" (also referred to as "P.A."), an "equity agreement" (also referred to as "E.A.") and an "amending and subordination agreement." These agreements, which incorporate and refine the general principles agreed to earlier in the memorandum of intent, were ultimately entered into as of April 29, 1985. The participation agreement and the equity agreement formed the core of the support program. There are no relevant inconsistencies between these documents and the memorandum of intent. I will, however, review in closer detail the former documents as their provisions are of crucial importance to the resolution of the issues raised by this appeal.

8 Section 2 of the participation agreement provided for the participants to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in 255,000,000 units in the portfolio assets of C.C.B. Each participant's interest was proportional to its financial contribution. For example, C.D.I.C. advanced $75 million and received a participation interest in 75,000,000 units. The total participation in the portfolio assets was divided into 529,798,627 units, with the portion of 255,000,000 units purchased by the participants commonly referred to as the "syndicated portion." C.C.B. retained beneficially an undivided participation interest in the remaining 274,798,627 units which comprised the aggregate of the "C.C.B. portion" of the portfolio assets.

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9 Under s. 5 of the participation agreement, C.C.B. warranted that the C.C.B. portion for each portfolio asset represented its "best estimate of the amount likely to be recovered from or with respect to that Portfolio Asset." Thus, as found by the learned chambers judge, the participants purchased, in essence, a portfolio of bad loans or that portion of a loan not likely to be recovered.

10 C.C.B. was appointed and authorized to act as agent to ad minister the portfolio assets (P.A. s. 6(a)). Pursuant to s. 9 of the participation agreement, all money received by C.C.B. on account of each portfolio asset, whether principal, interest or otherwise, was first to be retained by C.C.B. until the C.C.B. portion of that portfolio asset was completely recovered; then to be paid to the participants (except C.D.I.C.) proportionately to reduce or retire their respective advances; then to be paid to C.D.I.C. to reduce or retire its proportionate share; and finally to be retained by C.C.B. Each participant was entitled to receive these proceeds up until such time as it received an amount which, when taken together with all amounts received by that participant from C.C.B.'s pre-tax income pursuant to s. 10, was equal to the price paid by that participant for its participation certificate.

11 In addition to proceeds from C.C.B.'s portfolio assets, the participants were entitled to receive proportionately from C.C.B., on a quarterly basis, an amount equal to 50 per cent of C.C.B.'s pre-tax income (P.A. s. 10). C.C.B.'s "pre-tax income" was defined in s. 10 of the participation agreement as C.C.B.'s "net income ... before making any allowance for the payments to be made pursuant to this section, accrued interest on any presently existing bank debenture of CCB or any provision for income taxes payable to Canada, the United States of America and any political division of either." Again, C.C.B.'s obligation to make such payments would terminate after each participant received an amount pursuant to ss. 9 and 10 equal to the price paid by such participant for its participation certificate (P.A. s. 10).

12 Under s. 11 of the participation agreement, if C.C.B. failed by October 31, 1985 to obtain the shareholder and regulatory approval necessary for it to increase its authorized capital to the extent required for it to perform the equity agreement, as discussed below, then s. 10 of the participation agreement would be deemed to have been amended and would be construed as requiring C.C.B. to pay to the participants 100 per cent of C.C.B.'s pre-tax income. This obligation would continue until such time as the total amount received by each participant from the portfolio assets and C.C.B.'s pre-tax income satisfied the amount paid by that participant for its participation certificate, together with interest at prime rate. It should be noted that this was the only circumstance under which C.C.B. was to pay interest to the participants.

13 Section 8 of the participation agreement provided that C.C.B. indemnified each participant against any loss suffered by it by reason of the amounts realized from the portfolio assets and from 50 per cent of C.C.B.'s pre-tax income failing to equal the price paid by that participant for its participation certificate. This indemnity was to be paid only by payments of the amount and source described in ss. 10 and 11, with one important exception: "if CCB becomes insolvent or is wound up, any amount remaining unpaid and required to be paid in order to indemnify that Participant completely in accordance with the foregoing indemnity, shall constitute indebtedness of CCB, to which the provisions of section 13 shall apply."

14 The relevant parts of s. 13 of the participation agreement read as follows:

> **13. Priorities on Insolvency**
>
> (*a*) *Notwithstanding the provisions of section 277 of the Bank Act* [which otherwise gives Canada and a province a first and second charge respectively on the assets of an insolvent bank] or any other rule of law, each of the Participants agrees that, in the case of the insolvency or winding-up of CCB:
>
> > (i) neither Canada, CDIC nor Alberta shall, in connection with any money owing to it under this agreement, claim any charge on the assets of CCB;

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> (ii) *the right of each of the Participants other than CDIC* to money owing to it under this agreement *shall rank pari passu with the right of the depositors* of CCB to payment in full of the deposit liabilities of CCB;
>
> (iii) the right of CDIC to money owing to it by CCB, under this agreement but not by reason of the subrogation of CDIC to the claims of depositors of CCB (if any) shall be subordinate in right of payment to the prior payment in full of all money owing to the other Participants under this agreement and to the depositors of CCB, but shall rank in priority to any outstanding bank debentures of CCB.
>
> *Each of Canada, CDIC and Alberta acknowledges that it has waived, as set out above, any priority to which it would otherwise be entitled*. Each Participant agrees that this *section 13 is intended to benefit the depositors of CCB*, and to ensure to the benefit of the successors of CCB and any curator, liquidator or receiver that may be appointed to supervise or to wind up the business of CCB.

[Emphasis added.] Moreover, s. 13 provided that each participant would rank pari passu with each other except C.D.I.C. and that each would, as necessary, redistribute payments received by it in order to achieve this ranking.

15 Pursuant to s. 12 of the participation agreement, C.C.B. could not, without the consent of the participants, declare or pay any dividend or reduce its issued capital until such time as C.C.B. paid to each participant its purchase price, and any additional amount (interest at prime rate) payable under s. 11. Moreover, the participants required as a condition to their purchase, inter alia: (1) the execution of an amending and subordination agreement; (2) the execution of the equity agreement; and (3) the opinion of the Inspector General of Banks that C.C.B. would be solvent following the purchase (P.A. ss. 14 and 16). Finally, the parties expressly declared that the participants were not partners or joint venturers with each other (P.A. s. 18(j)) and that the law governing the agreement would be the law applicable in the province of Ontario (P.A. s. 18(d)).

16 The equity agreement (C.O.A. at pp. 154-74) gave the participants warrants providing for the right to subscribe to a total of 24,062,517 common shares of C.C.B. at a price of $0.25 per share, on a basis proportionate to each participant's participation interest (E.A. ss. 2, 3, 5 and 6). At the date of the agreement, C.C.B. had an authorized capital of 10,000,000 common shares with a par value of $10 each, of which 6,529,768 were issued and outstanding (E.A. s. 4). If all outstanding employee stock options to purchase common shares were exercised and all issued convertible preferred shares were converted into common shares, the issued capital of C.C.B. would consist of a total of 8,020,839 common shares (E.A. s. 4). Thus, if the warrants were fully exercised, the participants would own 75 per cent of C.C.B.'s common shares.

17 Shareholder and regulatory approval were required to increase C.C.B.'s authorized capital from its current level of 10,000,000 common shares to the 32,100,000 required in order to give full effect to the equity agreement. Pursuant to s. 15 thereof, C.C.B. had to first obtain shareholder approval no later than October 31, 1985, and next had to apply to the Minister of Finance pursuant to the *Bank Act*, R.S.C., 1985, c. B-1 (formerly S.C. 1980-81-82-83, c. 40), for the necessary change in its authorized capital. If such an application was not made by October 31, 1985, the provisions of s. 11 of the participation agreement (100 per cent pre-tax income plus interest) were triggered. In s. 8 of the memorandum of intent, Canada had agreed that "an application for such alteration in capital when made shall be approved for purposes of the Bank Act."

18 The limited authorized capital of C.C.B. was not the only obstacle to the issuance of common shares to the participants. Under present law, the chartered banks which were participants could not legally exercise their right to subscribe to common shares of C.C.B. This was recognized by the parties in para. (d) of the preamble to the equity agreement as well as in s. 10 of the agreement. Under s. 8 of the equity agreement, the warrants were made fully assignable and it was the declared intention of the participants, as recorded in the preamble, "that unless the present law is materially changed, they shall assign such rights."

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19 The participants' right to purchase these shares was to continue for a period of ten years after the date on which each participant had been repaid the full amount it had advanced under the terms of the participation agreement (E.A. ss. 1 and 12). Again, this agreement would be governed by and construed in accordance with the law applicable in the province of Ontario (E.A. s. 19).

20 Finally, under the amending and subordination agreement, the holders of all outstanding subordinated debentures issued by C.C.B. pursuant to s. 132 of the *Bank Act* (i.e., Canada, British Columbia, Alberta and the Workers' Compensation Board of British Columbia), agreed to postpone the repayment of the amounts represented by their debentures until such time as C.C.B. had paid to each participant an amount equal to the price paid by that participant for its participation certificate.

21 To summarize, the participants were to receive in return for the $255 million advanced under the support program, proportionally to their own financial contribution and up to that amount: (1) payments from the portfolio assets; (2)(a) 50 per cent of C.C.B.'s pre-tax income and warrants to buy up to 75 per cent of C.C.B.'s common shares, or (b) 100 per cent of C.C.B.'s pre-tax income, with interest on the amount contributed; and (3) an indemnity for any losses caused. Under these agreements, the participants could receive a return which was greater than their contribution only in two ways, namely, by exercising or assigning their warrants up to ten years after full repayment (however, this option was contingent on shareholder, regulatory and legislative approval) or, if these warrants could not be granted, by receiving interest on the amount advanced at the prime rate.

22 C.C.B. was advised by the Office of the Inspector General of Banks, by a letter dated April 24, 1985, as to the appropriate accounting treatment to be applied to these transactions. Following these guidelines, C.C.B. wrote down its loan assets by $255 million, charged the write-down to tax-allowable appropriations for contingencies and credited the $255 million received from the participants to tax-paid appropriations for contingencies. C.C.B. was not specifically directed by the Inspector General of Banks to record its indemnity towards the participants as a liability, nor did C.C.B. do so. By effectively "selling" that portion of its loan portfolio not likely to be recovered and by not recording its indemnity obligation under the participation agreement to repay the $255 million as a liability, C.C.B. was able to restore a position of solvency on its books, thereby allowing it to remain in business, which was, after all, the raison d'être of the support program.

23 Despite this financial assistance, C.C.B.'s financial status con tinued to deteriorate. For reasons beyond the scope of this appeal, the support program was unsuccessful in ensuring C.C.B.'s long-term solvency. By an order made September 3, 1985 on a petition by C.D.I.C., Wachowich J. of the Alberta Court of Queen's Bench ordered C.C.B. to be wound up pursuant to the *Winding-up Act*, R.S.C. 1970, c. W-10. At that point, none of the participants had exercised or assigned (or even been granted) any of their warrants under the equity agreement as the preliminary conditions of shareholder and regulatory approval, for the authorization and issuance of additional common shares had not been fulfilled. Price Waterhouse Limited was appointed, and remains, the sole liquidator of C.C.B. ("liquidator").

24 As of August 18, 1987 the liquidator had recovered approximately $112 million on account from C.C.B.'s portfolio assets, of which $5 million was attributable to the portion thereof beneficially owned by the participants (namely, the syndicated portion). The liquidator brought an application before Wachowich J. for advice and direction as to the interpretation of the support agreements. In particular, the liquidator sought to determine the validity and ranking of the claims of the participants pursuant to the participation agreement.

25 In a judgment rendered on December 7, 1987 Wachowich J. held the participants to be entitled to the repayment of sums recovered by the liquidator on the syndicated portion of the portfolio assets (the $5 million), but otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. Wachowich J. interpreted the injection of funds by the participants to have been a capital investment. The participants, apart from Canada and C.D.I.C., the respondents in this appeal, successfully

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appealed the latter part of this judgment. The Alberta Court of Appeal disagreed with Wachowich J., preferring to characterize the advance of $255 million as a loan. The Court of Appeal concluded that the participants were entitled to rank pari passu with C.C.B.'s unsecured creditors for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the syndicated portion of the portfolio assets.

26 On an application by the liquidator, Wachowich J. directed the liquidator to present an application to this court for leave to appeal from the Court of Appeal's decision. Wachowich J. further ordered that Lerner & Associates be appointed as legal representative ("legal representative") of C.C.B.'s general body of creditors, other than the participants, for purposes of the application for leave to appeal and further on the appeal. Leave to appeal to this court was granted on March 14, 1991. The liquidator, as an officer of the court and as the representative of all the creditors of C.C.B., takes no position in this appeal. The bank group and Alberta, the respondents before this court, made separate written and oral submissions.

II. Judgments in the Courts Below

A. Alberta Court of Queen's Bench

27 On the initial application, the participants took the position that they were entitled under the terms of the support agreements: (1) to receive their proportionate shares of the moneys received by the liquidator or C.C.B. on account of the portfolio assets; and (2) to rank pari passu with all the other unsecured creditors of C.C.B. for any amounts not recovered from the portfolio assets and still owing to them pursuant to the participation agreement. Wachowich J. agreed with the first proposition but rejected the second.

28 According to Wachowich J., the participants' first submission involved a consideration of the validity of the participation agreement. The learned chambers judge confessed it was a "difficult task" to determine the position of the participants with respect to C.C.B.'s estate given the "extraordinary nature of the agreement" involved (at p. 126) [A.R.]. He noted there were no precedents dealing with similar commercial agreements. In his view, the participation agreement in question was not prohibited by ss. 173 and 174 of the *Bank Act*. While the agreement did not relate to business in which a bank would normally or commonly engage, he noted that "given the unique circumstances and the stated purpose of the Participation Agreement as a whole, one can hardly regard this as an invalid transaction" (at p. 127). He found it was a valid contractual document binding on all parties and held that the participants were entitled to receive their proportionate share from moneys recovered by the liquidator from the portfolio assets, in the manner provided for in s. 9 of the participation agreement (i.e., to the extent such recoveries exceed the C.C.B. portion).

29 Next, Wachowich J. turned to a consideration of the ranking of the participants with the general body of creditors of C.C.B. for any amounts not recovered from the syndicated portion of the portfolio assets, and still owing pursuant to the participation agreement. He noted that the participants would have "valid claims" under the terms of the participation agreement for such amounts (at p. 128). However, whether they could rank pari passu with other unsecured creditors depended on the interpretation of the agreement taken as a whole and a determination of the "real basis upon which the $255 million was paid to C.C.B." (at p. 128).

30 In Wachowich J.'s view, the essence of the participation agreement was not the creation of a mere purchase and sale of assets with an added indemnity as to the value of those assets. Rather, the transaction reflected an investment of capital into C.C.B. (at p. 129):

> The agreement, as evidenced by all the surrounding circumstances, was really to effect an infusion of capital into C.C.B. whereby the Participants would be risking their monies in hope that the C.C.B. would continue as a viable and profitable business. If this in fact had occurred, the Support Group Participants stood to gain a healthy return on their investments.

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31 The learned chambers judge found support for his characterization in the following: (1) the portion of the portfolio assets purchased by the participants was of little value; (2) s. 2 of the participation agreement masked the true nature of the transaction, that is, the investment of working capital into C.C.B.; (3) the indemnity provision and repayment structure set up by the agreement were directly connected to the profits and income of C.C.B.; (4) the repayment of the purchase price was to come not only from the portfolio assets, but mainly from C.C.B.'s pre-tax income; (5) if C.C.B.'s business was successful, the participants would benefit not only in recovering their purchase price, but as well by purchasing common shares in C.C.B. under the equity agreement; (6) "[w]hile the transaction may not be a typical investment situation, where for example there is an outright purchase of shares, it is difficult to ignore the investment features of the agreement" (at p. 130); (7) while the accounting treatment had to be looked at with caution, the fact there was no liability to the participants recorded on the balance sheet of C.C.B., as created by the indemnity provisions of the agreement, supported the conclusion that the transaction was an investment; (8) the cases of *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 7 B.C.L.R. (2d) 90, 63 C.B.R. (N.S.) 76 (C.A.) ("*Laronge Realty*"); *Re Dickie* (1924), 5 C.B.R. 214 (N.S.T.D.); and *Re Meade*, [1951] 1 Ch. D. 774, [1951] 2 All E.R. 168, "stand for the general proposition that advances of monies will be classed as capital investments where the monies were used in the business and the business was carried on for the joint benefit of the parties involved" (at p. 131); and (9) the participants here did have a stake in the continued profitability of C.C.B. in that (a) the repayment of the money advanced would come from the income of C.C.B. and (b) their warrants allowed them to "continue to share in the profits of C.C.B." (at p. 131).

32 Thus, according to Wachowich J., the participants could not rank pari passu with the ordinary creditors of C.C.B., including unsecured creditors, for the amounts not recovered from the portfolio assets. In so doing, he applied the principle that "if a person contributes capital to a business, even though that person is not a partner in the business and may have received no share of the profits, they cannot prove their claim in bankruptcy in competition with the creditors of the business" (at p. 131): Halsbury's Laws of England (3rd ed.), vol. 2, at p. 495; *Laronge Realty*, supra; and *Re Beale; Ex parte Corbridge* (1876), 4 Ch. D. 246.

33 In concluding, Wachowich J. held the provisions of the participation agreement which attempt to rank the participants pari passu and to create a debt on insolvency are ineffective to alter the "existing legal nature of their relationship" with C.C.B. These provisions would be void as they are an attempt to alter insolvency laws through a private agreement: *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France*, [1975] 1 W.L.R. 758, [1975] 2 All E.R. 390 (H.L.).

B. Alberta Court of Appeal

34 The respondents (the participants apart from Canada and C.D.I.C.) appealed from Wachowich J.'s conclusion with respect to their ranking on insolvency, whereas the then legal representative cross-appealed from the conclusion that the participants could receive funds from the syndicated portion of the portfolio assets. Harradence J.A. (writing for the Court of Appeal) began by stating that the learned chambers judge had erred in law in his interpretation of the decisions in *Laronge Realty*, supra, *Re Dickie*, supra, and *Re Meade*, supra (at p. 207) [A.R.]:

> I have examined closely the cases relied upon as well as others to which I have been referred and the inescapable conclusion to be reached is that the proposition as stated [by Wachowich J.] can only be correct where one implies into the term 'monies were used in the business' a necessary condition that the investor has not expressly stipulated a requirement for the repayment of monies advanced. A failure to imply this term into the proposition results in a misstatement of the appropriate test and, further, is inconsistent with the decision of the Supreme Court of Canada in *Sukloff v. Rushforth* (1964), 45 D.L.R. (2d) 510 (S.C.C.).

35 Harradence J.A. reviewed the cases cited by Wachowich J. and noted that, unlike the case at bar, none of them involved transactions where provisions for the repayment of the money advanced had been included by

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the parties. Turning specifically to *Sukloff v. A.H. Rushforth & Co.*, [1964] S.C.R. 459, 6 C.B.R. (N.S.) 175, 45 D.L.R. (2d) 510 ("*Sukloff v. Rushforth*"), Harradence J.A. said that while it was "difficult to glean" from that case the exact reason for concluding that the transaction under consideration therein was a loan rather than a capital investment, "the only reasonable conclusion to be reached is that the provision for repayment was determinative of the nature of the transaction" (at p. 209). He concluded his review of the jurisprudence by stating (at p. 210): "where, as in this case, the evidence indicated that monies advanced to a business are to be repaid, and particularly when the terms of repayment are specified, the transaction is classified as a loan."

36 Harradence J.A. next turned to the interpretation of the participation agreement. He noted at the outset the rule prohibiting extrinsic evidence from contradicting express contractual terms. He reviewed a number of factors favouring interpreting the agreement as a loan, namely: (1) there is nothing in the express terms of the agreement which supports a conclusion that the money was advanced as an investment; (2) there are express provisions pointing to the opposite conclusion, including provisions for repayment and for an indemnity that full repayment will be made; (3) pursuant to the participation agreement, upon insolvency or winding-up, any amount remaining unpaid was to constitute indebtedness and, in such circumstances, the participants were to rank pari passu with other creditors; and (4) the intention of the participants was consistent with a "loan" characterization. He did not find it necessary to determine whether the accounting treatment was consistent with an investment, holding that such a factor is not determinative of the legal relationship of the parties.

37 Harradence J.A. found that repayment of the money advanced was intended and was coupled with express repayment provisions. Thus, relying on *Sukloff v. Rushforth*, supra, and the other cases cited, he concluded that the $255 million advanced was not to be characterized as an investment in capital but rather as a "loan coupled with a purchase agreement to C.C.B." (at p. 211).

38 The observation made by the learned chambers judge that the business of C.C.B. was carried on for the "joint benefit" of C.C.B. and the participants, because (1) repayment was to come from the income of C.C.B. and (2) the warrants, if exercised, would allow the participants to continue to share in the profits of C.C.B., was next addressed. With respect to the first factor, Harradence J.A. held that Wachowich J. erred in considering the *source of the funds for* repayment in concluding that the participants would be sharing in C.C.B.'s profits. His comments warrant citation (at p. 211):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the Support Group Participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of 'joint benefit'. Since the sums to be received by the Participants were limited to repayment of monies advanced, with a contingent right to interest, the source of the repayment monies is not relevant and, with respect, the learned Chambers Judge erred in concluding the Participants were 'sharing in profits' in this respect.

39 As for the second factor, Harradence J.A. summarily rejected it as an indicium of investment and "joint benefit" mainly because of the *contingent nature* of the warrants in question, as recognized by both the participation agreement and the equity agreement. He added (at p. 212): "Had shares actually been issued or even approval obtained, or if there was an obligation to purchase or if a purchase had been made, then the 'joint benefit' argument might have some merit and it would have been necessary to fully address this issue."

40 Finally, Harradence J.A. considered whether repayment to the respondents was nevertheless postponed pursuant to what are now s. 139 of the *Bankruptcy Act*, R.S.C. 1985, c. B-3, and s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5. In his view, the application of these provisions was precluded by his earlier conclusion that the participants were not to receive a rate of interest varying with the profits of C.C.B. or a share in the profits of C.C.B.

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41 Thus, the appeal was allowed and it was ordered that the respondents were entitled to rank pari passu with the ordinary creditors of C.C.B. for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets. In view of this result, the cross-appeal brought by the then legal representative, alleging an inconsistency in Wachowich J.'s conclusions, was dismissed.

III. Issues

42 There are many ways of characterizing the issues raised by this appeal. As I see it, the three main questions which need to be addressed are:

(1) Was the Court of Appeal correct in characterizing the advance of $255 million by the participants to the C.C.B. as a loan, as opposed to an investment in capital, thereby creating a debtor-creditor relationship between the parties?

(2) If the true legal nature of this transaction is indeed a loan, does this loan come within the postponement provision found in s. 4 of the *Partnerships Act*?

(3) If the *Partnerships Act* does not apply, should the respondents' claim for the money loaned under the participation agreement nonetheless be postponed to the claims of the general body of C.C.B. unsecured creditors, other than the participants, based on the United States doctrine of equitable subordination?

The legal representative raises a subsidiary issue concerning the portion of the moneys recovered attributable to the syndicated portion of the portfolio assets:

(4) Was the Court of Appeal correct in upholding the conclusion of the learned chambers judge that the participants are entitled to receive from the liquidator, pursuant to the participation agreement, the sums recovered on the syndicated portion of the portfolio assets?

43 For the reasons that follow, it is my view that the first and fourth questions should be answered in the affirmative while the second and third should be answered in the negative. In summary, the words chosen by the parties in their agreements clearly support the Court of Appeal's conclusion that the assistance program involved, in substance, a loan of $255 million and not a capital investment. The surrounding circumstances provide additional support for, rather than detract from, this conclusion. Although the transaction did have an equity component (the warrants), this aspect alone does not, in the circumstances of this case, transform the essential nature of the advance from a loan to an investment. Put another way, while it is true that this transaction does have "investment features," these features were incidental to the debt features of the arrangement and do not alter the substance of the debtor-creditor relationship that was created by the parties with respect to the $255 million advanced by the participants to C.C.B. Moreover, the fact that C.C.B.'s pre-tax income was the main source for repayment does not affect this characterization as the amount to be repaid from this source was limited to the sum advanced to C.C.B., plus a contingent interest at prime rate. Thus, the respondents are creditors of C.C.B. and, as such, are entitled to what may be called a "prima facie" pari passu ranking with the other unsecured creditors of C.C.B. in the distribution of C.C.B.'s assets.

44 In the circumstances of this case, this prima facie ranking is not altered by the principles of law and equity relied upon by the legal representative. Indeed, the loan in question does not fall within the ambit of the Ontario *Partnerships Act* (ss. 3(3)(*d*), 4) as the participants were to receive neither a "rate of interest varying with the profits" of C.C.B. nor a "share of the profits arising from carrying on the business" of C.C.B. In my view, the principles of equitable subordination have no application to the facts of this case. Finally, in light of these conclusions, the legal representative's subsidiary issue concerning the moneys recovered on the syndicated portion of the portfolio assets must also fail. Accordingly, I would dismiss the appeal.

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IV. Relevant Statutory Provisions

Winding-up Act:

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> **Distribution of Assets**
>
> 93. The property of the company shall be applied in satisfaction of its debts and liabilities, and the charges, costs and expenses incurred in winding-up its affairs.
>
> 94. All costs, charges and expenses properly incurred in the winding-up of a company, including the remuneration of the liquidator, are payable out of the assets of the company, in priority to all other claims.
>
> 95. The court shall distribute among the persons entitled thereto any surplus that remains after the satisfaction of the debts and liabilities of the company and the winding-up charges, costs and expenses, and unless otherwise provided by law or by the Act, charter or instrument of incorporation of the company, any property or assets remaining after the satisfaction shall be distributed among the members or shareholders according to their rights and interests in the company.

Partnerships Act:

46

> 3. In determining whether a partnership does or does not exist, regard shall be had to the following rules:
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> . . . . .
>
>> 3. The receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him or her a partner in the business, and in particular,
>>
>> (*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such;
>>
>> . . . . .
>>
>> (*d*) the advance of money by way of loan to a person engaged or about to engage in a business on a contract with that person that the lender is to receive a rate of interest varying with the profits, or is to receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such, provided that the contract is in writing and signed by or on behalf of all parties thereto;
>
> . . . . .
>
> 4. In the event of a person to whom money has been advanced by way of loan upon such a contract as is mentioned in section 3, or of a buyer of the goodwill in consideration of a share of the profits of the business, becoming insolvent or entering into an arrangement to pay his or her creditors less than 100 cents on the dollar or dying in insolvent circumstances, the lender of the loan is not entitled to recover anything in respect of the loan, and the seller of the goodwill is not entitled to recover anything in respect of the share of profits contracted for, until the claims of the other creditors of the borrower or buyer, for valuable consideration in money or money's worth, are satisfied.

V. Analysis

A. Characterization of the $255 million advanced: capital investment or loan?

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47 The first and foremost issue in this appeal concerns the determination of the true nature of the transaction in question between the participants and C.C.B. Was the $255 million advanced by the participants in the nature of a loan, as found by the Court of Appeal, or in the nature of an investment of capital, as found by the learned chambers judge? If the Court of Appeal was correct in describing the transaction as a loan, it follows that the participants are creditors of C.C.B. and as such, pursuant to both the participation agreement and ss. 93 to 95 of the *Winding-up Act*, they would be entitled, subject to the statutory (s. 4 of the *Partnerships Act*) and equity ("equitable subordination") principles raised by the legal representative, to rank pari passu with the other ordinary creditors of C.C.B. in the distribu tion of C.C.B.'s assets. If, however, Wachowich J.'s characterization is to be preferred, then, relying on an old common law principle, it is argued the participants would not be creditors entitled to an equal ranking with C.C.B.'s true creditors: *Re Beale*, supra; *Re Meade*, supra; *Laronge Realty*, supra; and Halsbury's Laws of England (4th ed.), vol. 3(2), at p. 315. Under this approach, it is said the participants would have an equitable right to share in the distribution of the assets of C.C.B., but only at such time as the ordinary creditors have been paid in full.

48 The principal argument raised by the legal representative in favour of finding the transaction to have been that of a capital infusion is the potential for unlimited returns and control over C.C.B. by reason of the warrants granted to the participants under the equity agreement. Other indicia of capital investment are also suggested. First, C.C.B.'s accounts did not show their obligation to the participants as a liability. It is submitted that, if the financial statements could have led creditors, including depositors, to believe that there was adequate capitalization, this should be taken into consideration in determining the rights of the ordinary creditors and the respondents. Second, it is argued that the Court of Appeal's interpretation of ss. 8 and 13 of the participation agreement fails to recognize that the rights of differing classes of people who provide funds for the use of a business crystallize prior to insolvency, and cannot be altered by an agreement. It is argued that the Court of Appeal erred in assuming that the characterization by the participants and C.C.B. of their rights and obligations inter se should be determinative of the relative priority of the claims of the participants and the ordinary creditors of C.C.B. According to the legal representative, "Section 13 should be disregarded by the Courts, as being a self-serving attempt by the Participants to enhance their position for distribution purposes in the event of insolvency." Finally, the legal representative argues that the Court of Appeal erred in its interpretation of *Sukloff v. Rushforth*, supra, which, according to him, stands for proposition that, if someone has an interest in a business, in the sense that his or her potential for return is unlimited except by the enterprise's actual ability to generate profits, that person may not rank as a creditor if the business becomes insolvent. The key, according to the legal representative, is the right or potential to an unlimited return, not the right to repayment.

49 The respondent Alberta, on the other hand, submits that the advance was a loan and offers the following arguments: (1) the agreement for the advance contained no express provision that the advance was an investment in capital but did contain express provisions to the contrary, including provisions for repayment and an indemnity for that repayment; (2) the parties intended the advance to be repayable; (3) C.C.B. was contingently liable to pay interest; (4) in its financial state ments C.C.B. accounted for the advance as being a debt by disclosing the outstanding balance of the advance at the opening, repayments during, and the obligation for the outstanding balance at the closing of each reporting period; (5) Mr. Justice Estey considered the advance to be a loan in the *Report of the Inquiry into the Collapse of the CCB and Northland Bank* (1986) ("Estey report"), at pp. 115, 118 and 125; (6) the participants could not and did not invest in C.C.B.'s equity capital; (7) the decision of this court in *Sukloff v. Rushforth*, supra, as correctly demonstrated by the Court of Appeal, supports the conclusion that the advance to C.C.B. was a loan; and (8) according to *Sukloff v. Rushforth*, supra, and other decisions, an advance of money which is to be repaid, without more, is a loan and not an investment in equity capital or the supply of capital for the business of the recipient for the joint benefit of the advancer of money and the recipient, even if it is described as an investment of capital or if the person advancing the money is to share the profits or to receive shares of the recipient or if the advance is repayable when funds are available or out of profits. Alberta also takes issue with the legal representative's characterization of s. 13 of the participation agreement. It submits that this is

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a common provision in loans and, rather than enhance the participants' ranking on insolvency, has the effect of reducing the otherwise priority ranking of Canada, Alberta and C.D.I.C.

50 For their part, the bank group notes that the agreements in question represent a unique response to a unique situation, and thus, cannot be perceived as a normal investment in a business. For the reasons given therein, they commend the Court of Appeal's characterization of the advances as a loan in the form of a purchase of doubtful assets. Specifically, they submit that Harradence J.A. was correct in finding that, because of the contingent nature of the warrants, the support agreements did not provide a right to share in profits or for a rate of interest that varied with profits. They characterize the equity agreement as a mere "sweetener." The bank group submits that the cases, including *Sukloff v. Rushforth*, supra, do not support the conclusion that a contingent right to profits in circumstances like the case at bar can represent an interest in the business. With respect to the accounting issue, they argue that they should be considered on a basis different from the other participants because they were prohibited from controlling or attempting to control C.C.B. Indeed, they had no control over how C.C.B. showed its obligations to them in its financial statements. Further, such a factor should not determine the nature of the legal relationship between the parties to the agreement.

51 For my part, I agree in essence with the position advanced by Alberta and the bank group. Briefly put, the words chosen by the parties in their agreements strongly support the Court of Appeal's conclusion that the financial assistance program involved, in sub stance, a loan of $255 million rather than a capital investment and there is nothing in the surrounding circumstances which distracts from this characterization. On the contrary, the surrounding circumstances offer additional support for the Court of Appeal's conclusion. As noted by Wachowich J. and the legal representative, the transaction did indeed have an equity component (the warrants) and did involve a repayment scheme linked to the profits of C.C.B. However, for reasons which I shall elaborate, these aspects are insufficient to justify the conclusion reached by Wachowich J.Similarly, the other indicia of capital investment put forward by the legal representative, such as the accounting treatment given to the advance, do not affect the substance of this transaction.

52 As in any case involving contractual interpretation, the characterization issue facing this court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required a consideration of admissible surrounding circumstances may be appropriate.

53 In the case at bar, it should be noted that the circumstances surrounding the financial arrangements between C.C.B. and the participants, and the agreements themselves, are somewhat unique. At the heart of this matter is the attempted rescue of a Canadian chartered bank. Recourse to emergency measures in order to preserve the solvency of a bank is, fortunately, relatively rare in our country. I say this not because financial support programs are harmful (quite the contrary), but because the events surrounding the C.C.B. rescue in the mid-1980s infrequently arise. Part of the result, however, is that the task of ascertaining the intention of the participants and of C.C.B. with respect to the advance of $255 million is not particularly simple. Indeed, the learned chambers judge described the participation agreement as a "unique document based on a unique set of facts" as well as an "extraordinary transaction," and he found it "most difficult" to characterize (at pp. 132 and 126). Similarly, Harradence J.A. said that "The unique situation of C.C.B. and the Participants resulted in novel and complex documentation, the interpretation and characterization of which is a challenging and difficult task" (at p. 206).

54 It is evident from reviewing the agreements in question that characteristics associated with both debt and equity financing are present. The most obvious examples are, on the one hand, ss. 8 and 13 of the participation agreement pertaining to C.C.B.'s indemnity towards the participants and their ranking in the event of a winding-up and, on the other hand, the provisions of the equity agreement con cerning the warrants granted by C.C.B. to the participants. Such a duality is apparently quite common in loan participation agreements. Indeed, in an article

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entitled "Characterization of Loan Participation Agreements" (1988), 14 Can. Bus. L.J. 336, Professor Ziegel uses the heterogeneity in some loan participations to explain, in part, the divergence of judicial and academic opinion in the United States on the proper characterization of a participation agreement (at p. 337):

> This issue [the characterization of the participation agreement] has provoked a large body of case law and textbook and periodical literature, most of it American, and the conclusions are not always the same. At one time or another one or more of the following descriptions have been applied to a participation agreement: a simple debtor-creditor relationship, with or without the benefit of security; an agency agreement; a partnership or joint venture; a trust; and, finally, a sale or assignment of an undivided interest in the loan.
>
> It is easy to see why there should be this divergence of opinion. As with any agreement, the parties are free to verbalize it as they see fit and ambiguous or neutral language may reflect their unwillingness to answer hard questions, perhaps in the hope that the need to do so may never arise. Frequently, the several parts of a participation agreement lend themselves to different characterizations and the agreement is really a composite of cumulative legal elements. Finally, there is a significant overlap between such flexible concepts as a secured loan or trust and the sale or assignment of an undivided share of a loan, and the language of the agreement may be consistent with more than one of them. Faced with such ambiguity, the job of the adjudicator, when a dispute arises, is to find the characterization that best seems to fit the parties' intentions as derived from the total agreement and all the surrounding circumstances.

55 As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the participants and C.C.B. in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

56 The weight to be given to one aspect of the support agreements over another in assessing the true intention of the parties underlies the difference in opinion between the learned chambers judge and the Court of Appeal's characterization of the transaction. Wachowich J. emphasized both the fact that the recovery by the participants of their contribution was dependent upon the income generated by C.C.B. and the participants' potential to share in the future success of C.C.B. by the warrants, even after having been repaid, as evidencing that the essence of the transaction was that of a capital investment. The Court of Appeal, however, largely dismissed the relevance of the equity agreement because of its contingent nature and emphasized instead that the participants were only entitled to receive from C.C.B. the amount advanced to it and that the parties had included specific provisions in the participation agreement referring to debt; all of which amounted to a very strong indicium of a loan.

57 In the circumstances of this case, it is my view that the learned chambers judge and the legal representative give far too much weight to the equity features associated with the equity agreement in characterizing the overall nature of the advance of $255 million. It is true the participants received warrants to purchase common shares of C.C.B. through the equity agreement. It is also true, at least in theory, that by fully exercising their warrants the

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participants would own 75 per cent of the common shares issued by C.C.B. However, it is evident on the face of the record that this possibility was not only a mere hypothesis, but it was unlikely to occur. As noted by the respondents and the Court of Appeal, shareholder and regulatory approval was required to permit an increase in C.C.B.'s authorized capital and, unless the warrants were assigned, an amendment to the *Bank Act* was necessary before the participants who are chartered banks could fully exercise their rights to purchase shares. It is not without significance that none of the participants ever exercised any of their warrants nor did they assign them. In these circumstances, I agree with the Court of Appeal that the true effectiveness of the equity agreement was highly contingent and that the learned chambers judge erred in not considering the warrants for what they really were, namely, so-called "sweeteners" or "kickers" with respect to the advance of $255 million which were simply additional features to the underlying loan arrangement between the parties. Undoubtedly, the warrants are an equity feature of the transaction supporting a conclusion that the advance was an investment. However, in the facts of this case, only minimal weight should be given to this factor in the overall characterization of the agreement. Alone, the highly contingent warrants are surely insufficient to tip the scales when faced with the strong indicia of debt present here as identified by the Court of Appeal.

58 Wachowich J. also erred in concluding that the participants would be "sharing in the profits" of C.C.B. under the support agreements. The participation agreement simply *referred to* C.C.B.'s profits (i.e., pre-tax income) as one of the *sources* for repayment. The other source for repayment, the moneys recovered on the syndicated portion of the portfolio assets, was not linked with C.C.B.'s profits. While full repayment from the portfolio assets alone was unlikely, the fact remains that the amount of money to be paid to the participants from both sources was fixed at the amount advanced by each for their participation certificate. Regardless of where the repayments were coming from, they remained mere repayments for moneys advanced. Of course, the participants would benefit from the success of C.C.B.'s business; however, this benefit would be capped by the amount of the advance. I shall examine in greater detail the "sharing in profits" argument of the legal representative when I deal with s. 4 of the *Partnerships Act*. For now, it is sufficient to state that, in the circumstances of this case, the source from which C.C.B. was to repay the advance made does not carry any weight in favour of a finding that said advance was an investment in capital rather than what it appears to be on the face of the agreements, namely, a loan of $255 million coupled with an equity "sweetener" or "kicker."

59 Another error committed by the learned chambers judge relates to his reliance on the decisions of *Laronge Realty*, supra, and *Re Meade*, supra. The latter case together with *Re Beale*, supra, are said to have established the common law principle applied in *Laronge Realty* and upon which Wachowich J. relied in order to deny ranking the participants pari passu with C.C.B.'s unsecured creditors other than the participants. This principle is stated as follows in Halsbury's Laws of England (4th ed.), vol. 3(2) (at p. 315):

> If a person advances money to another, not by way of loan but as a contribution to the capital of a business carried on for their joint benefit, the person who has made the advance, even though he is not a partner in the business and has received no share of the profits as such, is debarred from proving in the bankruptcy of the recipient of the money in competition with the creditors of the business.

Briefly, I agree with Harradence J.A.'s conclusion that none of the agreements at issue in the cases relied upon by Wachowich J. contained express provisions for the repayment of the money advanced and that such a factor was crucial to the conclusions reached therein. I also agree that the express repayment scheme set out in the participation agreement clearly distinguishes the case at bar from those in which the common law rule relied upon by Wachowich J. has been applied.

60 This rule was referred to, but *not* applied, by this court in *Sukloff v. Rushforth*, supra, a case upon which the legal representative strongly relies. There, Ritchie J. declined to apply the common law rule since he found that the money advanced by Mr. Sukloff was more in the nature of a loan, thereby creating a debtor-creditor relationship between the parties. Indeed, just after citing the above excerpt, Ritchie J. stated (at p. 467): "As I have indicated, I do not construe Mr. Sukloff's role as that of one who was supplying capital for a business carried on for the joint

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benefit of himself and the two limited companies." Earlier, he had specifically agreed with the trial judge's finding that Mr. Sukloff's relationship with the companies in question "was confined to that of a *lender or financier* who had a right to share in the profits, if any, of the undertakings of these companies" (at pp. 465-66) (emphasis added). This "share in the profits" aspect was later used by Ritchie J. in order to postpone part of the money advanced by Mr. Sukloff (the unsecured $10,000 upon which the legal representative asks this court to focus on) under what was then s. 98 (now s. 139) of the *Bankruptcy Act*, a provision similar to s. 4 of the *Partnerships Act*. However, this aspect had no effect whatsoever on the characterization of the true nature of the transaction involved and on the application of the common law rule set out in *Re Beale*, supra, and *Re Meade*, supra, and applied in *Laronge Realty*, supra. As found on the evidence, the advances in *Sukloff v. Rushforth*, supra, amounted to a loan.

61 As observed by Harradence J.A. in the case at bar, it is somewhat difficult to discern what specific evidence Ritchie J. was referring to when he agreed with the finding of the trial judge in *Sukloff v. Rushforth*, supra. However, I would note, as did Harradence J.A., that the agreements involved therein contained express repayment provisions similar to those contained in the participation agreement. It is not unreasonable to suggest that these provisions played an important role in the characterization of the advances as a loan. In any event, what is most important for our purposes is the fact that *none* of the moneys advanced by Mr. Sukloff was "postponed" under the common law principle advanced by Wachowich J. and the legal representative. The only part which was indeed postponed (the $10,000), was done so under the *Bankruptcy Act* and not following *Re Meade*, supra. I will explain in the context of my analysis of s. 4 of the *Partnerships Act* why, contrary to *Sukloff v. Rushforth*, supra, such statutory postponement has no application to the facts of this case (namely, because there is no profit sharing in the case at bar, simply a repayment out of profits). Suffice it here to say that, contrary to the legal representative's submissions, *Sukloff v. Rushforth* has no bearing on the characterization issue facing this court.

62 Similarly, contrary to the legal representative's submissions, the accounting treatment is not by itself of great weight in the characterization of the advance. I agree with the learned chambers judge that this "evidence" should be "looked at with caution" (at p. 130). I say this for the following interrelated reasons. First, C.C.B. was following the express directives given by the Office of the Inspector General of Banks, who is not a party to any of the agreements, in using the accounting methods it did. Second, as noted by the bank group, the accounting methods used by C.C.B. were beyond the control of many of the participants. Third, the legal representative is really asking us to look at the conduct of one party, after an arrangement has been signed, in order to discern the common intention of all contracting parties at the time of signing. This type of unilateral and after the fact "evidence" is clearly of little relevance and reliability with respect to the issues before this court. Fourth, as previously noted, the accounting treatment used and the success of the support program were closely linked and it is unwise to draw inferences on the legal relationship of the parties therefrom. For all these reasons, I would not place much weight on the accounting treatment used by C.C.B. in determining the true nature of the advance of $255 million. In so concluding, I do not wish to say that there may not be other cases where the accounting treatment *could* be helpful in determining the nature of a given transaction.

63 Finally, I cannot agree with Wachowich J. about the relevance to the characterization issue of the fact that the portion of the portfolio assets purchased by the participants was of little value. Even assuming that courts are entitled to weigh the value of the consideration given for a particular promise when characterizing an agreement, there was more to the support agreements than the mere purchase of participations in bad loans. Regardless of the true value of the syndicated portion, the participants were to be *repaid* the entire $255 million they had advanced to purchase their participation certificates. The source of this repayment was also the profits of C.C.B. and the parties agreed that any amount remaining unpaid upon insolvency would be considered an indebtedness by C.C.B. towards the participants.

64 On the other hand, the factors noted by the Court of Appeal of Alberta and the respondents as providing indicia of the "loan" nature of the advance of $255 million are clearly relevant to the characterization issue and they strongly support such a conclusion. I have already referred to these factors in summarizing the reasons of

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Harradence J.A. and the submissions made by Alberta and the bank group. To repeat the most important ones: (1) there is nothing in the express terms of the agreements which supports a conclusion that the money was advanced as an investment; and (2) there are express provisions supporting a characterization of the advance as a loan, including provisions for repayment (P.A. ss. 9-11), for an indemnity should full repayment not be made from the sources contemplated (P.A. s. 8), and for equal ranking with the ordinary creditors of C.C.B. (P.A. s. 13).

65 It is interesting to note that my conclusion that the $255 million advance was a loan also accords with the views of Mr. Justice Estey in his report. The relevant passages are found at pp. 115, 118 and 125 of the Estey report:

> The $255M reduced the bank's debt to the Bank of Canada, but itself became an obligation to be retired by collections on the Support Package loans or on liquidation, out of the assets of the bankrupt bank. The receipt of the $255M therefore is irrelevant to the presence or absence of solvency. Whatever state the bank was in at that time remained unaffected by the receipt of the Support Package moneys. The Inspector General, therefore, was in error in finding the bank to be solvent upon receipt of the $255M. It should be borne in mind that the $255M, by the terms of the interim and final agreements, remains an obligation in debt of the CCB.
>
> . . . . .
>
> The Support Package should have classified these moneys as an unrecoverable purchase price, as a capital grant of some nature or as a subordinated loan, repayable out of earnings only. What CCB needed at this time of crisis was a loan without recourse in the nature of a capital grant repayable only from future profits and not a loan which would retain that characteristic and revive when the bank ran into further difficulties.
>
> . . . . .
>
> The object of this Support Program therefore was to replace lost income and thereby protect and renew capital. The banks could not in law contribute equity capital, and the government agencies likewise were not in a position, either legally or practically, to do so. Resort was had to what amounted to a long-term loan repayable out of the prospects of collections from bad debts and future earnings. The money infused, therefore, could not be treated as capital, but only served to reduce liquidity advances.

66 Contrary to the legal representative's submissions, s. 13 of the participation agreement is not an attempt to enhance the ranking of the participants upon C.C.B.'s insolvency. As evidenced by the passages from this clause which I earlier emphasized, the main purpose and effect of s. 13 is to reduce, rather than enhance, the ranking of certain of the participants (Canada and Alberta) upon insolvency as the parties agreed to do away with s. 277 of the *Bank Act*. As for the other participants, there is nothing in s. 13 other than a confirmation that the ordinary principles of common law and of ss. 93 to 95 of the *Winding-up Act* apply upon insolvency, namely, the participants, as unsecured creditors of C.C.B., are entitled to rank pari passu with the other ordinary creditors of C.C.B.

67 For all the foregoing reasons, I find that the Court of Appeal did not err in characterizing the advance of $255 million to C.C.B. as being, in substance, a loan rather than an investment of capital. While indicia supporting both conclusions are present, the overall balance clearly tilts in favour of the characterization put forward by the respondents. Accordingly, I would dismiss this first ground of appeal.

B. Postponement under s. 4 of the Partnerships Act

68 In the alternative, the legal representative submits that, even if the advance of $255 million was properly characterized as a loan, the Court of Appeal erred in declining to postpone, under existing statutory and common law principles, the respondents' claims for the moneys not repaid until the claims of the other ordinary creditors of C.C.B. were satisfied. Relying on ss. 3(3)(*d*) and 4 of the *Partnerships Act*, he argues that, where a lender advances money to a business borrower under a contract providing that the lender shall "participate in the profits of that business," and the borrower subsequently becomes insolvent, the lender is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied. It is submitted that the support agreements in question are contracts of such a nature because the participants contracted to be repaid their advances out of C.C.B.'s pre-tax income (either 50 per cent or 100 per cent plus interest, depending

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on whether the equity agreement could be carried out), and because of the potential for profits inherent in the warrants granted to the participants under the equity agreement.

69 As noted earlier, the Alberta Court of Appeal rejected a similar argument on the grounds that, notwithstanding the source for repayment and the warrants, the participants were *not* to receive under the agreements a "rate of interest varying with the profits" or a "share of profits" (at p. 212). In other words, the loan in question was not one to which s. 4 of the *Partnerships Act* applied. The respondents before this court adopt a similar position on this issue.

70 Alberta argues, persuasively in my view, that a lender does not receive a "share of the profits" within the meaning of ss. 3(3)(*d*) and 4 of the Ontario *Partnerships Act* unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. It is submitted that a lender does not share in profits merely by having a contingent right to acquire or possibly even by having the right to acquire or by owning shares of the borrower. In the case at bar, Alberta submits that all amounts which the participants were entitled to be paid were to be applied only in repayment of the principal amount due and hence they were not entitled to and did not share in C.C.B.'s profits. As for the bank group, it is submitted that in the case of the insolvency of a bank, the *Winding-up Act* and not the *Partnerships Act* or the *Bankruptcy Act* determine the priority of claims. Moreover, they argue that the transaction at hand is not one to which the *Partnerships Act* applies because the participation agreement referred to profits only as a means of determining the source of the participants' right to repayment, and because any alleged "share of the profits" would stop when the sum advanced was repaid.

71 I have already found that the Court of Appeal was correct in characterizing the advance of $255 million under the support program as a loan. In order to determine the applicability of s. 4 of the *Partnerships Act* to the facts of this case, a provision which may apply regardless of whether a partnership exists, the general question to be answered is whether this loan was made "upon such a contract as is mentioned in section 3" of the Act. If so, then, subject to any constitutional arguments not made herein, the respondents would not be entitled to recover anything in respect of the loan until the claims of the other ordinary creditors of C.C.B. are satisfied.

72 The only provisions in s. 3 of the *Partnerships Act* which make specific reference to a "contract" are s. 3(3)(*b*) and (*d*). Section 3(3)(*b*) is clearly irrelevant to this appeal. Thus, at least at first glance, the contracts in the case at bar must fall within the ambit of s. 3(3)(*d*) of the *Partnerships Act* in order to trigger the application of s. 4. The specific question then becomes whether or not the support agreements provided that the participants were to receive a "rate of interest varying with the profits" of C.C.B, or a "share of the profits arising from carrying on the business" of C.C.B. While the legal representative originally structured his s. 4 argument exclusively around the wording in s. 3(3)(*d*) of the *Partnerships Act*, he expanded this argument during oral submissions to include s. 3(3)(*a*). He submitted that, even if the transaction does not fall within the ambit of the former subsection, it clearly falls within the latter. Accordingly, another specific question to be considered is whether s. 4 of the *Partnerships Act* can be triggered by "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business" which does not involve a contract of the sort described in s. 3(3)(*d*). I will deal with both of these questions in turn.

73 Sections 3(3)(*d*) and 4 of the *Partnerships Act* originate from the now repealed *Act to Amend the Law of Partnership*, 1865 (U.K.), 28 & 29 Vict., c. 86 ("Bovill's Act"). The intent of what is now s. 3 of the *Partnerships Act* was evidently to mitigate the harshness of the old common law rule, which was that any person who shared in the profits of the partnership was deemed to be a partner, and so liable for any debts of the partnership on insolvency: *Grace v. Smith* (1775), 2 Wm. Bl. 997, 96 E.R. 587 (at p. 588 per De Grey C.J.: "Every man who has a share of the profits of a trade ought also to bear his share of the loss"); and *Waugh v. Carver* (1793), 2 Hy. Bl. 235, 126 E.R. 525.

74 The old common law rule was first modified by the decision in *Cox v. Hickman* (1860), 8 H.L.C. 268, 11 E.R. 431, which in some respects was very similar on the facts to the present case. The company of Smith and

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Son fell into financial difficulties and was unable to pay its creditors. The Smiths entered into an arrangement with five of its creditors assigning the company to them (as trustees for all of the creditors), for a term of 21 years. During that period, the trustees were to carry on the business of the company "and to pay the net income, after answering all expenses; which net income was always to be deemed the property of the two Smiths, among [all] the creditors of the Smiths" (at p. 269) [H.L.C.]. In other words, the creditors "were to be paid their debts out of the profits of their debtors' business" (*Lindley on the Law of Partnership*, 15th ed. (London: Sweet & Maxwell, 1984), at p. 104). The most significant fact for our purposes is that the repayment was to be only to the extent of the debts; when all the debts had been paid, the trustees were to hold the estate in trust for the Smiths. Financial troubles continued under the new management, and the company once again became unable to pay its debts.

75 Since at that time the law was thought to be that a person who shared in the profits was liable as a partner, the question in *Cox v. Hickman*, supra, was not, as here, whether those creditors who were being paid out of profits were to be ranked equally with subsequent creditors, but whether the former group were to be themselves liable as partners to subsequent creditors. In deciding that they were not so liable, the House of Lords is considered to have established, amongst other things, that receipt of a share of the profits is not conclusive proof of a partnership as was previously thought (*Lindley on the Law of Partnership*, at p. 104).

76 However, it is interesting to note one excerpt of the opinion of Wightman J. (one of the judges who came to advise the House of Lords in *Cox v. Hickman*) who, instead of modifying the old common rule, would simply have not applied it to the facts of the case (at p. 443 E.R.):

> It is said that a person who shares in net profits is a partner; that may be so in some cases, but not in all; and it may be material to consider in what sense the words, 'sharing in the profits' are used. In the present case, I greatly doubt whether the creditor, who merely obtains payment of a debt incurred in the business by being paid the exact amount of his debt, and no more, out of the profits of the business, can be said to share the profits. If in the present case, the property of the Smiths had been assigned to the trustees to carry on the business, and divide the net profits, not amongst those creditors who signed the deed, but amongst all the creditors, until their debts were paid, would a creditor, by receiving from time to time a rateable proportion out of the net profits, become a partner? I should think not.

In my view, the undesirability of the result foreseen by Wightman J. is equally compelling in the context of ss. 3(3)(*d*) and 4 of the *Partnerships Act*.

77 Historically, s. 3(3)(*d*) of the *Partnerships Act* appears to refer to loans similar to those involved in *Sukloff v. Rushforth*, supra, namely, loans in which the creditor advances money to the debtor on the terms that it shall be repaid with interest, and in addition the creditor is to receive a share of the profits over and above any payments on principal until the amount is paid off, as opposed to loans such as those in the present case where the share of the profits is used solely to repay the principal. In other words, s. 3(3)(*d*) applied to loans which had no cap or limit on the amount to be paid to the creditor from the profits of the debtor's business or which had a cap unrelated to the principal owing on the debt.

78 It is not entirely clear in *Sukloff v. Rushforth*, supra, whether the lender actually received any of the profits of the company via the arrangement for 50 per cent of the profits. However, in many older cases it is clear that the lender did receive interest and the stated share of the profits for a period, and then claimed for the *entire amount* of the principal on bankruptcy of the debtor. In these cases ss. 2(3)(*d*) and 3 of the *Partnership Act*, 1890 (U.K.), 53 & 54 Vict., c. 39 (similar to ss. 3(3)(*d*) and 4 of the *Partnerships Act*) were applied to subordinate the claims: see *Ex parte Taylor; Re Grason* (1879), 12 Ch. D. 366 (C.A.); *Re Stone* (1886), 33 Ch. D. 541; *Re Hildesheim*, [1893] 2 Q.B. 357 (C.A.); *Re Mason; Ex parte Bing*, [1899] 1 Q.B. 810; and *Re Fort; Ex parte Schofield*, [1897] 2 Q.B. 495 (C.A.). These sections of the *Partnership Act*, 1890 essentially repeated Bovill's Act so it seems reasonable that this was the specific situation envisaged by the Act.

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79 Contrary to the oral submission of the legal representative, *Re Young; Ex parte Jones*, [1896] 2 Q.B. 484, is not inconsistent with the distinction I am drawing. There, Mr. Jones lent money to Mr. Young which was to be used to pay the expenses of Mr. Young's business. The terms of the agreement provided that, in return for the use of this sum, Jones was to be paid a fixed weekly sum out of the profits of the business. When Young became insolvent, Jones claimed for the entire amount of principal, without making allowance for the amounts received by virtue of the weekly payments. In other words, the weekly sum received by Jones out of profits was not for the purpose of repaying the principal sum of the debt. Thus, *Re Young* is clearly distinguishable from the facts of this case and should not be seen as foreclosing the interpretation of s. 3(3)(*d*) that I am advancing.

80 In addition, s. 3(3)(*a*) of the *Partnerships Act* provides strong support for the distinction between profits as the source of repayment, and a share in the profits, with any repayment of a fixed debt falling into the former category. Indeed, it provides that:

> (*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such.

This seems to preclude any reading of s. 3(3)(*d*) which would catch debts which are to be repaid "out of profits." In this respect, it is interesting to note that the authors of *Lindley on the Law of Partnership* are of the view that the equivalent of s. 3(3)(*a*), not s. 3(3)(*d*), applies to cases such as *Cox v. Hickman*, supra, where, as we have seen, an arrangement similar to the one at bar was involved (at p. 108).

81 For the foregoing reasons, I would conclude that any fixed debt to be repaid out of profits does not in itself constitute a "share of the profits" within the meaning of s. 3(3)(*d*) of the *Partnerships Act*. As argued by Alberta, a lender does not receive a "share of the profits" under this provision unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan.

82 Having said this, the question of whether the support agreements provided that the participants were to receive a "rate of interest varying with the profits" of C.C.B., or a "share of the profits arising from carrying on the business" of C.C.B., as to trigger s. 4 of the *Partnerships Act*, may be readily answered. Clearly, the participants were not to receive in return for the advance of $255 million a rate of interest varying with C.C.B.'s profits. The rate of interest to be paid was fixed according to the prime rate and was contingent on whether or not the equity agreement could be carried out. As for C.C.B.'s profits, they merely represented the source from which the participants were to be repaid their advance. In this respect, I entirely agree with the following excerpt taken from the reasons of Harradence J.A. in the case at bar (at p. 211):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the Support Group Participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of 'joint benefit'. Since the sums to be received by the Participants were limited to repayment of monies advanced, with a contingent right to interest, the source of the repayment monies is not relevant and, with respect, the learned Chambers Judge erred in concluding the Participants were 'sharing the profits' in this respect.

83 The participants had a fixed debt which would be repaid in part by the moneys received from the syndicated portion of the portfolio assets and in part by C.C.B.'s pre-tax income. With the exception of the contingent interest at prime rate, under no circumstances were the payments from the pre-tax income to be applied to anything but the repayment of the loan. All amounts that the participants were entitled to be paid were to be applied only in repayment of the principal amount of the loan. Once the loan was fully repaid, all payments from C.C.B.'s pre-tax income were to stop. Accordingly, I find that the participants were not to receive a "share of the profits" of C.C.B.

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within the meaning of s. 3(3)(*d*) of the *Partnerships Act* by virtue of the repayment scheme for the $255 million advance. I also do not accept that the contemplated granting of warrants under the highly contingent circumstances of this case alters this conclusion.

84 The question then is whether s. 4 of the *Partnerships Act* can be triggered by an arrangement falling under s. 3(3)(*a*). Indeed, as previously noted, the legal representative takes the alternative position that, even if s. 3(3)(*d*) does not apply, the transaction in this case is surely one contemplating "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business." While one cannot seriously dispute this proposition, the fact remains that s. 4 cannot apply unless "money has been advanced by way of loan upon such a contract as is mentioned in section 3." The first point to note is that s. 3(3)(*a*) of the *Partnerships Act* makes no reference whatsoever to a "contract" and thus appears to be beyond the realm of s. 4. Clearly, the legislature could have chosen a more general term than "contract" in s. 4 had it wished this postponement provision to apply to every transaction described in s. 3. The same could also be said about the absence of the word "loan" in s. 3(3)(*a*). It is not without significance that we were not presented with any jurisprudence in which a person who had a fixed debt to be paid out of profits (i.e., who would fall under s. 3(3)(*a*) and not s. 3(3)(*d*)) was subordinated under the Act.

85 Further, if the policy on which s. 4 of the *Partnerships Act* is based is that a person who reaps the rewards of profits must share some risk, then this would not apply to a creditor with a fixed debt, notwithstanding that the fund or source of repayment is profits, because his or her total return will not vary with the profitability of the company.

86 From the above, I conclude that s. 4 of the *Partnerships Act* cannot be triggered by what is described in s. 3(3)(*a*) as "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business," which does not involve a contract of the sort described in s. 3(3)(*d*). The present case may very well fall within s. 3(3)(*a*) of the Act. However, that section only deals with a guideline for determining whether or not a partnership has been created, an issue which is not raised in this appeal. Contrary to s. 3(3)(*d*) of the *Partnerships Act*, s. 3(3)(*a*) does not have the added function of triggering the postponement provision of the Act. As the participants were not to receive a "rate of interest varying with the profits" of C.C.B. or a "share of the profits arising from carrying on the business" of C.C.B., their claims for the return of the moneys advanced cannot be postponed under s. 4.

87 Accordingly, I would dismiss this ground of appeal. The Court of Appeal did not err in declining to postpone the respondents' claims under s. 4 of the *Partnerships Act*.

C. Equitable subordination

88 In the further alternative, the legal representative submits that even if the transaction in question is a loan and the *Partnerships Act* does not apply, the participants' claims should be subordinated on equitable grounds based on the United States doctrine of "equitable subordination."

89 More specifically, it is argued that the equitable jurisdiction of superior courts gives them authority in insolvency matters to subordinate claims that, while valid as against the insolvent's estate, arise from or are connected with conduct prejudicial to the interests of other creditors. While the legal representative does not assert that the conduct of the participants was fraudulent or worthy of censure, he argues that the participants acted to the detriment of the ordinary creditors of C.C.B. in ways (which I shall outline below) that should invoke this equitable jurisdiction. Both the bank group and Alberta challenge the proposition that equitable subordination is available under Canadian law in insolvency matters. In addition, the respondents argue that the facts of this case do not call for the application of equitable principles.

90 This issue does not appear to have been raised before Wachowich J. or the Court of Appeal and consequently this court does not have the benefit of any findings of fact as to the actual or potential prejudice suffered by C.C.B.'s

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depositors and other creditors as a result of the conduct of the participants. In this respect, the evidence presented to this court by the legal representative is limited to certain excerpts of the Estey report, incorporated by reference in the affidavit of Mr. Allan Taylor of the Royal Bank of Canada (C.O.A. at pp. 236-41). The excerpts in question are those found at pp. 114-21 of the Estey report under the heading "Flaws in the Support Program."

91 This court also does not have the benefit of the insight of the courts below as to whether or not, in the first place, the doctrine of equitable subordination should become part of Canadian insolvency law. As I see the matter, however, it is not necessary in the circumstances of this case to answer the question of whether a comparable equitable doctrine should exist in Canadian law and I expressly refrain from doing so. Assuming, for the sake of argument only, that Canadian courts have the power in insolvency matters to subordinate otherwise valid claims to those of other creditors on equitable grounds relating to the conduct of these creditors inter se, this court has been presented with insufficient grounds to justify the exercise of such a power in the case at bar. Briefly put, the reasons and limited evidence advanced by the legal representative before this court disclose neither inequitable conduct on the part of the participants nor injury to the ordinary creditors of C.C.B. as a result of the alleged misconduct.

92 As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute: see *Re Mobile Steel Co.*, 563 F. 2d 692 (5th Circ., 1977), at p. 700; *Re Multiponics Inc.*, 622 F. 2d 709 (5th Circ., 1980); A. DeNatale and P.B. Abram, "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Law. 417, at p. 423; and L.J. Crozier, "Equitable Subordination of Claims in Canadian Bankruptcy Law" (1992), 7 C.B.R. (3d) 40, at pp. 41-42. Even if this court were to accept that a comparable doctrine to equitable subordination should exist in Canadian law, I do not view the facts of this case as giving rise to the "inequitable conduct" and ensuring "detriment" necessary to trigger its application.

93 In this regard, the actions cited by the legal representative as being detrimental to the ordinary creditors of C.C.B., thereby giving rise to equitable subordination, come down to two elements: (1) the press release of March 25, 1985 issued by the Department of Finance announcing to the general public that the support program would leave C.C.B. "in a strong position of solvency" and that sufficient funds were being advanced "to ensure solvency"; and (2) the flaws in the support program outlined in the Estey report and described by the legal representative as (a) the inadequacy of the support program to ensure C.C.B.'s solvency, (b) the accounting treatment disguised the fact that the participation agreement required the entire amount advanced to be repaid, (c) the accounting treatment used by the bank group gave rise to tax benefits not available to ordinary depositors, (d) the participation agreement allegedly obliged C.C.B. to apply all amounts received on the syndicated portion of the portfolio assets to the participants, (e) the warrants would have the effect of prohibiting C.C.B. from raising funds in the equity market since they would enable the participants to acquire 75 per cent of the common shares of C.C.B. up to 10 years after the advances had been paid in full, and (f) after making their advances and receiving their participation certificates, the bank group ceased dealing with C.C.B. in the normal manner.

94 At the outset, I note that many of the actions relied on by the legal representative cannot be attributable to the participants. For example, the press release was not issued by the respondents and the accounting treatment given by C.C.B. to the advance of $255 million simply followed the instructions given by the Office of the Inspector General of Banks. Thus, even if some inequitable connotation could be given to these actions, they would not represent misconduct on the part of the respondents to whom the ordinary creditors of C.C.B. are now attempting to rank in priority.

95 Another difficulty with the legal representative's submission, however, is that I fail to see anything remotely inequitable in the conduct complained of. With respect to the press release, the evidence does not show that the participants were necessarily of a different opinion from that set out in the press release. Certainly, they advanced the funds on the condition that the Inspector General of Banks provide them with an opinion letter confirming

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the solvency of C.C.B. on the infusion of the proposed funds. As for the flaws in the support program, there is nothing to show that the participants' plans were other than well intentioned. As stated at the beginning of these reasons, it is beyond the scope of this appeal to engage in a detailed review of the reasons which led to the failure of the support program. Suffice it to say that the assertions of the legal representative in substance do not show wrongdoing or unfairness on the part of the participants, but merely show that the support program did not work, and perhaps with hindsight, offer some explanations as to why.

96 In any event, it does not appear to have been suggested at any time in the courts below nor was any evidence led to suggest that any creditor of C.C.B. was misled by any of the above actions or that the press release, accounting treatment or any flaw in the support program operated to cause any creditor to act to its detriment. Thus, even if this court were to find that the participants acted in an inequitable manner in their dealings with C.C.B. and its depositors and other creditors, we do not have a shred of evidence upon which to conclude that the improper conduct resulted in actual harm to the ordinary creditors of C.C.B. now before this court. One can only speculate that depositors and other creditors relied on the press release or accounting treatment and thereby suffered damages. We have been offered no United States' decision in which mere speculation of harm to other creditors has been found sufficient to meet the second requirement of the doctrine of equitable subordination. Of course, the ordinary creditors of C.C.B. who appear before this court have, to a varying extent, suffered from the winding-up of C.C.B., just as any creditor (including the participants) suffers following an insolvency or bankruptcy. The legal representative has not shown, however, that these ordinary creditors have suffered identifiable prejudice attributable specifically to the alleged misconduct of the participants.

97 Accordingly, I would reject this alternative ground of appeal. Even if equitable subordination is available under Canadian law, a question which I leave open for another day, the facts of this case do not call for an intervention with the pari passu ranking of the respondents in the name of equity.

D. The $5 million attributable to the syndicated portion of the portfolio assets

98 The last matter to be addressed pertains to the moneys recovered from the portfolio assets and attributable to the syndicated portion thereof. In his oral submissions, the legal representative argued that the learned chambers judge erred in allowing the participants to recover funds from the syndicated portion of the portfolio assets. A similar submission was made in the Alberta Court of Appeal but was summarily rejected (at p. 212). As I understand it, the argument is one of inconsistency between the treatment given, on the one hand, to the respondents' claim for their portion of the moneys recovered from the portfolio assets and, on the other hand, to the respondents' claim for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets. According to the legal representative, these two claims stem from the same financial arrangement and cannot be given different legal effects. It is argued that, if the advance of $255 million is really an investment of capital, as found by Wachowich J., then it is wrong to rank the respondents behind the ordinary creditors of C.C.B. only with respect to the claim for what is not repaid by moneys recovered from the portfolio assets. Similarly, if the transaction is really a loan but the loan is one to which s. 4 of the *Partnerships Act* applies, then both claims ought to be postponed.

99 This submission has already been answered by my conclusion that the advance of $255 million to C.C.B. was substantially in the nature of a loan and that the *Partnerships Act* does not apply to postpone the loan.

VI. Disposition

100 For the foregoing reasons, I would dismiss the appeal with costs here and in the courts below. As found by the learned chambers judge and upheld by the Court of Appeal, the participants are entitled to their proportionate share of the moneys recovered from the portfolio assets of C.C.B. in the manner set out in the participation agreement, that is, to the extent such recoveries exceed the C.C.B. portion of each of the portfolio assets. Moreover, as found by the Court of Appeal, the respondents are entitled to rank pari passu with the ordinary creditors of C.C.B. for all

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moneys advanced pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets.

Appeal dismissed.

Footnotes

* Stevenson J. took no part in the judgment.

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TAB 6

CITATION: Kitchener Frame Limited (Re), 2012 ONSC 234
COURT FILE NO.: CV-11-9298-00CL
DATE: 20120203

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

2012 ONSC 234 (CanLII)

IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED

RE: **IN THE MATTER OF THE CONSOLIDATED PROPOSAL OF KITCHENER FRAME LIMITED AND THYSSENKRUPP BUDD CANADA, INC., Applicants**

BEFORE: **MORAWETZ J.**

COUNSEL: **Edward A. Sellers and Jeremy E. Dacks, for the Applicants**

Hugh O'Reilly, Non-Union Representative Counsel

L. N. Gottheil, Union Representative Counsel

John Porter, for Ernst & Young Inc., Proposal Trustee

Michael McGraw, for CIBC Mellon Trust Company

Deborah McPhail, for Financial Services Commission of Ontario

ENDORSEMENT

[1] At the conclusion of this unopposed motion, the requested relief was granted. Counsel indicated that it would be helpful if the court could provide reasons in due course, specifically on the issue of a third-party release in the context of a proposal under Part III of the *Bankruptcy and Insolvency Act* ("*BIA*").

[2] Kitchener Frame Limited ("KFL") and Thyssenkrupp Budd Canada Inc. ("Budd Canada"), and together with KFL, (the "Applicants"), brought this motion for an order (the "Sanction Order") to sanction the amended consolidated proposal involving the Applicants dated August 31, 2011 (the "Consolidated Proposal") pursuant to the provisions of the *BIA*. Relief was also sought authorizing the Applicants and Ernst & Young Inc., in its capacity as proposal trustee

of each of the Applicants (the "Proposal Trustee") to take all steps necessary to implement the Consolidated Proposal in accordance with its terms.

[3] The Applicants submit that the requested relief is reasonable, that it benefits the general body of the Applicants' creditors and meets all other statutory requirements. Further, the Applicants submit that the court should also consider that the voting affected creditors (the "Affected Creditors") unanimously supported the Consolidated Proposal. As such, the Applicants submit that they have met the test as set out in s. 59(2) of the *BIA* with respect to approval of the Consolidated Proposal.

[4] The motion of the Applicants was supported by the Proposal Trustee. The Proposal Trustee filed its report recommending approval of the Consolidated Proposal and indicated that the Consolidated Proposal was in the best interests of the Affected Creditors.

[5] KFL and Budd Canada are inactive entities with no operating assets and no material liquid assets (other than the Escrow Funds). They do have significant and mounting obligations including pension and other non-pension post-employment benefit ("OPEB") obligations to the Applicants' former employees and certain former employees of Budcan Holdings Inc. or the surviving spouses of such former employees or others who may be entitled to claim through such persons in the *BIA* proceedings, including the OPEB creditors.

[6] The background facts with respect to this motion are fully set out in the affidavit of Mr. William E. Aziz, sworn on September 13, 2011.

[7] Affiliates of Budd Canada have provided up to date funding to Budd Canada to enable Budd Canada to fund, on behalf of KFL, such pension and OPEB obligations. However, given that KFL and Budd Canada have no active operations, the *status quo* is unsustainable.

[8] The Applicants have acknowledged that they are insolvent and, in connection with the *BIA* proposal, proceedings were commenced on July 4, 2011.

[9] On July 7, 2011, Wilton-Siegel J. granted Procedural Consolidation Orders in respect of KFL and Budd Canada which authorized the procedural consolidation of the Applicants and permitted them to file a single consolidated proposal to their creditors.

[10] The Orders of Wilton-Siegel J. also appointed separate representative counsel to represent the interests of the Union and Non-Union OPEB creditors and further authorized the Applicants to continue making payments to Blue Cross in respect of the OPEB Claims during the *BIA* proposal proceedings.

[11] On August 2, 2011, an order was granted extending the time to file a proposal to August 19, 2011.

[12] The parties proceeded to negotiate the terms of the Consolidated Proposal, which meetings involved the Applicants, the Proposal Trustee, senior members of the CAW, Union Representative Counsel and Non-Union Representative Counsel.

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[13] An agreement in principle was reached which essentially provided for the monetization and compromise of the OPEB claims of the OPEB creditors resulting in a one-time, lump-sum payment to each OPEB creditor term upon implementation of the Consolidated Proposal. The Consolidated Proposal also provides that the Applicants and their affiliates will forego any recoveries on account of their secured and unsecured inter-company claims, which total approximately $120 million. A condition precedent was the payment of sufficient funds to the Pension Fund Trustee such that when such funds are combined with the value of the assets held in the Pension Plans, the Pension Fund Trustee will be able to fully annuitize the Applicants' pension obligations and pay the commuted values to those creditors with pension claims who so elected so as to provide for the satisfaction of the Applicants' pension obligations in full.

[14] On August 19, 2011, the Applicants filed the Consolidated Proposal. Subsequent amendments were made on August 31, 2011 in advance of the creditors' meeting to reflect certain amendments to the proposal.

[15] The creditors' meeting was held on September 1, 2011 and, at the meeting, the Consolidated Proposal, as amended, was accepted by the required majority of creditors. Over 99.9% in number and over 99.8% in dollar value of the Affected Creditors' Class voted to accept the Consolidated Proposal. The Proposal Trustee noted that all creditors voted in favour of the Consolidated Proposal, with the exception of one creditor, Canada Revenue Agency (with 0.1% of the number of votes representing 0.2% of the value of the vote) who attended the meeting but abstained from voting. Therefore, the Consolidated Proposal was unanimously approved by the Affected Creditors. The Applicants thus satisfied the required "double majority" voting threshold required by the *BIA*.

[16] The issue on the motion was whether the court should sanction the Consolidated Proposal, including the substantive consolidation and releases contained therein.

[17] Pursuant to s. 54(2)(d) of the *BIA*, a proposal is deemed to be accepted by the creditors if it has achieved the requisite "double majority" voting threshold at a duly constituted meeting of creditors.

[18] The *BIA* requires the proposal trustee to apply to court to sanction the proposal. At such hearing, s. 59(2) of the *BIA* requires that the court refuse to approve the proposal where its terms are not reasonable or not calculated to benefit the general body of creditors.

[19] In order to satisfy s. 59(2) test, the courts have held that the following three-pronged test must be satisfied:

(a) the proposal is reasonable;

(b) the proposal is calculated to benefit the general body of creditors; and

(c) the proposal is made in good faith.

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See *Mayer (Re)* (1994), 25 CBR (3d) 113; *Steeves (Re)*, 25 CBR (4th) 317; *Magnus One Energy Corp. (Re)*, 53 CBR (5th) 243.

[20] The first two factors are set out in s. 59(2) of the *BIA* while the last factor has been implied by the court as an exercise of its equitable jurisdiction. The courts have generally taken into account the interests of the debtor, the interests of the creditors and the interests of the public at large in the integrity of the bankruptcy system. See *Farrell (Re)* 2003, 40 CBR (4th) 53.

[21] The courts have also accorded substantial deference to the majority vote of creditors at a meeting of creditors; see *Lofchik, Re* [1998] O.J. No. 322 (Ont. Bktcy). Similarly, the courts have also accorded deference to the recommendation of the proposal trustee. See *Magnus One, supra*.

[22] With respect to the first branch of the test for sanctioning a proposal, the debtor must satisfy the court that the proposal is reasonable. The court is authorized to only approve proposals which are reasonable and calculated to benefit the general body of creditors. The court should also consider the payment terms of the proposal and whether the distributions provided for are adequate to meet the requirements of commercial morality and maintaining the integrity of the bankruptcy system. For a discussion on this point, see *Lofchik, supra*, and *Farrell, supra*.

[23] In this case, the Applicants submit that, if the Consolidated Proposal is sanctioned, they would be in a position to satisfy all other conditions precedent to closing on or prior to the date of the proposal ("Proposal Implementation Date").

[24] With respect to the treatment of the Collective Bargaining Agreements, the Applicants and the CAW brought a joint application before the Ontario Labour Relations Board ("OLRB") on an expedited basis seeking the OLRB's consent to an early termination of the Collective Bargaining Agreements. Further, the CAW has agreed to abandon its collective bargaining rights in connection with the Collective Bargaining Agreements.

[25] With respect to the terms and conditions of a Senior Secured Loan Agreement between Budd Canada and TK Finance dated as of December 22, 2010, TK Finance provided a secured creditor facility to the Applicants to fund certain working capital requirements before and during the *BIA* proposal proceedings. As a result of the approval of the Consolidated Proposal at the meeting of creditors, TK Finance agreed to provide additional credit facilities to Budd Canada such that the Applicants would be in a position to pay all amounts required to be paid by or on behalf of the Applicants in connection with the Consolidated Proposal.

[26] On the issue as to whether creditors will receive greater recovery under the Consolidated Proposal than they would receive in the bankruptcy, it is noted that creditors with Pension Claims are unaffected by the Consolidated Proposal. The Consolidated Proposal provides for the satisfaction of Pension Claims in full as a condition precedent to implementation.

[27] With respect to Affected Creditors, the Applicants submit that they will receive far greater recovery from distributions under the Consolidated Proposal than the Affected Creditors

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would receive in the event of the bankruptcies of the Applicants. (See Sanction Affidavit of Mr. Aziz at para. 61.)

[28] The Proposal Trustee has stated that the Consolidated Proposal is advantageous to creditors for the reasons outlined in its Report and, in particular:

(a) the recoveries to creditors with claims in respect of OPEBs are considerably greater under the Amended Proposal than in a bankruptcy;

(b) payments under the Amended Proposal are expected in a timely manner shortly after the implementation of the Amended Proposal;

(c) the timing and quantum of distributions pursuant to the Amended Proposal are certain while distributions under a bankruptcy are dependent on the results of litigation, which cannot be predicted with certainty; and

(d) the Pension Plans (as described in the Proposal Trustee's Report) will be fully funded with funds from the Pension Escrow (as described in the Proposal Trustee's Report) and, if necessary, additional funding from an affiliate of the Companies if the funds in the Pension Escrow are not sufficient. In a bankruptcy, the Pension Plans may not be fully funded.

[29] The Applicants take the position that the Consolidated Proposal meets the requirements of commercial morality and maintains the integrity of the bankruptcy system, in light of the superior coverage to be afforded to the Applicants' creditors under the Consolidated Proposal than in the event of bankruptcy.

[30] The Applicants also submit that substantive consolidation inherent in the proposal will not prejudice any of the Affected Creditors and is appropriate in the circumstances. Although not expressly contemplated under the *BIA*, the Applicants submit that the court may look to its incidental, ancillary and auxiliary jurisdiction under s. 183 of the *BIA* and its equitable jurisdiction to grant an order for substantive consolidation. See *Ashley v. Marlow Group Private Portfolio Management Inc*. (2006) 22 CBR (5th) 126 (Ont. S.C.J.) (Commercial List). In deciding whether to grant substantive consolidation, courts have held that it should not be done at the expense of, or possible prejudice of, any particular creditor. See *Ashley, supra*. However, counsel submits that this court should take into account practical business considerations in applying the *BIA*. See *A & F Baillargeon Express Inc. (Trustee of) (Re)* (1993), 27 CBR (3d) 36.

[31] In this case, the Applicants submit that substantive consolidation inherent in the Consolidated Proposal is appropriate in the circumstances due to, among other things, the intertwined nature of the Applicants' assets and liabilities. Each Applicant had substantially the same creditor base and known liabilities (other than certain Excluded Claims). In addition, KFL had no cash or cash equivalents and the Applicants are each dependant on the Escrow Funds and borrowings under the Restated Senior Secured Loan Agreement to fund the same underlying pension and OPEB obligations and costs relating to the Proposal Proceedings.

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[32] The Applicants submit that creditors in neither estate will be materially prejudiced by substantive consolidation and based on the fact that no creditor objected to the substantial consolidation, counsel submits the Consolidated Proposal ought to be approved.

[33] With respect to whether the Consolidated Proposal is calculated to benefit the general body of creditors, TK Finance would be entitled to priority distributions out of the estate in a bankruptcy scenario. However, the Applicants and their affiliates have agreed to forego recoveries under the Consolidated Proposal on account of their secured and unsecured inter-company claims in the amount of approximately $120 million, thus enhancing the level of recovery for the Affected Creditors, virtually all of whom are OPEB creditors. It is also noted that TK Finance will be contributing over $35 million to fund the Consolidated Proposal.

[34] On this basis, the Applicants submit that the Consolidated Proposal is calculated to benefit the general body of creditors.

[35] With respect to the requirement of the proposal being made in good faith, the debtor must satisfy the court that it has provided full disclosure to its creditors of its assets and encumbrances against such assets.

[36] In this case, the Applicants and the Proposal Trustee have involved the creditors pursuant to the Representative Counsel Order, and through negotiations with the Union Representative Counsel and Non-Union Representative Counsel.

[37] There is also evidence that the Applicants have widely disseminated information regarding their *BIA* proposal proceedings through the media and through postings on the Proposal Trustee's website. Information packages have also prepared by the Proposal Trustee for the creditors.

[38] Finally, the Proposal Trustee has noted that the Applicants' conduct, both prior to and subsequent to the commencement of the *BIA* proposal proceedings, is not subject to censure in any respect and that the Applicants' have acted in good faith.

[39] There is also evidence that the Consolidated Proposal continues requisite statutory terms. The Consolidated Proposal provides for the payment of preferred claims under s. 136(1) of the *BIA*.

[40] Section 7.1 of the Consolidated Proposal contains a broad release in favour of the Applicants and in favour of certain third parties (the "Release"). In particular, the Release benefits the Proposal Trustee, Martinrea, the CAW, Union Representative Counsel, Non-Union Representative Counsel, Blue Cross, the Escrow Agent, the present and former shareholders and affiliates of the Applicants (including Thyssenkrupp USA, Inc. ("TK USA"), TK Finance, Thyssenkrupp Canada Inc. ("TK Canada") and Thyssenkrupp Budd Company), as well as their subsidiaries, directors, officers, members, partners, employees, auditors, financial advisors, legal counsel and agents of any of these parties and any person liable jointly or derivatively through any or all of the beneficiaries of the of the release (referred to individually as a "Released Party").

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[41] The Release covers all Affected Claims, Pension Claims and Escrow Fund Claims existing on or prior to the later of the Proposal Implementation Date and the date on which actions are taken to implement the Consolidated Proposal.

[42] The Release provides that all such claims are released and waived (other than the right to enforce the Applicants' or Proposal Trustee's obligations under the Consolidated Proposal) to the full extent permitted by applicable law. However, nothing in the Consolidated Proposal releases or discharges any Released Party for any criminal or other wilful misconduct or any present or former directors of the Applicants with respect to any matters set out in s. 50(14) of the *BIA*. Unaffected Claims are specifically carved out of the Release.

[43] The Applicants submit that the Release is both permissible under the *BIA* and appropriately granted in the context of the *BIA* proposal proceedings. Further, counsel submits, to the extent that the Release benefits third parties other than the Applicants, the Release is not prohibited by the *BIA* and it satisfies the criteria that has been established in granting third-party releases under the *Companies' Creditors Arrangement Act* ("*CCAA*"). Moreover, counsel submits that the scope of the Release is no broader than necessary to give effect to the purpose of the Consolidated Proposal and the contributions made by the third parties to the success of the Consolidated Proposal.

[44] No creditors or stakeholders objected to the scope of the Release which was fully disclosed in the negotiations, including the fact that the inclusion of the third-party releases was required to be part of the Consolidated Proposal. Counsel advises that the scope of the Release was referred to in the materials sent by the Proposal Trustee to the Affected Creditors prior to the meeting, specifically discussed at the meeting and adopted by the unanimous vote of the voting Affected Creditors.

[45] Counsel also submits that there is no provision in the *BIA* that clearly and expressly precludes the Applicants from including the Release in the Consolidated Proposal as long as the court is satisfied that the Consolidated Proposal is reasonable and for the general benefit of creditors.

[46] In this respect, it seems to me, that the governing statutes should not be technically or stringently interpreted in the insolvency context but, rather, should be interpreted in a manner that is flexible rather than technical and literal, in order to deal with the numerous situations and variations which arise from time to time. Further, taking a technical approach to the interpretation of the *BIA* would defeat the purpose of the legislation. See *NTW Management Group (Re)* (1994), 29 CBR (3d) 139; *Olympia & York Developments Ltd. (Re)* (1995), 34 CBR (3d) 93; *Olympia & York Developments Ltd. (Re)* (1997), 45 CBR (3d) 85.

[47] Moreover, the statutes which deal with the same subject matter are to be interpreted with the presumption of harmony, coherence and consistency. See *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24. This principle militates in favour of adopting an interpretation of the *BIA* that is harmonious, to the greatest extent possible, with the interpretation that has been given to the *CCAA*.

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[48] Counsel points out that historically, some case law has taken the position that s. 62(3) of the *BIA* precludes a proposal from containing a release that benefits third parties. Counsel submits that this result is not supported by a plain meaning of s. 62(3) and its interaction with other key sections in the *BIA*.

[49] Subsection 62(3) of the *BIA* reads as follows:

> (3) The acceptance of a proposal by a creditor does not release any person who would not be released under this Act by the discharge of the debtor.

[50] Counsel submits that there are two possible interpretations of this subsection:

(a) It prohibits third party releases – in other words, the phrase "does not release any person" is interpreted to mean "cannot release any person"; or

(b) It simply states that acceptance of a proposal does not automatically release any party other than the debtor – in other words, the phrase "does not release any person" is interpreted to mean "does not release any person without more"; it is protective not prohibitive.

[51] I agree with counsel's submission that the latter interpretation of s. 62(3) of the *BIA* conforms with the grammatical and ordinary sense of the words used. If Parliament had intended that only the debtor could be released, s. 62(3) would have been drafted more simply to say exactly that.

[52] Counsel further submits that the narrow interpretation would be a stringent and inflexible interpretation of the *BIA*, contrary to accepted wisdom that the *BIA* should be interpreted in a flexible, purposive manner.

[53] The *BIA* proposal provisions are designed to offer debtors an opportunity to carry out a going concern or value maximizing restructuring in order to avoid a bankruptcy and related liquidation and that these purposes justify taking a broad, flexible and purposive approach to the interpretation of the relevant provisions. This interpretation is supported by *Ted Leroy Trucking Ltd. (Re)*, 2010 SCC 60.

[54] Further, I agree with counsel's submissions that a more flexible purposive interpretation is in keeping with modern statutory principles and the need to give purposive interpretation to insolvency legislation must start from the proposition that there is no express prohibition in the *BIA* against including third-party releases in a proposal. At most, there are certain limited constraints on the scope of such releases, such as in s. 179 of the *BIA*, and the provision dealing specifically with the release of directors.

[55] In the absence of an express prohibition against including third-party releases in a proposal, counsel submits that it must be presumed that such releases are permitted (subject to compliance with any limited express restrictions, such as in the case of a release of directors). By extension, counsel submits that the court is entitled to approve a proposal containing a third-

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party release if the court is able to satisfy itself that the proposal (including the third-party release) is reasonable and for the general benefit for creditors such that all creditors (including the minority who did not vote in favour of the proposal) can be required to forego their claims against parties other than the debtors.

[56] The Applicants also submit that s. 62(3) of the *BIA* can only be properly understood when read together with other key sections of the *BIA*, particularly s. 179 which concerns the effect of an order of discharge:

> 179. An order of discharge does not release a person who at the time of the bankruptcy was a partner or co-trustee with the bankrupt or was jointly bound or had made a joint contract with the bankrupt, or a person who was surety or in the nature of a surety for the bankrupt.

[57] The order of discharge of a bankrupt has the effect of releasing the bankrupt from all claims provable in bankruptcy (section 178(2) *BIA*). In the absence of s. 179, this release could result in the automatic release at law of certain types of claims that are identified in s. 179. For example, under guarantee law, the discharge of the principal debt results in the automatic discharge of a guarantor. Similarly, counsel points out the settlement or satisfaction of a debt by one joint obligor generally results in the automatic release of both joint obligors. Section 179 therefore serves the limited purpose of altering the result that would incur at law, indicating that the rule that the *BIA* generally is that there is no automatic release of third-party guarantors of co-obligors when a bankrupt is discharged.

[58] Counsel submits that s. 62(3), which confirms that s. 179 applies to a proposal, was clearly intended to fulfil a very limited role – namely, to confirm that there is no automatic release of the specific types of co-obligors identified in s. 179 when a proposal is approved by the creditors and by the court. Counsel submits that it does not go further and preclude the creditors and the court from approving a proposal which contains the third-party release of the types of co-obligors set out in s. 179. I am in agreement with these submissions.

[59] Specific considerations also apply when releasing directors of a debtor company. The *BIA* contains specific limitations on the permissible scope of such releases as set out in s. 50(14). For this reason, there is a specific section in the *BIA* proposal provisions outlining the principles governing such a release. However, counsel argues, the presence of the provisions outlining the circumstances in which a proposal can contain a release of claims against the debtor's directors does not give rise to an inference that the directors are the only third parties that can be released in a proposal. Rather, the inference is that there are considerations applicable to a release or compromise of claims against directors that do not apply generally to other third parties. Hence, it is necessary to deal with this particular type of compromise and release expressly.

[60] I am also in agreement with the alternative submissions made by counsel in this area to the effect that if s. 62(3) of the *BIA* operates as a prohibition it refers only to those limitations that are expressly identified in the *BIA*, such as in s. 179 of the *BIA* and the specific limitations on the scope of releases that can benefit directors of the debtor.

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[61] Counsel submits that the Applicants' position regarding the proper interpretation of s. 62(3) of the *BIA* and its place in the scheme of the *BIA* is consistent with the generally accepted principle that a proposal under the *BIA* is a contract. See *Metcalfe & Mansfield Alternative Investments II Corp. (Ltd.)*, 2008 ONSC 587; *Employers' Liability Assurance Corp. v. Ideal Petroleum (1953) Ltd.*, [1978] 1 SCR 230; and *Society of Composeurs, Authors & Music Publishers of Canada v. Armitage* (2000), 20 CBR (4th) 160 (C.A.). Consequently, counsel submits that parties are entitled to put anything into a proposal that could lawfully be incorporated into any contract (see *Air Canada (Re)* (2004), 2 CBR (5th) 4) and that given that the prescribed majority creditors have the statutory right under the *BIA* to bind a minority, however, this principle is subject to any limitations that are contained in the express wording of the *BIA*.

[62] On this point, it seems to me, that any provision of the *BIA* which purports to limit the ability of the debtor to contract with its creditors should be clear and explicit. To hold otherwise would result in severely limiting the debtor's ability to contract with its creditors, thereby the decreasing the likelihood that a viable proposal could be reached. This would manifestly defeat the purpose of the proposal provisions of the *BIA*.

[63] The Applicants further submit that creditors' interests – including the interests of the minority creditors who do not vote in favour of a proposal containing a third-party release – are sufficiently protected by the overriding ability of a court to refuse to approve a proposal with an overly broad third-party release, or where the release results in the proposal failing to demonstrate that it is for the benefit of the general body of creditors. The Applicants submit that the application of the *Metcalfe* criteria to the release is a mechanism whereby this court can assure itself that these preconditions to approve the Consolidated Proposal contained in the Release have been satisfied.

[64] The Applicants acknowledge that there are several cases in which courts have held that a *BIA* proposal that includes a third-party release cannot be approved by the court but submits that these cases are based on a mistaken premise, are readily distinguishable and do not reflect the modern approach to Canadian insolvency law. Further, they submit that none of these cases are binding on this court and should not be followed.

[65] In *Kern Agencies Ltd. (No. 2) (Re)* (1931), 13 CBR 11, the court refused to approve a proposal that contained a release of the debtor's directors, officers and employees. Counsel points out that the court's refusal was based on a provision of the predecessor to the *BIA* which specifically provided that a proposal could only be binding on creditors (as far as relates to any debts due to them from the debtor). The current *BIA* does not contain equivalent general language. This case is clearly distinguishable.

[66] In *Mister C's Ltd. (Re)*, (1995) 32 CBR (3d) 242, the court refused to approve a proposal that had received creditor approval. The court cited numerous bases for its conclusion that the proposal was not reasonable or calculated to benefit the general body of creditors, one of which was the release of the principals of the debtor company. The scope of the release was only one of the issues with the proposal, which had additional significant issues (procedural irregularities,

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favourable terms for insiders, and inequitable treatment of creditors generally). I agree with counsel to the Applicants that this case can be distinguished.

[67] *Re Cosmic Adventures Halifax Inc*. (1999) 13 CBR (4th) 22 relies on *Kern* and furthermore the Applicants submit that the discussion of third-party releases is technically *obiter* because the proposal was amended on consent.

[68] The fourth case is *C.F.G. Construction Inc. (Re)*, 2010 CarswellQue 10226 where the Quebec Superior Court refused to approve a proposal containing a release of two sureties of the debtor. The case was decided on alternate grounds – either that the *BIA* did not permit a release of sureties, or in any event, the release could not be justified on the facts. I agree with the Applicants that this case is distinguishable. The case deals with the release of sureties and does not stand for any broader proposition.

[69] In general, the Applicants' submission on this issue is that the court should apply the decision of the Court of Appeal for Ontario in *Metcalfe*, together with the binding principle set out by the Supreme Court in *Ted Leroy Trucking*, dictating a more liberal approach to the permissibility of third-party releases in *BIA* proposals than is taken by the Quebec court in *C.F.G. Construction Inc*. I agree.

[70] The object of proposals under the *BIA* is to permit the debtor to restructure its business and, where possible, avoid the social and economic costs of liquidating its assets, which is precisely the same purpose as the *CCAA*. Although there are some differences between the two regimes and the *BIA* can generally be characterized as more "rules based", the thrust of the case law and the legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible, encouraging reorganization over liquidation. See *Ted Leroy Trucking*.

[71] Recent case law has indicated that, in appropriate circumstances, third-party releases can be included in a plan of compromise and arrangement that is approved under the *CCAA*. See *Metcalfe*. The *CCAA* does not contain any express provisions permitting such third-party releases apart from certain limitations that apply to the compromise of claims against directors of the debtor company. See *CCAA* s. 5.1 and *Allen-Vanguard Corporation (Re),* 2011 ONSC 733.

[72] Counsel submits that although the mechanisms for dealing with the release of sureties and similar claimants are somewhat different in the *BIA* and *CCAA*, the differences are not of such significance that the presence of s. 62(3) of the *BIA* should be viewed as dictating a different approach to third-party releases generally from the approach that applies under the *CCAA*. I agree with this submission.

[73] I also accept that if s. 62(3) of the *BIA* is interpreted as a prohibition against including the third-party release in the *BIA* proposal, the *BIA* and the *CCAA* would be in clear disharmony on this point. An interpretation of the *BIA* which leads to a result that is different from the *CCAA* should only be adopted pursuant to clear statutory language which, in my view, is not present in the *BIA*.

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[74] The most recent and persuasive example of the application of such a harmonious approach to the interpretation of the *BIA* and the *CCAA* can be found in *Ted Leroy Trucking*.

[75] At issue in *Ted Leroy Trucking* was how to resolve an apparent conflict between the deemed trust provisions of the *Excise Tax Act* and the provisions of the *CCAA*. The language of the *Excise Tax Act* created a deemed trust over GST amounts collected by the debtor that was stated to apply "despite any other Act of Parliament". The *CCAA* stated that the deemed trust for GST did not apply under the *CCAA*, unless the funds otherwise specified the criteria for a "true" trust. The court was required to determine which federal provision should prevail.

[76] By contrast, the same issue did not arise under the *BIA*, due to the language in the *Excise Tax Act* specifically indicating that the continued existence of the deemed trust depended on the terms of the *BIA*. The *BIA* contained a similar provision to the *CCAA* indicating that the deemed trust for GST amounts would no longer apply in a *BIA* proceeding.

[77] Deschamps J., on behalf of six other members of the court, with Fish J. concurring and Abella J. dissenting, held that the proper interpretation of the statutes was that the *CCAA* provision should prevail, the deemed trust under the *Excise Tax Act* would cease to exist in a *CCAA* proceeding. In resolving the conflict between the *Excise Tax Act* and the *CCAA*, Deschamps J. noted the strange asymmetry which would arise if the *BIA* and *CCAA* were not in harmony on this issue:

> Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

[78] It seems to me that these principles indicate that the court should generally strive, where the language of both statutes can support it, to give both statutes a harmonious interpretation to avoid the ills that can arise from "statute-shopping". These considerations, counsel submits, militate against adopting a strained reading of s. 62(3) of the *BIA* as a prohibition against third-party releases in a *BIA* proposal. I agree. In my opinion, there is no principled basis on which the analysis and treatment of a third-party release in a *BIA* proposal proceeding should differ from a CCAA proceeding.

[79] The Applicants submit that it logically follows that the court is entitled to approve the Consolidated Proposal, including the Release, on the basis that it is reasonable and calculated to

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benefit the general body of creditors. Further, in keeping with the principles of harmonious interpretation of the *BIA* and the *CCAA*, the court should satisfy itself that the *Metcalfe* criteria, which apply to the approval of a third-party release under the CCAA, has been satisfied in relation to the Release.

[80] In *Metcalfe*, the Court of Appeal for Ontario held that the requirements that must be satisfied to justify a third-party release are:

(a) the parties to be released are necessary and essential to the restructuring of the debtor;

(b) the claims to be released are rationally related to the purpose of the Plan (Proposal) and necessary for it;

(c) the Plan (Proposal) cannot succeed without the releases;

(d) the parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan (Proposal); and

(e) the Plan (Proposal) will benefit not only the debtor companies but creditors generally.

[81] These requirements have also been referenced in *Canwest Global Communications Corp. (Re),* 70 CBR (5th) 1 and *Angiotech Pharmaceuticals Inc. (Re)* 76 CBR (5th) 210.

[82] No single requirement listed above is determinative and the analysis must take into account the facts particular to each claim.

[83] The Applicants submit that the Release satisfies each of the *Metcalfe* criteria. Firstly, counsel submits that following the closing of the Asset Purchase Agreement in 2006, Budd Canada had no operating assets or income and relied on inter-company advances to fund the pension and OPEB requirements to be made by Budd Canada on behalf of KFL pursuant to the Asset Purchase Agreement. Such funded amounts total approximately $112.7 million in pension payments and $24.6 million in OPEB payments between the closing of the Asset Purchase Agreement and the Filing Date. In addition, TK Finance has been providing Budd Canada and KFL with the necessary funding to pay the professional and other costs associated with the *BIA* Proposal Proceedings and will continue to fund such amounts through the Proposal Implementation Date. Moreover, TK Canada and TK Finance have agreed to forego recoveries under the Consolidated Proposal on account of their existing secured and unsecured inter-company loans in the amount of approximately $120 million.

[84] Counsel submits that the releases provided in respect of the Applicants' affiliates are the *quid pro quo* for the sacrifices made by such affiliates to significantly enlarge recoveries for the unsecured creditors of the Applicants, particularly the OPEB creditors and reflects that the affiliates have provided over $135 million over the last five years in respect of the pension and OPEB amounts and additional availability of approximately $49 million to allow the Applicants to discharge their obligations to their former employees and retirees. Without the Releases,

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counsel submits, the Applicants' affiliates would have little or no incentive to contribute funds to the Consolidated Proposal and to waive their own rights against the Applicants.

[85] The Release in favour of Martinrea is fully discussed at paragraphs 121-127 of the factum. The Applicants submit that the third-party releases set out in the Consolidated Proposal are clearly rationally related, necessary and essential to the Consolidated Proposal and are not overly broad.

[86] Having reviewed the submissions in detail, I am in agreement that the Released Parties are contributing in a tangible and realistic way to the Consolidated Proposal.

[87] I am also satisfied that without the Applicants' commitment to include the Release in the Consolidated Proposal to protect the Released Parties, it is unlikely that certain of such parties would have been prepared to support the Consolidated Proposal. The releases provided in respect of the Applicants' affiliates are particularly significant in this regard, since the sacrifices and monetary contributions of such affiliates are the primary reason that the Applicants have been able to make the Consolidated Proposal. Further, I am also satisfied that without the Release, the Applicants would be unable to satisfy the borrowing conditions under the Amended and Restated Senior Secured Loan Agreement with respect to the Applicants having only certain permitted liabilities after the Proposal Implementation Date. The alternative for the Applicants is bankruptcy, a scenario in which their affiliates' claims aggregating approximately $120 million would significantly erode recoveries for the unsecured creditors of the Applicants.

[88] I am also satisfied that the Releases benefit the Applicants and creditors generally. The primary non-affiliated Creditors of the Applicants are the OPEB Creditors and Creditors with Pension Claims, together with the CRA. The Consolidated Proposal, in my view, clearly benefits these Creditors by generating higher recoveries than could be obtained from the bankruptcies of the Applicants. Moreover, the timing of any such bankruptcy recoveries is uncertain. As noted by the Proposal Trustee, the amount that the Affected Creditors would receive in the event of the bankruptcies of the Applicants is uncertain both in terms of quantum and timing, with the Applicants' funding of OPEB Claims terminating on bankruptcy, but distributions to the OPEB Creditors and other Creditors delayed for at least a year or two but perhaps much longer.

[89] The Applicants and their affiliates also benefit from the Release as an affiliate of the Applicants may become enabled to use the net operating losses (NOL) following a series of transactions that are expected to occur immediately following the Proposal Implementation Date.

[90] I am also satisfied that the Applicants have provided full and adequate disclosure of the Releases and their effect. Full disclosure was made in the proposal term sheet circulated to both Representative Counsel in early August 2011. The Release was negotiated as part of the Consolidated Proposal and the scope of the Release was disclosed by the Proposal Trustee in its Report to the creditors on the terms of the Consolidated Proposal, which Report was circulated by the Proposal Trustee to the Applicants' known creditors in advance of the creditors' meeting.

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[91] I am satisfied that the Applicants, with the assistance of the Proposal Trustee, took appropriate steps to ensure that the Affected Creditors were aware of the existence of the release provisions prior to the creditors' meeting.

[92] For the foregoing reasons, I have concluded that the Release contained in the Consolidated Proposal meets the *Metcalfe* criteria and should be approved.

[93] In the result, I am satisfied that the section 59(2) *BIA* test has been met and that it is appropriate to grant the Sanction Order in the form of the draft order attached to the Motion Record. An order has been signed to give effect to the foregoing.

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MORAWETZ J.

Date: February 3, 2012

TAB 7

Ontario Supreme Court
Mayer, Re
Date: 1994-03-03

Re proposal of Joseph Moise Mayer

Ontario Court of Justice (General Division) [In Bankruptcy] Registrar Ferron

Decision – March 3, 1994.

Kenneth H. Page, for insolvent.

(Doc. 31-279696)

[1] March 3, 1994. Registrar FERRON: – The application for the approval of the proposal of Joseph Moise Mayer came before the Court on February, 1994 and has been adjourned on two occasions for further information.

[2] In order to affirm a proposal, the Court must be satisfied that the proposal is:

1. reasonable;

2. calculated to benefit the general body of creditors; and

3. made in good faith.

[3] The first two provisions are statutory, while the third is implied. The Bankruptcy Court is a court of equity. An insolvent person asking for the Court's approval of a plan must do so in good faith requires full disclosure. There has not been full disclosure by the insolvent person in this application.

[4] The central provision of the proposal requires the acceptance by creditors in full payment of claims of the insolvent person's equity in "the premises in which the debtor resides".

[5] Nowhere, not in the proposal, not in the Trustee's report to creditors (where the property is called "family home" and "principal residence"), and not in the report to the Court is it disclosed that:

1. the premises which is to fund the proposal is held with the insolvent person's spouse; (the statement of affairs does make reference to a half interest in three properties including the

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property referred to in the proposal; that is ambiguous and might not be appreciated by the creditors); or

2. the property is encumbered by two mortgages, a charge in favour of Revenue Canada, and a charge for a line of credit; or

3. that municipal taxes of $24,000 for arrears are owing.

[6] Moreover, there was no appraisal for the property available to creditors or, initially, to the Court, so that the Creditors can have no idea of what equity might be available, assuming there is an equity available to creditors.

[7] When this matter came on before the Court initially, I directed counsel's attention to the omission of the appraisal, and I now have before me what is called an "appraisal". That appraisal consists of a two-line letter signed by sales representatives of a real estate company. The letter is addressed "To whom it may concern" and suggests that the property has a value of "about $750,000 in today's marketplace". The property, I am advised, has been on the market for some considerable time without result and one can only speculate that the property is overpriced. In any event, I repeat, no creditor has seen that appraisal.

[8] Even if the property were to sell for $750,000, the funds available for purposes of the proposal would be only $73,000 and when one deducts the selling commission, the additional interest accruing on the encumbrances, legal costs both of the proposal and of the sale of the property and the Trustee's fees, the amount available to creditors would be minimal.

[9] Moreover, the property has been on the market for some considerable time without results. The property may never sell for its so called appraised value. The proposal provides for no cut off date so that creditors may never be paid. In addition, if the property is sold for less than $750,000 the dividend to creditors would be reduced even more.

[10] The statutory report of the Trustee to the Court on the application for the approval of the proposal is deficient. Statutory Form Number 42, "Report of Trustee on Proposal", paragraph 9, provides by way of direction to the Trustee: "Set out assets in detail, giving the value as carried on the books of the Debtor and the Trustee's estimate in each case of the realizable value thereof."

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[11] Neither the Creditors nor the Court has been given the information required by the statute with which to gauge the value of the insolvent person's plan. That information which is available reveals the proposal not calculated to benefit the general body of creditors.

[12] Accordingly, the statement in the Trustee's Report to Creditors (Section 51(1)), viz under the heading "Recommendations and Summary", viz, "Based on a review of the condensed statement of assets and liabilities, it is estimated that there would be less of a distribution to Creditors in a bankruptcy scenario. Accordingly, the proposal produces a higher realization for Creditors", is incorrect and misleading. Since there is no appraisal there can be no estimate, and the statement in the report is of no value. It is skewed unfairly in favour of the insolvent person and cannot be supported.

[13] Nor is the Trustee entitled to make the statement under the heading, "Financial Position and Evaluation of Assets" simply because he cannot know what the assets will realize on bankruptcy for the same reason that he cannot know what will be available to Creditors in the proposal.

[14] Moreover, the Creditors have not been advised that they would be able to get at least as much and probably more in a bankruptcy of the Debtor as opposed to the proposal.

[15] In bankruptcy, the exact same asset, that is the principal residence, would be available to them, and the encumbrance to Revenue Canada for arrears of taxes would presumably abate, so that on that basis alone, the bankruptcy is more advantageous to Creditors than a proposal.

[16] In addition, on bankruptcy creditors would obtain the following assets which are not available on the proposal:

1. After acquired assets, that is contributions from the Debtor's income; and

2. The mortgage receivable and automobile referred to in the statement of affairs; and

3. The Debtor's accounts receivable, that is, the OHIP payments owing to the doctor at the date of bankruptcy; and

4. Assets not encumbered or the equity therein.

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[17] The admitted combined net income of the insolvent person, a doctor, and his spouse, is $7,690 per month, from which a payment order would probably be obtainable in a bankruptcy. In particular, the insolvent person's statement of earnings carries an item of disbursements entitled "Mortgage and Loans" – $6,547 per month. In bankruptcy, the "Loan" portion of that payment would probably be available to Creditors. The Trustee's report to the Court states, "The Debtor's main assets are mostly encumbered" which indicates that there are other than "main assets" and these are not encumbered. Such assets would be available to creditors. The above information was not given or made available to Creditors.

[18] It is clear that a plan to be approved by the Court must be more advantageous to Creditors than would be the case in a bankruptcy. See *Re Allen Theatres Ltd.* (1922), 3 C.B.R. 147 (Ont. S.C.) and *Re Rideau Carleton Raceway Holdings Ltd.* (1971), 15 C.B.R. (N.S.) 72 (Ont. S.C.) at 75. The proposal submitted does not meet that test.

[19] Finally, I note that of the thirteen Creditors with declared liabilities of $277,000, only one attended the Creditors' meeting. The proposal was approved by that Creditor and by one proxy which the Trustee voted in favour of the proposal. This is hardly an overwhelming or representative showing of creditors. How much of this rather dismal showing can be attributed to the paucity of information made available to Creditors is conjecture, but the Court must, notwithstanding, protect Creditors from themselves. See Honsberger, "Debt Restructuring", page 8-64.

[20] The proposal cannot be approved and is accordingly rejected.

Approval denied.

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TAB 8

1998 CarswellOnt 194
Ontario Court of Justice, General Division (In Bankruptcy)

Lofchik, Re

1998 CarswellOnt 194, [1998] O.J. No. 332, 1 C.B.R. (4th) 245, 52 O.T.C. 220, 77 A.C.W.S. (3d) 249

In The Matter of the Proposal of Thomas Ronald Lofchik of the Town of Ancaster in the Regional Municipality of Hamilton-Wentworth in the Province of Ontario

Farley J.

Heard: January 8, 1998
Judgment: January 28, 1998
Docket: 32-092921, Commercial List No. BK-000217

Counsel: P. Pichelli, a principal of Scott, Pichelli & Graci Ltd., the trustee of the proposal.
Mario Cupido, a representative of the opposing creditor, Centregate Properties Ltd.

Subject: Insolvency
Related Abridgment Classifications
Bankruptcy and insolvency
VI Proposal
  VI.4 Approval by court
    VI.4.b Conditions
      VI.4.b.iii Interests of creditors

Headnote
Bankruptcy --- Proposal — Approval by court — Conditions — Interests of creditors
Trustee applied for court approval of proposal of debtor — Application opposed by creditor who claimed not to have received notice of creditors' meeting until after date — At creditors' meeting, only one creditor attended and voted in favour of proposal — Proposal of debtor was technically correct in terms of content, mechanics and procedure — Full material disclosure was made, proposal was calculated to benefit general body of creditors rather than particular creditor and proposal was made in good faith — Payment terms of proposal were adequate as debtor agreed to make payments of significant sum that would generate meaningful returns to unsecured creditors — Furthermore, debtor agreed to enhance proposal by assigning interest in joint venture to general benefit of creditors — No default on part of debtor and trustee in that notice of meeting was mailed to all creditors including opposing creditor — Debtor's proposal approved.

Table of Authorities
Cases considered by *Farley J.*:
Gareau, Re (1922), 2 C.B.R. 265, 61 Que. S.C. 57 (C.S. Que.) — referred to
Ilford-Riverton Airways Ltd., Re (1974), 19 C.B.R. (N.S.) 186 (Man. Q.B.) — referred to
McNamara v. McNamara (1984), 53 C.B.R. (N.S.) 240 (Ont. Bktcy.) — referred to

Statutes considered:
Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
s. 54(1) [rep. & sub. 1992, c. 27, s. 22] — referred to

s. 57(a) — referred to

s. 59(1) [rep. & sub. 1997, c. 12, s. 36] — considered

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s. 59(2) — considered

s. 59(3) — considered

s. 173 — referred to

s. 177 — referred to

s. 198 — referred to

s. 199 — referred to

s. 200 — referred to

APPLICATION for approval of debtor's proposal to creditors.

***Farley J.*:**

1 Thomas Ronald Lofchik ("debtor") made a proposal to his creditors on October 21, 1997 following his notice of intention to do so the previous month. Notice of the meeting of creditors called to consider and vote on the proposal (together with the other required information) was mailed out by the trustee on October 27th. The meeting was held on November 12th. No creditor attended the meeting in person or by proxy. The only voting presence of a creditor at the meeting was that of the Toronto-Dominion Bank ("T-D Bank") which submitted a voting letter in favour of the proposal as to its proof of claim for $4,400. Thus the proposal was approved by the vote of that creditor.

2 The C.I.B.C. Mortgage Corporation submitted a proof of claim for $43,928.02 in time for the meeting but did not send in its voting letter in favour of the proposal until after meeting.

3 The opposing creditor, Centregate Properties Limited ("Centregate") which was aware of the debtor's intention to file a proposal, having received the debtor's notice in September, advised the trustee that it did not receive notice of the November 12th meeting and was unaware of it and the approval of the proposal until it received notice from the trustee of the motion for court approval. It was owed $72,000. The trustee subsequently verified that the other creditors in fact received notice of the November 12th meeting. Incidental to this follow up the trustee to see if motions had been received, some advised the trustee that they favoured the proposal but a majority in number did not. These other creditors did not attend the meeting in person or by proxy nor did they submit a voting letter for or against to be dealt with at the meeting. Neither did they attend the hearing before me.

4 The trustee's report indicated that the debtor had minimal assets as follows:

Household Goods	$ 2,000
1996 Mercury Marquis automobile	$27,000 ({*} fully encumbered)
9.2% interest - joint venture	unknown value{**}
25% interest - joint venture	unknown value{**}
Total assets	$29,000{**}

Notes: * It appears that the $27,000 secured debt relates to the automobile.** The joint ventures were said to be of an unknown value; one may therefore question how the total assets are said to be $29,000. However the trustee elsewhere in the material to creditors indicated that it seemed that of the two joint ventures only the Corunna one may have some value to a possible maximum of some $10,000 to $12,000 attributable to the debtor.

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As against liabilities as follows:

Secured creditors	$27,000{*}
Unsecured creditors	$301,145
Total liabilities	$328,145

Notes: * It appears that the $27,000 secured debt relates to the automobile.

The trustee provided further details as to the joint venture interest including real estate broker opinions of value. The 9.2% interest was as to a Hamilton building in which the debtor previously practised law. In fact the interest had been reduced to 7.4% as the debtor had missed paying several cash calls. It was submitted that there was no equity at present in the building as it was valued at $700,000 but subject to a mortgage for $699,000 and a cash flow shortfall was being experienced. The 25% interest referred to a 28-unit building in Corunna, Ontario. It was submitted that there was no material equity present in this project as it was valued at $550,000 but subject to a mortgage for $500,000 and a 21% vacancy rate was being experienced. Disposition costs and the difficulty of disposing of a minority interest had been ignored in each joint venture. The opposing creditor had not seen the estimates of value before and was quite justified in its concern that the values had not been able to be verified

5 However, assuming that there is no realizable equity in the joint venture at the present, then the debtor's net position is that he has unencumbered assets of $2,000 (but being household goods, these would be exempt on a bankruptcy) and unsecured liabilities of $301,145. The debtor is presently a judge of the Ontario Court of Justice (General Division). The trustees report went on to advise:

> The debtor's financial difficulties are the result of investing in various development projects when he was a solicitor in the City of Hamilton. Of his total debts, approximately $235,300 is strictly related to various condominium projects and other real estate ventures. The debtor is unable to meet the shortfall demands on the various real estate projects and as a result thereof, has submitted this proposal. The proposal calls for payment through its term totalling $44,400.
>
> . . . . .
>
> We are further of the opinion that the debtor's proposal is an advantageous one for the creditors for the following reasons: the trustee is of the opinion that the proposal is more advantageous than a bankruptcy. In a bankruptcy, the only asset the trustee is entitled to is surplus income for a period of nine months. The said surplus income based on the Senate Committee Guidelines would be $2,070 per month for nine months, totalling $18,630. There would be no other free assets or assets with any value which would realize the creditors any additional funds, with the exception of Corunna (joint venture), which may realize $10,000 to $12,000 but it may be difficult to liquidate because it is a minority interest. The proposal will provide a higher realization than a bankruptcy liquidation. The proposal will also assist in rehabilitating the debtor and will cause the least disruption to the debtor and his family as well as generate a higher return to the unsecured creditors.

6 A judge's gross salary is $160,000. After taking off taxes and other deductions the debtor's net monthly income is $6,900. His wife (who has always owned the family residence) also has a monthly income of $700 so that the family's net monthly income is $7,600. Their expenses are $6,300 a month for an estimated surplus of $1,300. The debtor's two children are approaching university age. The debtor's net income should not be minimized; it would place him in the top 10% (and probably top 5%) of salaried persons in Canada.

7 The proposal is for the payment of $44,400 over 36 months at the rate of $1,000 per month for the first year, $1,200 for the second year and $1,500 for the third year.

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8 The trustee advised that the proposal was precipitated by the prospect of garnishment proceedings being instituted by two creditors; Centregate verified that it was one of those creditors. Its claim arose out of the debtor buying two units out of an 80 unit project it was developing when it agreed to reduce its customary 25% cash at closing to 10% cash and a 15% vendor take back second mortgage. Centregate submitted that this was a speculation by the debtor but acknowledged that it knew it as such at the time. The debtor's financial woes are not unique; this court has seen numerous (all too numerous I regret to say) instances of persons investing heavily in assets (usually real estate or stocks) on the basis of high leverage loans with the expectation of increasing prices. When values plunge, as they did for real estate at the turn of the last decade, the result is the classic squeeze which it seems people have to rediscover every ten or twenty years.

9 Section 59 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B.-3 as amended ("BIA") provides:

> s.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, the person making the proposal, 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.
>
> (3) Where any of the facts mentioned in sections 173 and 177 are proved against the debtor, the court shall refuse to approve the proposal unless it provides reasonable security for the payment of not less than fifty cents on the dollar on all the unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct.

10 In dealing with this matter I am guided and constrained by the legislation and jurisprudence. As set forth in Houlden & Morawetz, *The 1998 Annotated Bankruptcy and Insolvency Act* (1997, Carswell Thomson Professional Publishing, Scarborough) at p. 162:

> ...In deciding whether the proposal should be approved, the court must take the following interests into account: (a) the interests of the debtor in making a settlement with creditors; (b) the interests of creditors in procuring a settlement which is reasonable and which does not prejudice their rights; and (c) the interests of the public in the fashioning of a settlement which preserves the integrity of the bankruptcy process and complies with the requirements of commercial morality: *Re Gardner* (1921), 1 C.B.R. 424 (Ont. S.C.); *Re Summer Co. (1984) Ltd.* (1987), 64 C.B.R. (N.S.) 218 (N.B.Q.B.); *Re Stone* (1976), 22 C.B.R. (N.S.) 152 (Ont. S.C.); *Re National Fruit Exchange Inc.* (1948), 29 C.B.R. 125 (C.S. Que.); *Re The Man With The Axe Ltd. (No.2)* (1961), 2 C.B.R. (N.S.) 12 (Man. Q.B.)

Houlden & Morawetz went on to state at pp. 164-5:

> **(9) Conditions that Must be Met Before the Court will Approve a Proposal**
>
> ***(a) Generally***
>
> Under s. 59(2), the court before it can approve a proposal must be satisfied: (a) that the terms are reasonable; and (b) that the terms are calculated to benefit the general body of creditors. In addition, the court must be satisfied that the formalities of the Act have been complied with, see *ante* E§4 "Procedure for Filing a Notice of Intention or Proposal"; and that the terms required by the Act to be included in a proposal are in the proposal (see *infra* in this section).

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In determining whether to approve a proposal, the court must consider not only the wishes and interests of creditors, but also the conduct and interests of the debtor, the interests of the public and future creditors and the requirements of commercial morality: *Re Gardner* (1921), 1 C.B.R. 424 (Ont. S.C.); *Re Summer Co. (1984) Ltd.* (1987), 64 C.B.R. (N.S.) 218 (N.B.Q.B.); *Re Stone* (1976), 22 C.B.R. (N.S.) 152 (Ont. S.C.); *Re National Fruit Exchange Inc.* (1948), 29 C.B.R. 125 (C.S. Que.); *Re The Man With The Axe Ltd.* (No. 2) (1961), 2 C.B.R. (N.S.) 12 (Man.Q.B.)

(b) Terms are Reasonable

In order for the court to approve a proposal, it must be satisfied that the term are reasonable: s. 59(2). To be reasonable, the proposal must have a reasonable possibility of being successfully completed in accordance with its terms: *Re McNamara and McNamara* (1984), 53 C.B.R. (N.S.) 240 (Ont. S.C.); *Re Gareau (English & Scotch Woollen Co.)* (1922), 2 C.B.R. 265 (C.S. Que.). In *Re Farkvam* (1966), 39 C.B.R. (3d) 293 (B.C. Master), affirmed (May 28. 1996), Doc. Prince George 32237 (B.C.S.C.), The Registrar was of the opinion that "reasonable", in addition to requiring that there is a reasonable possibility that the debtor will be able to meet the terms of the proposal, also requires that the proposal meets the requirements of commercial morality and maintains the integrity of the bankruptcy system.

(c) Calculated to Benefit the General Body of Creditors

The court will refuse to approve a proposal that might harm or prejudice the interests of creditors. If, for example, a proposal provided that the trustee could delegate his duties under the proposal to a committee of creditors, such a delegation could prejudice creditors, and the court would likely find that such a proposal was not calculated to benefit the general body of creditors.

A proposal that has been skilfully and craftily drafted to serve the interests of persons other than the creditors is not calculated to benefit the general body of creditors: *Re Summer Co. (1984) Ltd.* (1987), 64 C.B.R. (N.S.) 218 (N.B.Q.B.).

A proposal that fails to make full disclosure of the assets of the debtor and the encumbrances against them is not calculated to benefit the general body of creditors: *Re Mayer* (1994), 25 C.B.R. (3d) 113 (Ont. Gen. Div.).

(d) Good Faith

A person seeking court approval of a proposal must be acting in good faith. Good faith requires full disclosure of the assets of the debtor and the encumbrances against them. In *Re Mayer* (1994), 25 C.B.R. (3d) 113 (Ont. Gen. Div.), creditors were required, by the terms of a proposal, to accept in full settlement of their claims the debtor's equity in the premises in which the debtor resided, but the materials given to creditors did not disclose that the premises were held jointly with the debtor's spouse, nor did it disclose the extent of the encumbrances. In addition, there was no proper appraisal of the property. The court found that the debtor was not acting in good faith and refused to approve the proposal.

(d) Terms that Must be Contained in a Proposal in Order for It to be Approved by the Court

In order for a proposal to be approved by the court, there are certain statutory terms which must be contained in it. These are detailed *ante* E§3(2) "Terms of Proposal - Statutory Terms Which Must be Included in a Proposal". If a proposal does not contain these terms, the court cannot approve it. Thus, if a proposal does not provide for payment in full of claims of preferred creditors, the court will not approve it: *Re Masvoir Corp.; Rainville v. Dep. Minister of Revenue (Que.)* (1979), 30 C.B.R. (N.S.) 197 (C.S. Que.). Preferred creditors may, however, waive or compromise their claims: *Re Kenmore Building Materials Ltd.* (1966), 9 C.B.R. (N.S.) 41 (Ont. C.A.).

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11 The proposal of the debtor and the trustee's application for court approval appears to be technically correct as to the contents, mechanics and procedure. There has been full material disclosure, the proposal appears to be calculated to benefit the general body of creditors and not just some particular creditor or special interest and it appears to have been made in good faith. As well there does not appear to have been any infraction by the debtor of any one of the offences mentioned in sections 198, 199 and 200 of BIA. As well there would not appear to be any difficulty with sections 173 and 177 (specifically although the assets of debtor are not of the value equal to 50 cents on the dollar of the debtor's unsecured liabilities, it would appear that this has arisen from circumstances for which the debtor cannot justly be held responsible in light of the downturn in the property market). I am satisfied on the financial information presented that the debtor will be able to fulfill the terms of the proposal by making the monthly payments as it appears that there is sufficient surplus income at the present time and in the third year I would assume that the budget could be somewhat trimmed if there were no adjustment in the revenue.

12 Is the proposal generous? The answer is no. But that is not the question although it is obvious that the debtor could pay more by extending the payments out over a longer period of time. If he had done so, then it appears that he would not have invoked what appears to be the sincerely held indignation of Centregate. Rather the question is whether the (payment) terms of the proposal are reasonable in the sense of being adequate enough to meet the requirements of commercial morality and maintaining the integrity of the bankruptcy system. In my view the payment terms of this proposal are adequate for that purpose and the debtor is obligating himself to make payments of a significant sum which will generate a meaningful percentage dividend for the unsecured creditors. The debtor while enjoying a significant salary as indicated above, is on a fixed income in the sense that his salary scale is established and he does not have the opportunity as he previously did either as a lawyer of earning more by working harder, more efficiently or more successfully or as a knowledgeable investor who may successfully invest in an upswing asset. In my view the monetary terms are right on the edge of acceptability particularly when one considers that someone in similar circumstances in a bankruptcy discharge hearing would likely have to pay in total something in the nature of what this proposal provides (it should be kept in mind in this regard that with the 1997 amendments there are mandatory features with respect to surplus income and this factor in my view will have to be taken into account in crafting discharge terms).

13 The proposal has been advanced for approval by the trustee; it has been unanimously approved by the (sole) creditor voting on it. As indicated in Houlden & Morawetz at p. 165:

> **(10) Effect of Acceptance of Proposal by Creditors**
>
> Even if a proposal receives the unqualified recommendation of the trustee and the overwhelming support of creditors, this does not mean that the court must approve it: *Re Gardner* (1921), 1 C.B.R. 424 (Ont. H.C.): *Re Allen Theatres Ltd.* (1922), 3 C.B.R. 147 (Ont. S.C.); *Re Alberta Western Wholesale Lumber Ltd.* (1961), 2 C.B.R. (N.S.) 151, 27 D.L.R. (2d) 598 (B.C.S.C.).
>
> If, however, a large majority of creditors, i.e., substantially in excess of the statutory majority, have voted for acceptance of a proposal, it will take strong reasons for the court to substitute its judgment for that of the creditors: *Re McIntyre* (1922), 2 C.B.R. 396 (N.B.K.B.); *Re Landsmann & Wexler* (1936), 17 C.B.R. 240 (C.S. Que.); *École Int. de Haute Esthetique Edith Serei Inc. (Receiver of) v. Edith Serei Int. (1987) Inc.* (1989), 78 C.B.R. (N.S.) 36 (C.S. Qué.); *Re Leger and Lamoureaux* (1925), 7 C.B.R. 280 (C.S. Que.); *Re Slavik* (1993), 21 C.B.R. (3d) 278 (B.C.S.C).

I am however mindful of the fact that the sole creditor voting had a much smaller claim than Centregate which is in court objecting. *McNamara v. McNamara* (1984), 53 C.B.R. (N.S.) 240 (Ont. Bktcy.) observed that there is no requirement for any written or formal objection to be filed prior to the hearing. Further I note that the onus is on the debtor (not the opposing creditors) to establish that the proposal should be approved by the court: see *McNamara*, supra, *Gareau, Re* (1922), 2 C.B.R. 265 (C.S. Que.). I was cognizant of Centregate's concern about there possibly

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being equity in the two joint ventures at the present time; it also seems to me that it is conceivable that property values may increase in the future in such a way that these interests may become of some realizable value. A court has only a very limited power to make alterations or amendments of a proposal although it should be noted that the meeting of creditors can do so (that is, the creditors may negotiate with a debtor making a proposal on the basis that they will turn down the proposal if the debtor does not amend it): see s. 54(1):

> s.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. (emphasis added)

This illustrates the significant benefit of creditors actually participating in meetings of creditors. However the trustee has now provided me following my inquiry at the hearing with assignments of the debtor's interest in the two joint ventures for the general benefit of the creditors. (It is interesting to note that the one assignment for the Hamilton building describes the debtor's interest being conveyed as 22.5%; however this does not affect the end result). This thereby eliminates the concern about there either being equity in the two joint ventures presently or in the future if the property market improves as this is now being added to the proposal as a supplement over and above the monetary terms. I am of the view that this beneficial addition is an acceptable procedure in the spirit of *Ilford-Riverton Airways Ltd., Re* (1974), 19 C.B.R. (N.S.) 186 (Man. Q.B.). As to Centregate's other concern that the proposal is not generous enough, I would observe that: (i) as discussed above it is (marginally) adequate; (ii) the only creditor who did participate in the voting process did vote in favour; and (iii) there has been an enhancement (although of some indeterminate value, if any) by virtue of the aforesaid assignment of the joint venture interests for the general benefit of the creditors. None of the other creditors (and specifically those which the trustee advised he contacted after the meeting to determine whether they had received the material and who then indicated that they were not favourably disposed to the proposal) attended this hearing to voice their opposition to the court approving the proposal.

14 What then of Centregate's submission that it did not vote because it did not receive notice of the November 12th meeting? It emphatically states that if it had received notice, it would have voted against the creditors approving the proposal as it found it quite distasteful. If that event (of Centregate voting against) actually did take place with no other changes then there would have been two creditors voting (the T-D Bank $4,400 for and Centregate $72,000 against). The proposal would have been defeated on both a numbers of creditors and dollar of claim basis and the debtor would have been deemed to have made an assignment in bankruptcy (s.57(a)). However as I observed at the hearing the difficulty is that it appears that the debtor and the trustee did what was mechanically required of them and particularly that such notice was mailed to all creditors of the debtor - including Centregate. Thus there has been no default on their part. While the results may be very unfortunate for Centregate's position if it did not receive that notice and as a result did not voice (because it could not for lack of notice), there is a general policy concern. I would emphasize that my following comments are general comments and they are not directed at Centregate. Unless every creditor in a proposal situation were to attend the meeting or indicate in advance of the meeting that he would not be attending then the result of any meeting would always be open to question if someone claimed that they did not receive notice. Not only would there be the situation of such creditor possibly being able to swing the negative vote into a majority situation but also that creditor could claim that he would have been able to provide the other creditors attending with such information as would make them change their positive votes into negative ones. It is quite conceivable that this could be subject to abuse by unscrupulous creditors lying in the wait. The opposite situation is also a danger: a proposal otherwise voted down could have the debtor and friendly creditors who had not attended the meeting arguing that the proposal should be approved. In this regard it may be that it would be desirable to have notices sent out by combination of registered and ordinarily mail (the combination being desirable as many people do not respond to registered mail) perhaps with the one mailing to advise only of the nature of the other. Possibly a legal notice in a local newspaper of general circulation in addition to an ordinary mailing would be helpful.

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15 In the end result the debtor's proposal as approved by the creditors and amended by the addition of the joint venture assignments is approved.

Application granted.

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TAB 9

Court of Queen's Bench of Alberta

Citation: Re San Francisco Gifts Ltd. (*Companies' Creditors Arrangement Act*), 2005 ABQB 91

Date: 20050209
Docket: 0403 00170
Registry: Edmonton

2005 ABQB 91 (CanLII)

Between:

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

- and -

And In the Matter of a Plan of Compromise or Arrangement of San Francisco Gifts Ltd., San Francisco Retail Gifts Incorporated (Previously Called San Francisco Gifts Incorporated), San Francisco Gift Stores Limited, San Francisco Gifts (Atlantic) Limited, San Francisco Stores Ltd., San Francisco Gifts & Novelties Inc., San Francisco Gifts & Novelty Merchandising Corporation (Previously Called San Francisco Gifts and Novelty Corporation), San Francisco (The Rock) Ltd. (Previously Called San Francisco Newfoundland Ltd.) And San Francisco Retail Gifts & Novelties Limited (Previously Called San Francisco Gifts & Novelties Limited)

Memorandum of Decision
of the
Honourable Madam Justice J.E. Topolniski

INTRODUCTION

[1] The San Francisco group of companies (San Francisco) obtained *Companies' Creditors Arrangement Act*[1] (*CCAA*) protection on January 7, 2000 (Initial Order). Key to that protection was the requisite stay of proceedings that gives a debtor company breathing room to formulate a plan of arrangement. The stay was extended three times thereafter with the expectation that the

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

entire *CCAA* process would be completed by February 7th, 2005. That date was not met. Accordingly, San Francisco now applies to have the stay extended to June 30, 2005.

[2] A small group of landlords opposes the motion on the basis of San Francisco's recent guilty plea to *Copyright Act* offenses and the sentencing judge's description of San Francisco's conduct as: "…a despicable fraud on the public. Not only not insignificant but bordering on a massive scale…" The landlords suggest that this precludes any possibility of the company having acted in "good faith" and therefore having met the statutory prerequisite to an extension. Further, they contend that extending the stay would bring the administration of justice into disrepute.

[3] San Francisco acknowledges that its conduct was stupid, offensive and dangerous. That said, it contends that it already has been sanctioned and that it has "paid its debt to society." It argues that subjecting it to another consequence in this proceeding would be akin to double jeopardy. Apart from the obvious consequential harm to the company itself, San Francisco expresses concern that its creditors might be disadvantaged if it is forced into bankruptcy.

[4] While there has been some delay in moving this matter forward towards the creditor vote, this delay is primarily attributable to the time it took San Francisco to deal with leave to appeal my classification decision of September 28, 2004. Despite the opposing landlords' mild protestations to the contrary, it is evident that the company has acted with due diligence. The real focus of this application is on the meaning and scope of the term "good faith" as that term is used in s. 11(6) of the *CCAA*, and on whether San Francisco's conduct renders it unworthy of the protective umbrella of the Act in its restructuring efforts. It also raises questions about the role of a supervising court in *CCAA* proceedings.

BACKGROUND

[5] San Francisco operates a national chain of novelty goods stores from its head office in Edmonton, Alberta. It currently has 62 locations and approximately 400 employees.

[6] The group of companies is comprised of the operating company, San Francisco Gifts Ltd., and a number of hollow nominee companies. The operating company holds all of the group's assets. It is 100 percent owned by Laurier Investments Corp., which in turn is 100 percent owned by Barry Slawsky (Slawsky), the driving force behind the companies.

[7] Apart from typical priority challenges in insolvency matters, this proceeding has been punctuated by a series of challenges to the process and its continuation, led primarily by a group of landlords that includes the opposing landlords.

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[8] On December 30, 2004, San Francisco pleaded guilty to nine charges under s. 42 of the *Copyright Act*,[2] which creates offences for a variety of conduct constituting wilful copyright infringement. The evidence in that proceeding established that:

> (a) An investigation by the St. John's, Newfoundland, Fire Marshall, arising from a complaint about a faulty lamp sold by San Francisco, led to the discovery that the lamp bore a counterfeit safety certification label commonly called a "UL" label.[3] The R.C.M.P. conducted searches of San Francisco stores across the country, its head office, and a warehouse, which turned up other counterfeit electrical UL labels as well as counterfeit products bearing the symbols of trademark holders of Playboy, Marvel Comics and others.
>
> (b) Counterfeit UL labels were found in the offices of Slawsky and San Francisco's Head of Sales. There was also a fax from "a Chinese location" found in Slawsky's office that threatened that a report to Canadian authorities about the counterfeit safety labels would be made if payment was not forthcoming.
>
> (c) *Copyright Act* charges against Slawsky were withdrawn when San Francisco entered a plea of guilty to the charges;
>
> (d) The sentencing judge accepted counsels' joint submission that a $150,000.00 fine would be appropriate. In passing sentence, he condemned the company's conduct, particularly as it related to the counterfeit labels, expressing grave concern for the safety of unknowing consumers.[4]

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[2] R.S.C. 1985, c. C-42.

[3] Underwriters' Laboratories (UL) operates facilities globally for the testing, certification and quality assessment of products, systems and services. Products are tested to Canadian standards and, if the product complies with those standards, UL issues an identification or listing mark confirming certification (Transcript of the proceedings held December 30, 2004 at pp.4-5)

[4] Judge Stevens-Guille said: "Quite frankly, this is and should be described as nothing else than a despicable fraud on the public. Not only not insignificant but bordering on a massive scale company, stores, all of these places that we have been told they had stores…We are talking about electrical appliances that cause fires bought by someone who whether they relied on the UL certificate or not it had a certificate on it and to go to the exercise of getting cheap stuff somewhere and dressing it up with false labels and false safety certificates causes me great pause, such pause that if it were an individual who pled guilty before me today my starting point would be a term of imprisonment in a federal penitentiary, without a doubt." (Transcript of the proceedings held December 30, 2004 at pp. 18/15-18 and 19/2-11).

(e) San Francisco was co-operative during the R.C.M.P. investigation and the Crown's prosecution of the case.

(f) San Francisco had been convicted of similar offences in 1998.

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[9] Judge Stevens-Guille's condemnation of San Francisco's conduct was the subject of local and national newspaper coverage.

[10] The company paid the $150,000.00 fine from last year's profits.

ANALYSIS

Fundamentals

[11] The well established remedial purpose of the *CCAA* is to facilitate the making of a compromise or arrangement by an insolvent company with its creditors to the end that the company is able to stay in business. The premise is that this will result in a benefit to the company, its creditors and employees.[5] The Act is to be given a large and liberal interpretation.[6]

[12] The court's jurisdiction under s. 11(6) to extend a stay of proceedings (beyond the initial 30 days of a *CCAA* order) is preconditioned on the applicant satisfying it that:

(a) circumstances exist that make such an order appropriate; and

(b) the applicant has acted, and is acting, in good faith and with due diligence.

[13] Whether it is "appropriate" to make the order is not dependant on finding "due diligence" and "good faith." Indeed, refusal on that basis can be the result of an independent or interconnected finding. Stays of proceedings have been refused where the company is hopelessly

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[5] See for example ***Chef Ready Foods Ltd. v. Hongkong Bank of Canada*** (1990), 4 C.B.R. (3d) 311 (B.C.C.A.) and ***Meridian Development Inc. v. Toronto Dominion Bank*** (1984), 52 C.B.R. (N.S.) 109 (ABQB).

[6] ***Elan Corporation v. Comsikey*** (1990), 1 C.B.R. (3d) 101 (Ont. C.A.).

insolvent; has acted in bad faith;[7] or where the plan of arrangement is unworkable, impractical or essentially doomed to failure.[8]

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Meaning of "Good Faith"

[14] The term "good faith" is not defined in the *CCAA* and there is a paucity of judicial consideration about its meaning in the context of stay extension applications. The opposing landlords on this application rely on the following definition of "good faith" found in *Black's Law Dictionary* to support the proposition that good faith encompasses general commercial fairness and honesty:

> A state of mind consisting of: (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealings in a given trade or business, or (4) absence of intent to defraud or seek unconscionable advantage.[9] [Emphasis added]

[15] "Good faith" is defined as "honesty of intention" in the *Concise Oxford Dictionary*.[10]

[16] Regardless of which definition is used, honesty is at the core. Honesty is what the opposing landlords urge is desperately wanting now and, as evidenced by San Francisco's earlier conviction for *Copyright Act* offences, was wanting in the past.

[17] Accepting that the duty of "good faith" requires honesty, the question is whether that duty is owed to the court and the stakeholders directly affected by the process, including investors, creditors and employees, or does the *CCAA* cast a broader net by requiring good faith in terms of the company's dealings with the public at large? As will be seen from the following review of the jurisprudence, it usually means the former.

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[7] ***Re Avery Construction Co. Ltd.***, [1942] 4 D.L.R. 558 at 559 (Ont. S.C.).

[8] ***Re Fracmaster Ltd.*** (1999), 11 C.B.R. (4th) 204 (Alta. Q.B.); aff'd 11 C.B.R. (4th) 230 (Alta. C.A.).

[9] *Black's Law Dictionary*, 7th ed. (St. Paul, Minnesota: West Group, 1999), p.701.

[10] *The Concise Oxford Dictionary of Current English*, 6th ed., (Oxford, Eng.: Clarendon Press, 1976), p.373.

[18] ***Re Rio Nevada Energy Inc.***[11] and ***Re Skeena Cellulose Inc***.[12] both involved opposed stay extension applications. In ***Skeena***, one of the company's two major secured creditors argued that the company's failure to carry out certain layoffs in the time recommended by the monitor showed a lack of good faith and due diligence. Brenner C.J.S.C. found that the delay in carrying out the layoffs was not a matter of bad faith. Given the severe consequences of terminating the stay, he granted the extension.

[19] Romaine J. rejected a suggestion of lack of good faith arising from a creditor dispute and allegations of debtor dishonesty in ***Rio Nevada***, finding that: "Rio Nevada has acted and is acting in good faith with respect to these proceedings."[13] [Emphasis added]

[20] ***Sairex GmbH v. Prudential Steel Ltd.***[14] involved an application by a creditor to proceed against a company under *CCAA* protection. Farley J. declined the application despite his sympathy for the creditor's position and his view that the creditor could make out a fairly strong case. He said: "… I would think that public policy also dictates that a company under *CCAA* protection or about to apply for it should not be allowed to engage in very offensive business practices against another and thumb its nose at the world from the safety of the *CCAA*."[15] In the end, he concluded that the dominant purpose behind the company's actions was not to harm the creditor.

[21] Inventory suppliers in ***Re Agro Pacific Industries Ltd.*** [16] sought to set aside a *CCAA* stay on the ground that the company had not been acting in good faith in entering into contracts. The suppliers' contention that the company knew it was in shaky financial circumstances when it ordered goods and that it did so to pay down the secured creditors was rejected by Thackeray J. He was not satisfied that there was any lack of good faith or collusion between the company and its secured creditors to disadvantage the unsecured creditors.

[22] ***Re Juniper Lumber Co.***[17] addressed a creditor's allegations of bad faith in the context of an application to set aside the *ex parte* Initial Order. Turnbull J. held that, while fraud may not always preclude *CCAA* relief, it was of such a magnitude in that case as to warrant setting aside

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[11] (2000), 283 A.R. 146 (Q.B.).

[12] 2001 BCSC 1423, 29 C.B.R. (4th) 157.

[13] ***Rio Nevada***, at para. 31.

[14] (1991), 8 C.B.R. (3d) 62 (Ont. Ct. Just. (Gen. Div.).

[15] ***Sairex GmbH***, at p. 73.

[16] 2000 BCSC 837, 76 B.C.L.R. (3d) 364.

[17] [2000] N.B.J. No.125 (Q.B.T.D.) (QL).

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the order. He commented that: "basic honesty has to be present" in the course of conduct between a bank and its customer.[18] However, his decision was overturned by the Court of Appeal because the necessary evidentiary foundation was wanting.[19]

[23] ***Elan Corp. v. Comiskey***,[20] although addressing instant trust deeds, which are no longer of concern under the present *CCAA,* offers a useful discussion of "good faith." Doherty J.A., dissenting in part, commented:

> …A debtor company should not be allowed to use the Act for any purpose other than to attempt a legitimate reorganization. If the purpose of the application is to advantage one creditor over another, to defeat the legitimate interests of creditors, to delay the inevitable failure of the debtor company, or for some other improper purpose, the court has the means available to it, apart entirely from s. 3 of the Act, to prevent misuse of the Act. In cases where the debtor company acts in bad faith, the court may refuse to order a meeting of creditors, it may deny interim protection, it may vary interim protection initially given when the bad faith is shown, or it may refuse to sanction any plan which emanates from the meeting of the creditors.[21]

[24] Doherty J.A. referred to an article by L. Crozier, "*Good Faith and the Companies' Creditors Arrangement Act*,"[22] in which the author contends that the possibility of abuse and manipulation by debtors should be checked by implying a requirement of good faith, as American bankruptcy courts routinely do by invoking good faith to dismiss applications under Chapter 11 of the *Bankruptcy Code* where the debtor's conduct in filing for reorganization is found to constitute bad faith.[23] He also suggests that, as a result of the injunctive nature of the stay, the court's power to take into account the debtor's conduct is inherent in its equitable jurisdiction.

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[18] ***Re Juniper***, at para. 13.

[19] 2001 NBCA 30.

[20] (1990), 1 O.R. (3d) 289 (C.A.).

[21] ***Elan Corp***., at p. 313.

[22] (1989), 15 Can. Bus. L.J. 89.

[23] Crozier cites ***Re Victory Construction Co. Inc.*** 9 B.R. 549 (1981) as an example of this. The court in that case found that the debtor company's purpose in filing under c. 11 was to isolate assets from its creditors rather than to reorganize the business. At p. 558, the court commented that good faith was "an implicit prerequisite to the filing or continuation of a proceeding under Chapter 11 of the *Code*."

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[25] An obligation of good faith in the context of an application to sanction a plan of arrangement was implied in ***Re First Investors Corp. Ltd.***[24] While ***First Investors*** was an atypical *CCAA* proceeding, it is worth discussion. Allegations that fraud had been committed on creditors and consumers/investors led to the additional appointment of both a receiver and an inspector under the Alberta *Business Corporations Act*. The inspector had a broad mandate to investigate the company's affairs and business practices that included inquiring into whether the company had intended to defraud anyone.

[26] Berger J. (as he then was) noted that the *CCAA* is derived from s. 153 of the English *Companies Act*, 1929 (19 and 20 Geo. 5) c. 23. Having sought assistance from other legislation with wording similar to the *CCAA* and with a genesis in the British statute,[25] he concluded that the court should not sanction an illegal, improper or unfair plan of arrangement.[26] He emphasized that: "If evidence of fraud, negligence, wrongdoing or illegality emerges, the Court may be called upon by interested parties to draw certain conclusions in fact and in law that bear directly upon the Plans of Arrangement."[27] He also determined that, while it might be expedient to approve the plans, the court was bound to proceed with caution, "so as to ensure that wrongful acts, if any, do not receive judicial sanction."[28]

[27] In the end, Berger J. adjourned the application pending receipt of a report by the inspector. His decision was reversed on appeal[29] on the basis that there was nothing in the plans that sanctioned wrongful acts or omissions. The Court of Appeal remitted the matter back for reconsideration on the merits, stating that while the discretion to be exercised must relate to the merits or propriety of the plans, the court could consider whether approving the plans would sanction possible wrongdoing or otherwise hinder later litigation.

Supervising Court's Role

[28] The court's role during the stay period has been described as a supervisory one, meant to: "…preserve the *status quo* and to move the process along to the point where an arrangement or

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[24] (1987), 46 D.L.R. (4th) 669 at 673-674, 67 C.B.R. (N.S.) 237 (Alta. Q.B.); See also ***Re Agro Pacific Industries Ltd.***, footnote 16, at para. 40 where Thackray J. held that there was an implied duty of good faith on initial applications.

[25] ***First Investors***, at p. 676.

[26] ***First Investors***, at p. 677.

[27] ***First Investors***, at p. 678.

[28] ***First Investors***, at p. 678.

[29] (1988), 89 A.R. 344, 71 C.B.R. (N.S.) 71 (C.A.).

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compromise is approved or it is evident that the attempt is doomed to failure."[30] That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling of creditors' meetings and the like. On the contrary, this role requires attention to changing circumstances and vigilance in ensuring that a delicate balance of interests is maintained.

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[29] Although the supervising judge's main concern centres on actions affecting stakeholders in the proceeding, she is also responsible for protecting the institutional integrity of the *CCAA* courts, preserving their public esteem, and doing equity.[31] She cannot turn a blind eye to corporate conduct that could affect the public's confidence in the *CCAA* process but must be alive to concerns of offensive business practices that are of such gravity that the interests of stakeholders in the proceeding must yield to those of the public at large.

CONCLUSIONS

[30] While "good faith" in the context of stay applications is generally focused on the debtor's dealings with stakeholders, concern for the broader public interest mandates that a stay not be granted if the result will be to condone wrongdoing.[32]

[31] Although there is a possibility that a debtor company's business practices will be so offensive as to warrant refusal of a stay extension on public policy grounds, this is not such a case. Clearly, San Francisco's sale of knockoff goods was illegal and offensive. Most troubling was its sale to an unwitting public of goods bearing counterfeit safety labels. Allowing the stay to continue in this case is not to minimize the repugnant nature of San Francisco's conduct. However, the company has been condemned for its illegal conduct in the appropriate forum and punishment levied. Denying the stay extension application would be an additional form of punishment. Of greater concern is the effect that it would have on San Francisco's creditors, particularly the unsecured creditors, who would be denied their right to vote on the plan and whatever chance they might have for a small financial recovery, one which they, for the most part, patiently await.

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[30] McFarlane J.A. in ***Re Pacific National Lease Holding Corp.*** (1992), 15 C.B.R. (3d) 265 at 270 (B.C.C.A.), quoting with approval Brenner J. in the court below at [1992] B.C.J. No. 3070 at para. 26 (S.C.) (QL).

[31] L. J. Crozier, footnote 22 at p. 95, quotes Edith H. Jones, in "The Good Faith Requirement in Bankruptcy," Proceedings of the 61st Annual Meeting of the National Conference of Bankruptcy Judges, 1987, as statingd that: "... the bankruptcy judge usually at the instance of counsel, upon the filing of appropriate motions, is principally responsible to protect the institutional integrity of the bankruptcy courts, preserve their public esteem, and do equity in specific cases."

[32] ***First Investors Corp. v. Alberta*** (1988), 89 A.R. 344 at para. 16 (C.A.); ***Re Canadian Cottons Limited*** (1952), 33 C.B.R. 38.

[32] San Francisco has met the prerequisites that it has acted and is acting with due diligence and in good faith in working towards presenting a plan of arrangement to its creditors. Appreciating that the *CCAA* is to be given a broad and liberal interpretation to give effect to its remedial purpose, I am satisfied that, in the circumstances, extending the stay of proceedings is appropriate. The stay is extended to July 19, 2005. The revised time frame for next steps in the proceedings is set out on the attached Schedule.

[33] Although San Francisco has paid the $150,000.00 fine, the Monitor is satisfied that the company's current cash flow statements indicate that it is financially viable. Whether San Francisco can weather any loss of public confidence arising from its actions and resulting conviction is yet to be seen. Its creditors may look more critically at the plan of arrangement, and its customers and business associates may reconsider the value of their continued relationship with the company. However, that is sheer speculation.

Heard on the 17th day of January, 2005.
Dated at Edmonton, Alberta February 9th, 2005.

J.E. Topolniski
J.C.Q.B.A.

Appearances:

Richard T.G. Reeson, Q.C. Miller Thomson LLP (formerly Witten LLP) John Bridgadear Howard J. Sniderman Witten LLP	for the Companies
Michael McCabe, Q.C Reynolds, Mirth, Richards & Farmer LLP	for the Monitor - Browning Crocker Inc.

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Jeremy H. Hockin Parlee McLaws LLP	for Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc.; 20 Vic Management Ltd.; Morguard Investments Limited; Morguard Real Estate Investments Trust; Millwoods Town Centre, Edmonton; Park Place, Lethbridge; Metro Town , Burnaby, BC; Northgate Mall, Edmonton; Brandon Shopping Mall, MB; Herongate Mall, Ottawa, ON; Westmount Shopping Centre, London; Village Mall, St. John's NFLD; Kingsway Garden Mall; Westbrook Mall; Bonnie Doon Shopping Centre; Red Deer Centre; Marlborough Mall; Circle Park Mall; Kildonan Place Mall; Cambridge Centre; Oshawa Centre; Tecumseh Mall; Downtown Chatham Centre; Simcoe Town Centre; Niagara Square; Halifax Shopping Centre; RioCan Property Services; 1113443 Ontario Inc.; Shoppers World, Brampton, ON; Tillicum Mall, Victoria, BC; Confederation Mall, Saskatoon, SK; Parkland Mall, Yorkton, SK; Cambrian Mall, Sault Ste. Marie, ON; Northumberland Mall, Cobourg, ON; Orangeville Mall, Orangeville, ON; Renfrew Mall, Renfrew, ON; Orillia Square Mall, Orillia, ON; Elgin Mall, St. Thomas, ON; Lawrence Square, North York, ON; Trinity Conception Square, Carbonear, NFLD; Charlottetown Mall, Charlottetown PEI; Timiskaming Square
Kent Rowan Ogilvie LLP	Locher Evers International Neuvo Rags Quality Press
	And Lauer Transportation Services as represented by its employee Tim Shelley

Schedule

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Time Frames

1.	February 14, 2005	Date Monitor posts Notice to Creditors on website
2.	February 14, 2005	Date Monitor publishes the advertisement for one day in Globe & Mail or National Post
3.	April 1, 2005	Date for receipt of claims from creditors
4.	May 13, 2005	Date by which Monitor must send Notice of Revision or Disallowance.
5.	June 13, 2005	Last date for bringing application to challenge a Notice of Revision or Disallowance.
6.	June 27, 2005	Date for creditors meeting to vote on the Plan.
7.	July 11, 2005	Date for court application to approve Plan (if required).
8.	August 18, 2005	Date for Distribution to Prove Unsecured Claims

Stay Extended to July 19, 2005

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TAB 10

Court of Queen's Bench of Alberta

Citation: Re Canada North Group Inc, 2017 ABQB 508

Date: 20170817
Docket: 1703 12327
Registry: Edmonton

2017 ABQB 508 (CanLII)

In the Matter of the
***Companies' Creditors Arrangement Act*,**
RSC 1985, c C-36, as amended

and in the Matter of a Plan of Arrangement of
Canada North Group Inc., Canada North Camps Inc.,
Campcorp Structures Ltd., D.J. Catering Ltd.,
816956 Alberta Ltd. and 1371047 Alberta Ltd.

Reasons for Decision
of the
Honourable Mr. Justice S.D. Hillier

I Introduction

[1] Canada North Camps Inc. (CNC), Campcorp Structures Ltd., D.J. Catering Ltd., 816956 Alberta Ltd. and 1371047 Alberta Ltd. (collectively, the Group) request extension of a Stay under s. 11.02(2) of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (*CCAA*) until November 3, 2017 and ancillary orders.

[2] The Canadian Western Bank (CWB) cross-applies for an order lifting the Stay and appointing either a full or interim Receiver pursuant to s. 243 (or ss. 47 and 244 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (*BIA*)), s. 13(2) of the *Judicature Act*, RSA 2000, c J-2, s. 99(a) of the *Business Corporations Act*, RSA 2000, c B-9, and s. 65(7) of the *Personal Property Security Act*, RSA 2000, c P-7.

II History

[3] The Group operates or provides a number of services including work camps in the natural resource sector, modular construction manufacturing, camp land rentals as well as real estate holdings including a golf course. CWB has been the Group's major secured creditor for a significant period of time.

[4] 1919209 Alberta Ltd. (1919) is an insolvent affiliated debtor holding company of two of the companies in the Group. It was incorporated to lease camp equipment from Weslease Income

Growth Fund LP (Weslease) and provide that camp equipment to Canada North Camps Inc. for its use. 1919's operations are integrated with those of the other applicants.

[5] CNC entered into an agreement to construct a camp on Wandering River. 1371047, and Wandering River Properties Ltd. (owned 2/3 by 1371047) subsequently purchased a parcel for that purpose. CNC joined with the local Heart Lake First Nation and formed Heart Lake CNC LP, Heart Lake Canada North Group GP Ltd., Wandering River Properties Ltd., and Canada North Group LP Holdings Ltd.

[6] An action by Max Fuel Distributors Ltd. as against Shayne McCracken arises from the operation of the camp business. The other creditors of the Group are stayed from enforcing collateral claims against Shayne McCracken.

[7] The Group's operations and profitability have been significantly impacted since 2014 by the downturn in the economy. Earlier attempts by the Group and CWB to deal with the debt and cash flow issues proved to be unsuccessful.

[8] In March 2017, the parties signed a Forbearance Agreement but problems continued. When they were unable to reach a new resolution in a full meeting on June 21, 2017, the Group issued Notices of Intention to make proposals under the *BIA* effective June 26, 2017.

[9] On July 5, 2017, Nielsen J. granted an initial Stay under s. 11.02(1) of the *CCAA*. He imposed numerous terms, including that:

- Ernst & Young be appointed as Monitor;
- R. e. I. Group Inc. be appointed as Chief Restructuring Officer (CRO);
- the Stay continue until August 3, 2017, subject to review;
- Debtor in Possession (DIP) financing from the Business Development Bank of Canada (BDC) be made available, not to exceed $1M;
- Notice of Intention proceedings under the *BIA* be "taken up" and continued under the *CCAA*.

[10] On July 27, 2017, the Group applied under s. 11.02(2) of the *CCAA* for an extension of the Stay to November 3, 2017. It also applied to add 1919 as an applicant in these proceedings.

[11] As well, it applied to expand the Stay to apply to proceedings against the entities involved in the Wandering River contract, and against Shayne McCracken.

[12] Finally, the Group applied for an increase in the DIP financing to a maximum of $2,500,000 and an interim lender's charge up to the same amount due to elevated costs associated with a significant short-term increase in work under a camps contract with the British Columbia provincial government for workers on the wildfires.

[13] The CWB cross-applied for an order lifting the Stay and appointing a full or interim Receiver.

[14] The Monitor sought approval of his First Report and activities, a suspension of limitation periods on claims, and the power to examine the parties regarding questioned transactions on lot sales prior to the *CCAA* Order (preferences) under s. 36.2 of the *CCAA*. Other interested parties also made submissions as affecting their interests.

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[15] In an oral decision, this Court extended the Stay to September 29, 2017 with a review to be held on September 26, 2017. The cross-application was dismissed. The Court also issued a series of ancillary directions. The parties were advised that written reasons would be issued dealing with the main issue as to extension of the Stay or appointment of a Receiver. These are the written reasons.

III Affidavit Evidence

[16] The Group's stated preliminary plan is to return operations to profitability as demand increases, consider sale of some of its assets, and seek new financing or equity investment as required in order to provide a viable Plan of Arrangement.

[17] The Group has presented extensive affidavits from Ms. Shayne McCracken, Director and Secretary of the applicants, in support of the various applications, containing the following key assertions:

– the Group has acted in good faith and with due diligence, working closely with the CRO and cooperating with the Monitor as they gain an understanding of the business and structure;

– the Group has specifically worked with the CRO and Monitor to improve financial reporting and accounting processes;

– together they have taken initial steps to develop a Plan of Arrangement to present to creditors, including a detailed overview of assets and liabilities;

– the Group has been the subject of unsolicited investment and purchase interest, which the Group, Monitor and CRO are pursuing;

– meetings have taken place with interested parties as well as arrangements related to drawdowns on DIP financing;

– work has included contracts with the Province of British Columbia to address efforts in consequence of raging wildfires in that province.

[18] Ms. McCracken's affidavits purport to meet head on the concerns of CWB with the accounting treatment of certain accounts receivable, particularly in relation to the Grand Rapids Pipeline Project and the margining of custom negotiated deferred revenue. In late 2016, cost estimates were prepared for demobilization of the Grand Rapids camp, including removal of the camp for just over $2M and reclamation work estimated at roughly $5.36M based on detailed costing. Ms. McCracken asserted that the practice of clients assuming the costs of setting up and removing camps by advance invoicing is used by others in the camp industry.

[19] The margining of custom negotiated deferred revenue allows the Group access to necessary financing to commence work prior to being paid. Ms. McCracken found support for the accounting practice in question in the custom negotiated deferred revenue term of the margining requirement that was part of the credit agreement with CWB.

[20] Two significant receivables were placed on the books between March and May 2017 (it is unclear when they were actually posted and sent to the client) on Grand Rapids. This ostensibly led to a claim against the financing and increased CWB's exposure significantly at a time when the parties were trying to sort things out following the Forbearance Agreement in mid-March.

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[21] Ms. McCracken specifically denied CWB's allegation that these invoices were provided in bad faith to artificially inflate the amount available on the operating line. She deposed that the invoicing for this work was reviewed by the Group's corporate counsel. As well, it was part of the financial reporting to CWB and there were regular conversations with account managers at CWB who were aware of the origin and nature of all significant receivables, including the Grand Rapid receivables. Ms. McCracken maintained the view that the receivables were appropriately margined as deferred revenue.

[22] Ms. McCracken noted that Grand Rapids has now raised issues with respect to payment of some of the invoices and a meeting is scheduled with it in Calgary in early August to discuss payment of those invoices.

[23] Ms. Jessica Taha filed extensive material for CWB challenging the Stay, and supporting the appointment of a Receiver. The following assertions are germane, particularly as concerns margining of receivables:

- the Group had been margining receivables for which work had not yet been done (citing Grand Rapids);
- as a result, the operating line was overdrawn by over $3.8M for work not yet done which only came to light at the June 21, 2017 meeting; subsequent information reflects that it is overdrawn by $8M;
- the Group had only performed 10% of required work on one contract and only 40% for another, and none of this was consistent with the margining as represented by the Group, and arranged between the parties dating back to 2012;
- despite representations to the contrary before Nielsen J., CWB was not aware of this prior to the June 21, 2017 meeting.

[24] Ms. Taha attested to her belief that as the level of work dropped dramatically in the economic downturn, the Group changed its approach without advising CWB, and started to render invoices for work which had not yet been done, categorizing those invoices as deferred revenue capable of margining.

[25] In response, Ms. McCracken maintained her position that the Grand Rapids deferred revenue was properly included in the financial statements. She deposed that Ms. Taha's position that deferred revenue was only permitted to be used for margining based on the percentage of the work performed is inconsistent with the supporting material provided by Ms. Taha. The Group kept their branch representatives apprised of the status of the deferred revenue inclusions in the margining calculations and none raised a concern.

[26] In counter response, CWB prepared three affidavits of senior officers at the Edmonton Main Branch deposing that they were unaware of the material amounts that were being margined without the work having been done, and each was unaware of anyone else at CWB having had such knowledge until the meeting on June 21, 2017.

[27] Glenn MacDougall, Manager of ECN Capital Corp. (ECN), also filed an affidavit. ECN is an equipment lessor and creditor of the Group. In short, he opines that the work resulting from the BC wildfires is a temporary salve on the Group's financial circumstances, and it is unlikely that the Group will be able to make a viable Plan of Arrangement. He deposed that ECN would

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be materially prejudiced by the continuation of the Stay, as it will erode the value of ECN's security.

[28] With respect to expanding the Stay, Ms. McCracken deposed that direct claims against affiliates have been reviewed. The Group now seeks to expand the stay to specific affiliates where those affiliates are facing claims directly connected to the overall camp operations, in order to preserve the *status quo*, prevent unnecessary expenditures of effort on litigation, maximize recovery for all parties, and allow for an orderly determination of priority and claims.

[29] Regarding inclusion of 1919, Ms. McCracken deposed that 1919 has no revenue other than lease income from Canada North and is completely dependent on such payments to fulfill its obligations under the leases. It is included in the consolidated cash flow projections and financial statements for the Group, as it is treated as a flow through entity. The equipment it leases is essential to the uninterrupted operations of the Group.

[30] Finally, Ms. McCracken explained that the increased work for the B.C. government, although welcome, creates a cash flow issue as the work is invoiced approximately a week after completion and receipt of payment typically takes approximately four weeks from invoicing. Consequently, the Group anticipates a cash flow shortage in August 2017 that will not be met by the present DIP facility. On July 21, 2017, the interim lender approved an increase to the DIP financing to a maximum of $2,500,000.

IV Monitor's First Report

[31] The Monitor has provided a First Report, advising of various steps taken in conjunction with the CRO, highlights of which include:

General

- a new cash management procedure has been initiated to ensure efficient control of cash and cash reporting, with a review of cash flow projections;
- the Group's management and staff have been making significant efforts in all respects and are cooperating fully with the efforts of the CRO;
- based on the Monitor's own work with Group management, the Group appears to have acted in good faith and with due diligence;
- the actual end cash balance for the two weeks ending July 15, 2017 was higher than projected by over $400K and collections higher than projected by nearly $350K;
- while cash disbursements were lower, this was largely due to temporary deferrals;
- the contracts relating to the B.C. wildfires will have a significant positive impact on future cash inflows and receivables.

Accounts Receivable

- the Group has used atypical accounting practices as reflected in four areas;

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- the steps being adopted in response to CWB's concerns include removing Grand Rapids and Heart Lake related receivables as a conservative strategy while quantum is reviewed;
- some but not all of the room guarantees or reservations have been reversed out.

Status of Restructuring Efforts and Related Plan

- the Group's business and operations are very complex;
- the CRO believes, based on preliminary work to date and co-operation of the management team, that there is certainly potential for a going concern plan that could provide significantly greater value to stakeholders as compared to a liquidation;
- the CRO is of the initial view that several profit and gross margin improvements have been realized by the Group due to changes to operations, staffing and other operational matters.

1919

- the leasing arrangement with Weslease has been extended for use by the Group valued at approximately $6M and listed as: three Jack+Jill dorms, two power distribution centres and one waste water treatment plant;
- expansion of the Stay to include 1919 is reasonable.

[32] As well, the Monitor and the Group have been in contact with various parties who have expressed interest in participating in a restructuring through refinancing, purchasing assets or investing in the Group.

V Law

[33] An initial Stay under s. 11.02(1) of the *CCAA* may be imposed for a maximum period of 30 days. The role of this Court on a subsequent application under s. 11.02(2) is not to re-evaluate the initial decision, but rather to consider whether the applicant has established that the current circumstances support an extension as being appropriate and that the applicant has acted, and is acting, in good faith and with due diligence, as required under s. 11.02(3).

[34] The purpose of the *CCAA* is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Appropriateness of an extension under the *CCAA* is assessed by inquiring into whether the order sought advances the policy objectives underlying the *CCAA*. A stay can be lifted if the reorganization is doomed to failure, but where the order sought realistically advances those objectives, a *CCAA* court has the discretion to grant it: ***Century Services Inc v Canada (Attorney General)***, 2010 SCC 60 at paras 15, 70, 71, [2010] 3 SCR 62.

[35] In applying for an extension, the applicant must provide evidence of at least "a kernel of a plan" which will advance the *CCAA* objectives: ***North American Tungsten Corp, Re***, 2015 BCSC 1376, 2015 CarswellBC 2232 at para 26, citing ***Azure Dynamics Corp, Re***, 2012 BCSC 781, 91 CBR (5th) 310.

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[36] Pursuant to s. 11.02(3), the applicant is required to demonstrate that it has acted, and continues to act, in good faith. Honesty is at the core of "good faith": ***San Francisco Gifts Ltd., Re***, 2005 ABQB 91 at para16, 10 CBR (5th) 275.

[37] Section 11.02(3) refers to consideration of good faith and due diligence in both the past and present tense. Romaine J. in ***Alberta Treasury Branches v Tallgrass Energy Corp***, 2013 ABQB 432 at para 13, 9 CBR (6th) 161 confirmed the language of s. 11.02(3), to the effect that the court needs to be satisfied that the applicant has acted in the past, and is acting, in good faith. See also ***Alexis Paragon Limited Partnership (Re)***, 2014 ABQB 65 at para 16, 9 CBR (6th) 43.

[38] By contrast, in ***Muscletech Research and Development Inc (Re)***, [2006] OJ No 462 at para 4, 19 CBR (5th) 57 (Sup Ct Just), Farley J. held that the question of good faith relates to how the parties are conducting themselves in the context of the *CCAA* proceedings. Courts in subsequent cases adopted this view: ***Pacific Shores Resort & Spa Ltd (Re)***, 2011 BCSC 1775 at para 31-32, [2011] BCJ No 2482, and ***4519922 Canada Inc.(Re)***, 2015 ONSC 124 in paras 44-46, 22 CBR (6th) 44.

[39] In ***Guestlogix Inc, Re***, 2016 ONSC 1348, [2016] OJ No 1129, the Court expanded the stay to proceedings against a guarantor, noting that it was insolvent and in default of its obligations, highly integrated with the debtor company, and the debtor company would be able to include all the assets of the guarantor in a potential transaction if the guarantor were added.

[40] The Court has broad equitable jurisdiction to determine appropriate allocation among assets of administration, interim financing and directors' charges: ***Hunters Trailer& Marine, Re***, 2001 ABQB 1094, 30 CBR (4th) 206. The Court in ***Canwest Publishing Inc (Re)***, 2010 ONSC 222 at para 54, 63 CBR (5th) 115 set out factors to be considered in determining priority of charges under s. 11.52 of the *CCAA* which are critical to the successful restructuring of the business:

(a) the size and complexity of the businesses being restructured;

(b) the proposed role of the beneficiaries of the charge;

(c) whether there is an unwarranted duplication of roles;

(d) whether the quantum of the proposed charge appears to be fair and reasonable;

(e) the position of the secured creditors likely to be affected by the charge; and

(f) the position of the Monitor.

[41] Section 11.2(4) of the *CCAA* provides that in deciding whether to make an order allowing DIP financing, the Court must consider:

(a) the period during which the company is expected to be subject to *CCAA* proceedings;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

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(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report.

[42] In ***US Steel Canada Inc (Re)***, 2014 ONSC 6145 at paras 12-18, 20 CBR (6th) 116 the Court discussed the authority under s. 11.2 to grant priority to the DIP lender's charge to secure the DIP loan. In addition to the factors set out in s. 11.2(4), it considered the following in granting priority:

(a) notice had been given to all of the secured parties likely to be affected and broadly to all *PPSA* registrants, and other interested entities;

(b) the maximum amount of the DIP loan was appropriate based on the anticipated cash flow requirements of the applicant as reflected in its cash flow projections for the entire restructuring period, in order to continue to carry on its business during the restructuring period;

(c) the cash flows were the subject of a favourable report of the Monitor in its First Report;

(d) the Applicant's business would continue to be managed by the applicant's management with the assistance of the CRO during the restructuring period;

(e) the existing operational relationships between the applicant and its largest creditor would continue; and

(f) the DIP loan would assist in, and enhance, the restructuring process.

VI Analysis

Extension of Order

[43] Various factors were profiled by Ms. Wanke before Nielsen J. to support the Group's position that a restructuring under the *CCAA* is possible; if the objective is liquidation, then appointment of a Receiver is appropriate. Nielsen J. recognized the possibility of a successful restructuring in rejecting the application to appoint a Receiver and granting the application to impose a Stay under the *CCAA* with a Monitor and CRO. In recognizing that a lot of work had been done, he found that those supporting the steps to restructure should be given that opportunity in the collective best interest despite the prejudice of deferral and risk as regards repayment of CWB and other creditors.

[44] I now have the responsibility to measure the progress in the period leading up to expiry of the initial Stay. Without second-guessing the initial decision, I must assess the current circumstances, including the good faith and due diligence of the parties in light of steps taken to date.

2017 ABQB 508 (CanLII)

[45] The legislative objective of a *CCAA* order is to provide the Court considerable scope to maintain the *status quo* for a company to make proposal arrangements to facilitate remaining in operation for a collective benefit. One may have preferred to see some further advancement on the "germ of a Plan" but I am satisfied that the CRO has begun consultations with unsolicited parties who have expressed an interest and that a structure for such a Plan is now an important priority.

[46] I am mindful that the Monitor was obliged to report on just under three weeks of activity in rendering a First Report by July 24, 2017. Various factors have impacted the lack of concrete progress on a Plan at this point, including the value of the Group as a going concern estimated at $97M (equipment, manufacturing and real estate) with diverse activities, assets and work product, the complexity of restructuring, and the need to modernize the sophistication of a family operation that is unable to operate as it has done historically.

[47] Professional advisors are now in place assisting in this required modernization. Potential investors have and continue to express interest in the Group. It appears that DIP funding has been used prudently to cover operational expenses including higher than expected professional expenses. Cash flows are quite healthy and the Group owns a number of assets of marketable value.

[48] CWB notes that Nielsen J. indicated on the initial Stay application that the Group would have to show more than a germ of a plan at the next hearing. It is not entirely surprising that three weeks did not prove long enough to complete the steps necessary to create a Plan of Arrangement. There is no allegation of delay or inertia by the Monitor or the CRO in performance of significant responsibilities undertaken since confirmation of their appointment July 5, 2017. The Monitor reported that the Group has been working with due diligence and in full cooperation. A number of competing interests require the attention of the Monitor. Having considered all of the circumstances before the Court, I am satisfied that the Group has established due diligence.

[49] It bears noting that CWB is not the only party who would be affected by receivership. Employees, other creditors, clients, and the public would also be affected. Changes have already been implemented by the CRO, as observed and reported by the Monitor.

[50] The Group has had the recent opportunity to enter into contracts with the Province of B.C. in relation to the wildfires. It appears that despite the Group's liquidity crisis – impacted by various factors, including market conditions – the business of the Group may well be salvageable. This assessment appears to be supported by: the cash flow projections, recoveries on receivables, and changes begun by the CRO in consultation with the Monitor with particular regard to increased work potential and to increase the sophistication of accounting.

[51] However, CWB takes the position that the Group has been in default of its obligations to CWB for many months. CWB extended time for the Group to find refinancing and continued to make available to the Group the operating line facility in the amount of $12,000,000, margined on accounts receivable of the Group. CWB asserts that the Group took advantage of CWB by falsely including one or more multi-million dollar accounts receivable for which the work had not yet been done.

[52] The parties disagree as to whether the law supports serious consideration of past bad faith if it is relevant to the viability of the *CCAA* proposal or its continuation.

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[53] The language of s. 11.02(3) of the *CCAA* does not temporally restrict the consideration of bad faith. The wording of that provision is captured broadly in ***Tallgrass***. It would appear that ***Muscletech*** and the cases which followed it stand for the proposition that courts should look only to conduct in the context of the *CCAA* process. This represents a restrictive reading of s. 11.02(3) and the purpose of such a narrow interpretation is unclear.

[54] It is logical that past due diligence will usually have minimal relevance as a factor. However, past bad faith illuminated after *CCAA* proceedings have been initiated may undermine the confidence of creditors and the Court in the viability of *CCAA* proceedings. In my view, past bad faith may well be a relevant factor in the Court's assessment under s. 11.02(3). This is in keeping with the approach taken in ***Alexis Paragon***, 2014 ABQB 65 at paras 37-38.

[55] I note that the facts in this case are distinguishable from those in ***San Francisco*** where the alleged deception appeared to be aimed at deriving an advantage from customers through knock off products and counterfeit safety labels, rather than deriving an advantage from a financing secured creditor through accounting practices as alleged here by CWB.

[56] Again, the major issue in this regard is, and has been profiled as, the status of accounts receivable in terms of the margining of contracts for work not yet performed or not fully performed.

[57] CWB takes the position that, upon consultation with her client and corporate counsel, Ms. Wanke misrepresented the situation to Nielsen J. in her oral submissions on July 5, 2017. While this Court is not reviewing the basis for Nielsen J.'s order, the issue of margining was raised at that time and the allegation of bad faith remains a live issue. I understand the interpretation placed by CWB on the representations made in front of Nielsen J. both from Affidavits and then information provided to legal counsel. Ms. Wanke summarized her understanding as being that this was part of the camp business on the books of the Group and not a lack of good faith. I accept her expression on this review to the effect that she would have preferred to have been more familiar with the Grand Rapids contract at the time but that this issue only surfaced latterly. She said she would have stated the client's position somewhat differently, but that the net effect remains that the margining was consistent with the Group's understanding of its entitlement.

[58] CWB's concerns regarding the margining are understandable. It takes the position that while margining on deferred revenue was permissible, the Grand Rapids contracts do not qualify for that treatment according to the terms as agreed to between the parties notwithstanding the assertions advanced by the Group. CWB says there was an understanding as relates to the formula to be applied to these receivables that was violated, especially as to the two major Grand Rapids accounts issued between the end of March 2017 and beginning of May 2017. Counsel for CWB took the Court through a number of documents relating to the credit agreement between CWB and the Group to explain what the Group's reasonable understanding should have been in relation to contracts qualifying for special treatment of the accounts receivable for margining purposes.

[59] The Monitor has reviewed and discounted a number of entries as inappropriate; it will likely have to further endorse commitment to revise other receivables. The Court agrees that a commitment to revise other receivables may be appropriate. However, there are a number of priorities competing for the attention of the CRO. It is difficult to measure whether any breaches of the protocol were intentionally deceptive as distinct from aggressive and misguided. That distinction is harder to make based on duelling affidavits as distinct from oral testimony,

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questioning or at minimum some objective detailed analysis by the Monitor to assist the Court's interpretation of events.

[60] I have struggled to understand the treatment of invoicing as to the records of accounts receivable, particularly as the idea of charging for work not done is rather foreign to my experience as to the entitlement to collect. So too, the deferral of the time for payment extending from 45 days to 120 days obfuscates the idea of entitlement. The matter is complicated by the risk and relative reliability of these receivables as assets, distinct from a bad or at least tainted debt that needs to be monitored for collection procedures. All of these aspects appear to arise in far greater sums for 2016 than in any previous year which, understandably, is further troubling to principals at CWB.

[61] I endorse the concerns of CWB as legitimate. Even in the absence of a finding of bad faith, the practice employed as reflected in treatment of the Grand Rapids receivables raises legitimate concerns regarding the future viability of the Group. I accept that the practice in question has resulted in margining which has led to overall debt to CWB which is incongruent with the Group's receivables as they would be represented in the normal course, as confirmed in the Monitor's First Report.

[62] I also note CWB's concern that the cash flow projection relied on by the Monitor did not take into account unpaid professional fees relating to the work toward reorganization, and the projected loss to the end of October 2017 is considerably offset only by the fortuitous and uncertain wildfire camp work. CWB's receivables, to the extent they are collectible, are being used up by payment of the professional fees and interim financing.

[63] Nevertheless, I am not prepared to conclude on the basis of the material as presented to me that the Group has failed to act in good faith to the extent of disentitling the extension sought.

[64] Clearly, the parties now disagree on the interpretation of the arrangement between them as regards margining based on deferred revenue. The issue before this Court is not the correct interpretation of the various document referred to by CWB's counsel, but rather whether the Group's reliance on its understanding amounted to bad faith. There has been no trial of the latter issue. While raising questions, the evidence adduced on this application falls short of supporting a finding of bad faith in the sense of knowing reliance on an unsupportable interpretation of the documents, or intentional concealing of the practice or any relevant financial information. This is particularly so in light of the evidence of the Group's understanding that the arrangement between CWB and the Group expressly contemplated that the Group was permitted to margin deferred revenue when no work had been done.

[65] If the CWB was not aware of the effect or extent of this type of margining, it is not clear from the evidence that the Group understood it was acting other than consistently with the intention of the parties in this regard. This view of the matter is generally supported by the Monitor's information that the sophistication of all facets of the accounting system in place has not kept up with the sophistication of its business. The CRO is working to address accounting practices which require improvement.

[66] There is undeniably a considerable difference in the parties' interpretations of the conduct and reporting. Obviously, a debtor may be motivated to maximize access to funding. The past practice here is somewhat unclear, but even if the Group exceeded the terms or protocol as generally agreed, I do not ascribe bad faith to its actions.

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[67] Overall, I find that extension of the Stay is in the best interest. However, a further vigorous review must take place within a reasonable period of time.

[68] The November 3, 2017 date targeted by the Group is not reasonable in the circumstances.

[69] As such, the next hearing is set for September 26, 2017. The Court will require a Report from the Monitor at least 7 business days prior to that date.

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Increase in DIP Financing

[70] Ms. McCracken suggests in her affidavit that they only need a small increase in the DIP loan to cover operations in light of healthy cash flows and significant assets.

[71] While the creditors may rightly take issue with the characterization of the increase as "small", I approve the request to increase the DIP financing from $1M to $2.5M in the form of order proposed by counsel for the Group to address the anticipated cash flow shortage resulting from welcome work during what is typically a slower season for the Group. Counsel for CWB took no issue with the form of order.

[72] At the close of submissions, counsel for CRA alerted the Court, as well as BDC in particular, that it took issue with the increase in DIP financing and that it would be applying for priority with respect to $1.14M owing to the Minister by the Group for unremitted source deductions and GST. It was seeking an order to vary so as to put the administrative charge, director's charge and interim lender charges in second place behind the CRA. In light of that information, BDC counsel indicated that the CRA's position would not impair BDC's ability to advance the DIP financing, noting that the matter would be argued at a later date.

1919

[73] The application to add 1919 was not opposed. As was the case in ***Guestlogix***, the operations of 1919 are inextricably linked to those of the Group, as it leases important equipment and provides it Canada North.

[74] I order that 1919 be added as a party included in the Group. Counsel for the Group agreed to include in the order a clause restating the allocation provision in the initial Stay Order to recognize that Welease has made this concern known at this point. Counsel for CWB did not take issue with such a provision in the order.

Approval of Monitor's First Report

[75] And at the request of the Monitor, I approve:

- his First Report and activities;
- suspend the limitation periods on claims;
- confer power to examine parties on questioned transactions regarding lot sales prior to *CCAA*.

[76] The further Report of the Monitor is required at least 7 days before the next hearing.

Expansion of Stay

[77] The Stay is expanded to apply to proceedings against Heart Lake and associated parties involved in the Grand Rapids contracts, and proceedings by Max Fuel against Ms. McCracken.

Counsel for CWB did not take issue with this. In the result, the applications for appointment of a Receiver, interim or otherwise, are dismissed.

Sealing of Confidential Information

[78] I order that the confidential information identified as such on the Court file be sealed.

Service Protocol to Reduce Costs

[79] The Monitor is to maintain a service list of parties who provide the Monitor with email addresses. Those parties may be served by email effective the date of the email. All others are to be served by the Monitor posting its and others' materials on its website, effective as at the date of posting.

VII Conclusion

[80] I have determined that it is in the collective interest to extend the *CCAA* Stay to September 29, 2017. The Order will be subject to review by me on September 26, 2017 in usual consultation with the Court Coordinator.

Heard on the 27th day of July, 2017.
Dated at the City of Edmonton, Alberta this 17th day of August, 2017.

S.D. Hillier
J.C.Q.B.A.

2017 ABQB 508 (CanLII)

Appearances:

S.A. Wanke and S. Norris
DLA Piper (Canada) LLP
for the Applicants/Cross-Respondents

C.P. Russell, Q.C.
McLennan Ross LLP
for the Respondent/Cross-Applicant

D.R. Bieganek, Q.C.
Duncan Craig LLP
for the Monitor, Ernst &Young LLP

J. Oliver
Cassels Brock
for Business Development Bank of Canada

T.M. Warner
Miller Thompson
for ECN Capital Corp.

M.J. McCabe, Q.C.
Reynolds Mirth Richards & Farmer LLP
for PricewaterhouseCoopers

R.J. Wasylyshyn
Ogilvie LLP
for Weslease Income Growth Fund LP

H.M.B.Ferris
Lawson Lundell LLP
for First Island Financial Services Ltd.

G.F. Body
Justice Canada
for Canada Revenue Agency

2017 ABQB 508 (CanLII)

TAB 11

DATE: 20001208
DOCKET: C34129

COURT OF APPEAL FOR ONTARIO

IN THE MATTER OF THE PROPOSAL OF EUGENIO AND JULIANA CICORIA OF THE CITY OF BRANTFORD, IN THE COUNTY OF BRANT, IN THE PROVINCE OF ONTARIO

RE: CANADIAN IMPERIAL BANK OF COMMERCE
(Appellant)

–and– EUGENIO CICORIA and JULIANA CICORIA
(Respondents)

BEFORE: ABELLA, LASKIN and ROSENBERG JJ.A.

COUNSEL: Michael J. Valente, for the appellant

James Steven Cimba, for the respondent

HEARD: December 5, 2000

On appeal from the order of Justice George Yates dated March 28, 2000.

ENDORSEMENT

[1] The proposal put forward by the respondents and approved by the court compromised the bank's secured claim. The approved proposal treated part of the bank's claim as unsecured. The bank did not apply to revise the proposed assessment of its security. Therefore the proposal approved by the court was binding on all unsecured claims under s.62(2)(a) of the *Bankruptcy and Insolvency Act*.

[2] Equality among creditors is a basic principle of insolvency law. A side agreement that violates that equality is unenforceable. Such an agreement amounts to a fraud on the other creditors. This secret side agreement does violate the principle of equality. Therefore Yates J. was correct in concluding that the side agreement between the bank and the Cicorias was unenforceable.

[3] It follows that since Mr. Farmer negotiated the side agreement, he should be removed as an inspector.

2000 CanLII 16990 (ON CA)

[4] The parties agree that no allegations of misconduct were made against the trustee before Yates J. and that no evidence was put before him to justify a finding of misconduct. Therefore, having regard to the consent of the parties, paragraph 2 of the order of Yates J. is amended to delete any reference to the trustee.

[5] The appeal is dismissed with costs on a solicitor-and-client basis. In accordance with the order of McMurtry C.J.O., there shall be no costs to the trustee.

Signed: "R.S. Abella J.A."
"John Laskin J.A."
"M. Rosenberg J.A."

2000 CanLII 16990 (ON CA)

TAB 12

Re COBOURG FELT Co., Ex parte WEAVER.

Ont.

S.C.

1925.

Ontario Supreme Court in Bankruptcy, Fisher, J. March 30, 1925.

O. H. King, for applicant; *H. J. Smith*, for respondent.

FISHER, J.:—By an order dated July 7, 1922, the Court approved of the composition agreed to by the debtor company and its creditors. The terms of the composition were, the company was to pay to all unsecured creditors 60c. in the dollar, in 10 equal monthly payments, commencing February 15, 1923. Weaver was an unsecured creditor under the composition to the extent of upwards of $2,000. Between January 20, 1923, and June 28, 1924, Weaver purchased from the debtor company goods to the value of $554.17. These goods appear to have been ordered by Weaver from the company through its travellers. Weaver stated that when he received the goods he credited the amount owing for them on his account with the company and that he understood the company debited his account with the amount owing for the goods. He also stated that the goods so received and credited were by him considered as part payment of his 60c. in the dollar. Weaver says, and there is no contradiction, that the company sent him invoices at the time the goods were purchased and delivered but never drew on him or made demand for payment.

Between November 7, 1923, and March 14, 1924, Weaver received from the company 5 dividends of $98 each, or a total of $494.90. The company was unable to continue its payments under the composition and made an authorized assignment on June 17, 1924.

The trustee contends that Weaver is indebted to him as representing the creditors of the insolvent company in the amount of $554.57, and also that the delivery of the goods by the com-

1925 CanLII 392 (ON SC)

Ont.
S.C.
1925.
RE COBOURG FELT CO., EX P. WEAVER.
Fisher, J.

pany to Weaver constitutes, in these circumsances, a fraudulent preference.

Weaver claims that he is entitled to set off the $554.57 as against the company's indebtedness to him.

The trustee in his affidavit states that after deducting all payments made by the company to Weaver under the composition, the company is indebted to him in the sum of $2,000.

At the time the assignment was made, Weaver had only received the same dividends as the other creditors, but also goods to the value of $554.57 in excess of his due proportion of the composition.

It is of the essence of composition agreements that they shall be carried out in the utmost good faith, that all creditors shall be treated equally and that there shall be no secret arrangement or transactions whereby one creditor shall have or obtain or be given any undue advantage over other creditors. A debtor may, I think, pay the composition in goods, or in cash, but if he undertakes to pay a creditor in goods, the goods must not exceed in value the cash to which that creditor is then entitled in common with the other creditors; otherwise it is a fraud on the other creditors and a ground for annulling the composition.

It is the duty of the Court to guard against any invasion of the equitable rights of creditors under a composition and to refuse to sanction or permit any transaction which has the effect of giving to any one particular creditor any benefit or advantage over and above that which he is entitled to in common with the other creditors.

To allow the proposed set-off in this case would be sanctioning a transaction which is inconsistent with, and in effect, a fraud on the composition and against equity and good conscience.

The sole question is: is Weaver bound to pay the trustee $554.57 for the goods purchased, or is he entitled to set off this sum as against his general account against the debtor company. The trustee does not allege there was any collusion between the company and Weaver to give Weaver a preference.

During the period of the composition, it is admitted Weaver received $494 in dividends and in goods $554.57, in all the sum of $1,049.47. In other words, Weaver received $554.57 in excess of the dividends under the composition.

Section 13 (12) of the Bankruptcy Act 1919 (Can.), c. 36, states that "A composition, extension or scheme accepted and approved in pursuance of this section shall be binding on all

1925 CanLII 392 (ON SC)

the creditors so far as relates to any debts due to them from the debtor provable under this Act . . .".

Section 13 (15):—"All parts of this Act shall, so far as the nature of the case and the terms of the composition, extension or scheme admit, apply thereto . . ."

There can be no question that after a composition is approved by the Court, the debtor, unless the order of the Court otherwise provides, is entitled to carry on his business in the usual way and pledge his assets for that purpose and incur new liabilities with other creditors.

Section 28 (1) provides that:—"The law of set-off shall apply to all claims made against the estate, . . except in so far as any claim for set-off shall be affected by the provisions of this Act respecting frauds or fraudulent preferences."

If the contention of counsel for Weaver is to be upheld, it would mean that Weaver would obtain an undue preference over the other creditors. He was bound by the composition entered into between the company and its creditors under which he agreed to accept 60c. in the dollar in payment for his account.

It must be admitted that Weaver and the other composition creditors had a right to purchase goods from the debtor during the period of the composition, but if all the creditors did what Weaver has done, *viz.*, purchase goods and not pay for them and then claim a set-off, how would it be possible for the company to carry out its composition? If so, the whole assets might be swept away by the action of one, and the effect would be to deprive the debtor of the means of paying his composition. The assets are the funds for payment of the composition. There can be no benefit to one creditor behind the back of the other creditors of the composition, and this situation must have been well-known to Weaver.

It seems to me Weaver might just as well have purchased goods, the value of which together with the dividends he was to receive, would pay him in full, whilst the other creditors would only get their dividends as agreed under the composition.

The mere fact that the company did not insist on payment for the goods is to me the best evidence—unless there was collusion, and it is admitted there was not—that they intended the invoice value thereof was to be applied on the dividends Weaver was to become entitled to, and therefore I do not see how he can keep the dividends and the goods too, or their value, as no further dividends beyond those he has received have become payable to him.

1925 CanLII 392 (ON SC)

Sask.
C.A.
1925.

Section 31 of the Act as amended by 1920 (Can.), c. 34, s. 8. has no application to this transaction, because there is not the slightest suggestion of a transfer by the company (the debtors) to Weaver (the creditor) with a view of giving him a preference. The preference here arises by Weaver claiming to be entitled to set off his compromised debt as against a debt due by him to the company for the goods purchased, before all the composition creditors were paid. This would be a fraud on the bankruptcy laws.

It must be conceded that if the company had demanded payment for these goods at or after delivery, or at any time before the assignment, Weaver would not, in view of the terms of the composition, have had the right to set off, and therefore if he had no right against the company, what higher or better right has he now against the company's trustee in bankruptcy?

The jurisdiction in bankruptcy relative to the right of set-off is an equitable one, and I can see no reason whatever why in the circumstances of the present case Weaver should be held entitled to so deal with the debtor company, after he had accepted the composition, in such a manner that in the event of the debtor company going into bankruptcy, he would be paid in full, because he might just as well, as I have stated, have purchased sufficient goods to pay himself in full and upon bankruptcy happening, claim a set-off. There never was a moment of time after the composition and before the assignment, that Weaver could have claimed a set-off, and therefore Weaver cannot now by refusing to return the goods or money to the trustee create a right of set-off which he otherwise would not have had.

There will be judgment in favour of the trustee for the sum of $554.57, together with costs.

Application granted.

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TAB 13

THOMAS GEORGE BRIGHAM (DEFENDANT) .... APPELLANT;

1900
*Mar. 5.
June 12.

AND

LA BANQUE JACQUES-CARTIER (PLAINTIFF) .... RESPONDENT.

ON APPEAL FROM THE SUPERIOR COURT FOR LOWER CANADA, SITTING IN REVIEW, AT MONTREAL.

Assignment for benefit of creditors—Fraudulent preference—Bribery—Promissory note—Illegal consideration—Nullity—Costs.

A secret arrangement whereby the provisions of the Code of Civil Procedure respecting equal distribution of the assets of insolvents are defeated and advantage given to a particular unsecured creditor is a fraud upon the general body of creditors notwithstanding that the agreement for the additional payment may be made by a third person who has no direct interest in the insolvent's business.

A promissory note given to secure the amount of the preference payable under such an arrangement is wholly void.

An agreement for a payment to an inspector of an insolvent estate to influence his consent to an arrangement which is not for the general benefit of the creditors is a bribe which is, in itself, sufficient reason to adjudge the transaction, to induce which it was given, corrupt, fraudulent and void.

APPEAL from the judgment of the Superior Court for Lower Canada, sitting in review, at Montreal, affirming a judgment of the Superior Court, District of Ottawa (1), maintaining the plaintiff's action with costs.

The questions at issue upon this appeal and a statement of the case will be found in the judgments reported.

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*PRESENT:—Sir Henry Strong C.J. and Gwynne, Sedgewick, King and Girouard JJ.

(1) Q. R. 16 S. C. 113.

1900 CanLII 60 (SCC)

1900
BRIGHAM
v.
LA BANQUE
JACQUES-
CARTIER.

Aylen Q.C. for the appellant. The transaction which served as consideration for the notes sued on is prohibited by the policy of the law providing for equal distribution of assets amongst an insolvent's creditors and contrary to good morals and public order. *Ex dolo malo non oritur actio.* Arts. 789, 990 C. C. *Greene* v. *Tobin* (1); *Birch* v. *Jervis* (2), per Tenterden C.J.; *Hall* v. *Dyson* (3); *Nerot* v. *Wallace* (4); *Gastonguay* v. *Savoie* (5); *Arpin* v. *Poulin* (6); *Martin* v. *Poulin* (7); *Leclaire* v. *Casgrain* (8); *Ross* v. *Paul* (9); *Garneau* v. *Larivière* (10); *McDonald* v. *Senez* (11); *Bury* v. *Nowell* (12); *Howland Sons & Co.* v. *Grant* (13); 16 Laurent, n. 157; Lyon-Caen & Renault, (2 ed.) Faillites, nos. 965, 968 & 968, *bis;* Code de Commerce. Arts. 596, 597, 598; 3 Bédarride, Dr. Com., Faillites, nos. 1285, 1286, 1287 & 1292; 31 Demolombe, nos. 431, 433, 434.

Foran Q.C. and *Lajoie* for the respondent. The transaction was merely a sale by the bank of its claim against the insolvent estate and, after being duly approved by the judge's order, the transfer was made accordingly. Subsequently, to simplify matters, the appellant consented to the respondent receiving from George C. Wright, on account of his promissory note, the 30 cents in the dollar, which the latter had undertaken to pay, and credit was given in the usual manner Arts. 1715, 1716 C. C.; 28 Laurent, n. 50; Troplong, Mandat, nn. 519, 522, 535, 597. The bank had full liberty to sell the debt; *Fry* v. *Malcolm* (14); *Four*

(1) Q. R. 1 S. C. 377.
(2) 3 C. & P. 379.
(3) 16 Jur. 270; 21 L. J. Q. B. 224.
(4) 3 T. R. 17.
(5) 29 Can. S. C. R. 613.
(6) 22 L. C. Jur. 331.
(7) 4 Legal News 20; 1 Dor. Q. B. 75.
(8) M. L. R. 3 S. C. 355.
(9) M. L. R. 3 Q. B. 299.
(10) Q. R. 1 S. C. 491.
(11) 21 L. C. Jur. 290.
(12) Q. R. 10 S. C. 537.
(13) 26 Can. S. C. R. 372.
(14) 5 Taunt 117.

1900 CanLII 60 (SCC)

1900

BRIGHAM
v.
LA BANQUE
JACQUES-
CARTIER.

v. *Tardy* (1). See also S. V. '38-1-461; S. V. '74-1-127; and *Beausoleil* v. *Normand* (2). As there is no legislative prohibition nor an Insolvent Act whereby the majority of creditors could bind the remainder to conditions of composition and discharge, nothing, as between debtor and creditor, could invalidate an agreement by the debtor undertaking to pay such creditor more than the amount of the composition and a promissory note given for such excess is valid. *Racine* v. *Champoux* (3); *Lamalice* v. *Ethier* (4); *Tees* v. *McArthur* (5); *Collins* v. *Baril* (6); *Chapleau* v. *Lemay* (7), and authorities there cited.

In this instance, four inspectors advocated the transfer before the agreement was made and it did not affect the assets of the insolvents. The appellant's relationship to the insolvents and George C. Wright was sufficient consideration for the note. The appellant cannot invoke his own fraud and perfidy. *Nemo potest invocare turpitudinem suam.* See Benjamin on Sales, no. 513 (*a*), 16 Laurent, no. 109; Dal. Rep. vo. "Oblig." no. 115; *Dussol* v. *Benoit* (8); *Mahieu* v. *Blum* (9); Merlin Quest. de Dr. vo. "Atermoiement" pp. 278, 279; Sirey & Gilbert, Code de Commerce, Arts. 597, 598.

THE CHIEF JUSTICE.—In my opinion the judgment appealed from is erroneous and must be reversed. The depositions disclose uncontradicted facts which shew that the promissory note, the balance of which is sought to be recovered in this action, was given for the purpose of carrying out what amounted to a fraud

(1) S. V. '55-1-357.
(2) 9 Can. S. C. R. 711.
(3) M. L. R. 6 S. C. 478.
(4) Q. R. 1 S. C. 377 note.
(5) 35 L. C. Jur. 33.
(6) Q. R. 1 S. C. 377; Q. R. 4 S. C. 192.
(7) 14 R. L. 198.
(8) Dal. 1890-2-256.
(9) Dal. 1890-1-303.

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on the creditors of the insolvent firm of C. B. Wright & Sons, other than the respondent.

The facts are not complicated and may be concisely stated as follows: The firm of C. B. Wright & Sons having abandoned their property for the benefit of their creditors under the provisions of the Code of Civil Procedure relating to cessions of property contained in Articles 853 to 892 inclusively, the defendant, Thomas George Brigham, Mr. Anderson of the Union Bank, Mr. Hector McRae, Mr. Campbell and Mr. de Martigny, the general manager of the respondent's bank, were appointed inspectors of the estate, and Mr. Hyde was named as curator. Of the five inspectors, three were creditors in their own right, and the other two, Mr. Anderson and Mr. de Martigny, were the officers and representatives of banks which were large creditors. George C. Wright, a son of one and a brother of the other partner in the insolvent firm, proposed to purchase the assets for an amount sufficient to pay privileged creditors in full, and the unprivileged creditors a dividend of thirty cents in the dollar on the amount of their debts.

This proposition having been submitted to the inspectors, it was, on the 8th of November, 1894, at a meeting of those persons, accepted by all but de Martigny, the respondent's general manager, who expressly dissented from the resolution in which the approval of the offer by the other inspectors was recorded. Subsequently, by a secret arrangement between George C. Wright and Mr. de Martigny, acting on behalf of the respondent bank, it was agreed that the respondent should be paid ten cents in the dollar more than the other creditors, that is to say, forty per cent of their debt, and that, in consideration of this arrangement which was to be kept secret from the other creditors, and also in consideration of $150 to be paid to Mr. de Martigny

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for his own personal use, he (de Martigny), should withdraw his objection as one of the inspectors, and the Banque Jacques-Cartier should accept the forty cents in satisfaction of their interest in the assets. This arrangement, as far as regards the acceptance of the forty cents, was assented to by the directors of the respondent bank.

Mr. de Martigny having refused to accept the note of George C. Wright for the additional ten per cent to be paid to the bank, the latter having no other means of paying the excess over the thirty per cent, applied to the present appellant, who was his brother-in-law, to secure the payment of the additional amount to de Martigny's satisfaction, and also to pay de Martigny the $150 he was to receive as a bonus for his services in the matter.

In order to carry out this arrangement a meeting was held on the 27th of November, 1894, at the office of the solicitor of the bank in Hull, where there appears to have been present besides Mr. McDougall (the solicitor and a mis-en-cause in the present action), Mr. de Martigny, George C. Wright and the appellant. The latter then signed, a promissory note for the sum of $7,676.45, being forty per cent of the full amount of the respondent's claim against the estate according to the divident sheet settled by the curator, also a cheque purporting to be drawn by the appellant on the Quebec Bank of Ottawa in favour of Mr. de Martigny for $150.

These securities having been placed in the hands of Mr. McDougall, and Mr. de Martigny having also deposited with him all the notes and securities held by the bank for their debt to be delivered up to the respondent on payment of the respondent's claim as well as of the cheque, a memorandum signed by Mr. McDougall, as trustee, which is set forth in the decla-

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ration, was drawn up and signed by him whereby the arrangement with Mr. de Martigny was described as a sale by the bank of its debt and claim to the appellant, and whereby it was agreed that the documents mentioned as having been signed by the appellant should be held by Mr. McDougall as a trustee until the sale of the estate to George C Wright, and the transfer in pursuance of such sale should be completed by payment of the purchase money.

On the same day, Mr. Justice Malhiot, a judge of the Superior Court, authorised the proposed sale of the estate to George C. Wright at the price mentioned in the letter of the latter to the curator, dated 30th October, 1894, therein referred to, namely, a sum sufficient to pay the privileged debts in full and thirty cents in the dollar on the unprivileged debts, and the learned judge signed an order accordingly. This order was made upon the withdrawal of all opposition by Mr. de Martigny and the respondent bank.

There was no communication either to the judge who so made the order, or to the inspectors other than de Martigny and the appellant, or to the curator, Hyde, or to any of the other creditors of the secret agreement of the 27th of November, 1894, which had, as before mentioned, been entered into between Mr. de Martigny on behalf of the respondent and the appellant.

The attempt to give this transaction the colour of a sale by the respondent of its debt or claim to the appellant was just one of those fraudulent contrivances which so often recoil against those who resort to them. So far from helping the respondent's case it assists to prove the fraudulent character of the transaction as regards the general body of the creditors.

In the divident sheet dated the 10th of July, 1895, prepared and signed by John Hyde, the curator to the estate, the respondent is collocated as a creditor for

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the full amount of its claim, $18,953.05, and the dividend to which it was entitled therein at thirty cents in the dollar is put down at $5,685.91. This latter amount was, months after the bank had pretended to sell its debt to the appellant, received by the bank itself and credited as a payment on the promissory note of the appellant for the balance of which alone, after deducting the payment, this action is brought.

How the respondent could have honestly and rightfully claimed and received payment of the thirty cents in the dollar out of the estate if it really had sold and transferred the debt to the appellant is not explained. The inference must be and is that the arrangement so carefully cloaked and concealed from all those who were interested in frustrating it was in substance and in reality nothing less than an agreement by which the bank was to receive ten per cent more than the other creditors, induced by a money payment of $150 secured to de Martigny by the cheque deposited with Mr. McDougall, and the concealment practised by the parties shews their consciousness of the fraudulent and illegal character of the arrangement they had entered into.

The law applicable to such an agreement cannot be and is not doubtful. Where the law carefully provides for the equal distribution of assets amongst creditors any arrangement concealed from the general body of creditors, whereby the policy of the law is defeated, and a particular creditor, having no legal right to preference or priority, is secured an advantage over the other creditors must, under every system of law, be void as a fraud on those to whom another is so preferred in the distribution of assets. *Cockshott* v. *Bennett* (1) *Jackson* v. *Lomas* (2); *Eastabrook* v. *Scott* (3); *Jackman* v. *Mitchell* (4); *Mare* v. *Sandford* ( ).

(1) 2 T. R. 763.
(2) 4 T. R. 166.
(3) 3 Ves. 456.
(4) 13 Ves. 581.
(5) 1 Giff. 288.

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All the ground of fairness, common honesty and public policy which have led to the establishment of the principle by the English courts that such an arrangement cannot stand are equally applicable under the Quebec Code.

That the additional amount which, under the secret agreement, was in the present case to be paid to the respondent, was guaranteed and to be paid in the first instance by a third person, the appellant, who was to take no direct interest in the purchased assets, can make no difference. Upon a principle well established by the English courts such a payment by a third person is just as much a fraud on the general body of creditors as a payment or an agreement to pay by the insolvent debtor himself. *Wells* v. *Girling* (1); *Knight* v. *Hunt* (2); *Bradshaw* v. *Bradshaw* (3); *McKewan* v. *Sanderson* (4); *Re Milner* (5).

For these reasons the promissory note sued upon must be considered as wholly void, as having been given in furtherance of a fraudulent and corrupt agreement, and the judgment recovered on it cannot stand. To decide otherwise would be to subvert all those principles of equality in the payment of creditors which the articles of the Code providing for abandonment were destined to secure.

There remains the question of the $150 cheque payable to Mr. de Martigny and signed by the appellant. That is not sued upon in this action, but it is material as shewing that for this personal advantage in addition to the extra ten cents on the dollar to be paid to the respondent, de Martigny was induced to allow himself to be influenced to consent to a sale which, as he says himself, was not for the general

(1) 1 Brod. & Bing. 447.
(2) 5 Bing. 432.
(3) 9 M. & W. 29.
(4) L. R. 20 Eq. 65.
(5) 15 Q. B. D. 605.

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benefit of the creditors. This $150 cheque was therefore nothing less than an illegal advantage, and for this reason alone the transaction to induce which it was given must be adjudged corrupt, fraudulent and void.

The appeal is allowed with costs, and the action must be dismissed without costs. The appellant was himself an inspector and should not have been a party to the agreement with de Martigny.

GWYNNE, SEDGEWICK and KING JJ. concurred in the judgment, allowing the appeal with costs in the Supreme Court and dismissing the action without costs. No costs to be allowed in the Court of Review or in the Court of Queen's Bench.

GIROUARD J.—The question raised by the appeal is not whether pending the proceedings for the liquidation of an insolvent estate, a creditor can *boná fide* sell or transfer his claim to a third party, whether a creditor or not, for a sum larger than the amount realised or received by the other creditors, but whether one of the inspectors of an insolvent estate, without the knowledge of his co-inspectors, or of the curator or judge, and in violation of his duties as such inspector, can legally bargain for and secure an undue preference with a third party, whether related or not to the insolvent, in favour of a creditor who is a party to the transaction, fully aware of its nature and object. Is such a contract contrary to public order and public morals?

The facts of the case are not disputed, and in order to fully understand the point at issue it is sufficient to reproduce the following remarks of Acting Chief Justice Tait, speaking for the court appealed from:—

As I have stated, Mr. de Martigny, general manager of the plaintiff, was appointed one of the inspectors of the estate. Under the law it

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is the duty of the judge, upon demand of a party interested, to appoint upon the advice of the creditors, inspectors or advisers. (Arts. 769 and 772 C. C. P. (old); Arts. 867 and 877 (new).

Those gentlemen, in accepting that position, became officers of the court like the curator, and like him are subject to its order. It seems to me that an inspector is bound to act in absolute good faith towards the court. Now we have it established in this case that de Martigny first opposed the acceptance of George C. Wright's proposition to purchase the balance of the assets although the other inspectors were in favour of that offer. He has stated in his evidence that the plaintiff at first wanted fifty cents on the dollar; that George C. Wright, the purchaser, offered him his own note for an additional ten cents, which he refused; that afterwards the Board of Directors told him to accept forty cents on the dollar if he thought best, and that after it was arranged that the bank was to get forty cents, the method of carrying this out was being left to the solicitor. He admits that it was understood that the plaintiff should get the thirty cents from the curator in the same manner as the ordinary creditors, but all he thought of was to settle his bank's claim, and did not concern himself about the Union Bank. He admits that it is probable that the Union Bank would have asked for forty cents if they had known that the plaintiff was getting it. I now quote from his evidence at page 7, which is as follows:

Q. You see this resolution of the inspectors of the 8th of November was not approved of by you. It says, "motion carried, Mr. de Martigny dissenting." Would you read the letter recited in that resolution and say if it is the offer of the purchase of this estate that you refer to?—A. Yes.

Q. Why did you dissent from that?—A. It was accepted.

Q. It was accepted afterwards, but you voted against it?—A. I voted against it at the time, because I had not sold at the time.

Q. Why did you vote against it?—A. Because we thought the estate would pay a great deal more than that. That was our impression, and that is my impression yet.

Q. That has always been your impression?—A. Yes.

Q. And has that always been the impression of the directors of your bank?—A. Yes.

And at page 11, his evidence is as follows:

Q. You still were dissenting at this time, the 8th of November?—A. Yes, always dissenting.

Q. Did you notify your bank that a majority of the inspectors had passed a resolution accepting, as far as they could, the thirty cents?—A. Yes.

Q. What did they say?—A. They authorised me to refuse it.

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Q. What steps did they take to protect your refusal?—A. I left it completely to the lawyer.

Q. Did you give him instructions to refuse the transfer for the thirty cents?—A. Until the sale was made to Mr. Brigham, always.

Q. So it was the intention of the bank to oppose the carrying out of the sale for thirty cents from the start?—A. Yes, they wanted to get fifty cents.

Q. And then when this arrangement was made with Mr. Brigham, whatever it was, they withdrew their opposition?—A. Yes.

He states that his intention was to be paid by some one ten cents over the other creditors, and although he does not admit any agreement to keep the matter secret, still he intimates that the reason it was kept a secret was that they did not want the other parties to hear of it, as they might object.

It is clear from the proof of record that the other inspectors would not have allowed the sale of the estate to have been made had they known the plaintiff's real motive for withdrawing its opposition to it.

The learned Chief Justice could not however disturb the judgment of the Superior Court condemning the third party, that is the appellant, to pay the extra ten per cent, because

the proof seems to fall short of establishing conclusively that it was represented to the judge that Mr. de Martigny had withdrawn his opposition. If it had been established to my satisfaction, (continues the learned Chief Justice), that Mr. de Martigny had allowed it to be represented to the judge that he was in favour of this sale while at the same time he was under the belief that the assets were worth more than thirty cents on the dollar, and in virtue of that belief had secured by secret arrangement, ten cents more than any other creditor, I should have regarded such conduct as wilful deception practised towards the judge, and taken in conjunction with his conduct towards his co-inspectors, I should have considered that there was ample ground for reversing this judgment. In such a case I think it should be our duty to see that inspectors act in good faith and above board in their transactions towards their co-inspectors, and towards the court.

As we understand the case, we believe it is of little importance whether the judge was actually deceived or not. We know for a certainty that an attempt was made to deceive him; that he was not made aware of the transaction concluded with the appellant through

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one of the inspectors. We have also the evidence of some of the inspectors that, after the compromise with the bank, Mr. de Martigny recommended "very strongly" the acceptance of the offer of thirty cents, and that they were all deceived by him Finally we cannot forget that as such inspector, Mr. de Martigny was the "adviser" of both the curator and of the judge, and that his duty was clearly to communicate to them his honest opinion as to the value of the estate. He intentionally did not do so at the request of the respondents and for their benefit, because his sole object was to protect a large preference in favour of his bank and a remuneration of $150 for his alleged expenses and fees, or rather a promise from the appellant to pay both.

The Superior Court held that the cheque for the $150 was absolutely void and null, and dismissed de Martigny's action, but maintained the claim of the bank for the amount of the preference. We believe that the contract or note to obtain such a preference is likewise null and void and cannot be enforced, as being contrary to public order and good morals. The whole transaction savours of a bribe made to a person in a position of trust to violate the duties of his trust. To sanction especially such a partial and even corrupt conduct on the part of officers of a court of justice, called upon to discharge quasi judicial functions, and to permit any party to it to benefit by the same, would be to destroy the machinery created by the legislature for the honest and equitable realisation and distribution of insolvent estates. This court has recently laid down in *Gastonguay* v. *Savoie* (1) that

no one having duties of a fiduciary character to discharge should be allowed to put his duties in conflict with his interest,

(1) 29 Can. S. C. R. 614.

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and in *Lambe* v. *Armstrong* (1), we said that to permit litigants in default

to take advantage of the irregularities and misdoings of officers of the court would be simply to hinder the administration of justice and destroy the usefulness of courts of law.

We are therefore of opinion that the appeal should be allowed with costs and that the action of the respondent should be dismissed without costs, as the appellant was himself one of the inspectors and participated in the fraud. No costs will be allowed in any of the courts below.

Appeal allowed with costs.

Solicitor for the appellant: *Henry Aylen.*

Solicitor for the respondent: *Thomas P. Foran.*

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*Nov. 8.
*Dec. 30.

ISIDORE HOCHBERGER AND OTHERS (PLAINTIFFS) .... APPELLANTS;

AND

MOSES RITTENBERG (DEFENDANT). RESPONDENT.

ON APPEAL FROM THE COURT OF KING'S BENCH, APPEAL SIDE, PROVINCE OF QUEBEC.

Debtor and creditor—Agreement for extension of time—Preference—Public order—Advantage to creditor—Security for debt—Conflict of laws—Lex loci.

Where a debtor obtains the assent in writing of his creditors to an extension of time for payment of their respective debts, upon an undertaking the he will not "give a preference" without their consent, a prior secret arrangement by which one of such creditors obtains security and more favourable terms of payment than that provided in the agreement is void as a fraud against the other creditors and as against public order.

The debtor carried on his business in Toronto where the deed granting the extension of time was drawn and executed. H., a New York creditor, obtained security by means of the debtor's promissory notes, drawn up and made payable in Toronto and indorsed by the defendant, residing in Montreal. The action on the notes was brought, in Quebec, against the indorser.

Held, per Idington and Anglin JJ., that the case should be decided according to the law of Ontario if there is any difference between it and the Quebec law on the subject-matter.

Judgment appealed from (Q.R. 25 K.B. 421), affirmed.

APPEAL from a decision of the Court of King's Bench, Appeal Side, for the Province of Quebec(1), affirming the judgment at the trial in favour of the defendant.

In the spring of 1913, one Grossman, a jeweller of the City of Toronto and brother-in-law of respondent, having become financially embarrassed in his business,

*PRESENT:—Sir Charles Fitzpatrick C.J. and Idington, Duff, Anglin and Brodeur JJ.

(1) Q.R. 25 K.B. 421.

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called a meeting of his principal creditors, with a view of obtaining from them an extension of time.

After some *pourparlers* with representatives of creditors present they all agreed to an extension of delay and a memorandum of extension of time was drafted and was submitted to the above-mentioned creditors and signed by Grossman, and his creditors, with the exception of appellants whose representative was not authorized to sign.

Shortly afterwards, Julius Hochberger, one of the appellants, came to Toronto, for the purpose of ascertaining the financial standing of their debtor, with special instructions as regards settlement to be made with him. During the course of the discussion, which took place with Grossman alone at Toronto, Julius Hochberger refused to consent to the proposed extension unless appellants' claim was secured and the promissory notes then offered in settlement be made at shorter dates.

The promissory notes sued upon in this case having been prepared by Julius Hochberger, Grossman sent them to respondent, at Montreal, with a request to indorse them. Respondent returned the notes to Grossman refusing to indorse unless he got more particulars about them.

Having been informed by Grossman that plaintiffs, appellants, would not consent to the extension unless their claim was secured, and knowing that Max D. Eisen, the representative of plaintiffs, in Toronto, had previously promised Grossman that Hochberber would supply him with certain goods to carry him along, and replenish his stock, he then and there consented to indorse the notes, not being told that appellants were to sign the memorandum of agreement for extension.

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Defendant, respondent, having returned the promissory notes to Grossman, at Toronto, never heard anything further about them until the following January (1914), when Grossman, being incapable of meeting his payments, had to make an abandonment of his property for the benefit of his creditors. An action was then brought against respondent as indorser.

Lafleur K.C. and *Lamothe K.C.* for the appellants.

R. G. deLorimier K.C. and *Amie Geoffrion K.C.* for the respondent.

THE CHIEF JUSTICE.—This appeal should be dismissed with costs.

The promissory notes sued on were obtained in execution of an agreement between the appellants and their insolvent debtor.

The defendant, indorser of the notes, was a brother-in-law of the maker, Grossman, a jeweller, of the City of Toronto, and the appellants were amongst the latter's creditors. The notes were given to induce the appellants to sign Grossman's deed of composition.

As Best C.J. said in *Knight* v. *Hunt*(1), at page 433, these agreements for composition with creditors require the strictest good faith. The principle to be drawn from all the cases on this subject is

that a man who enters into an engagement of this kind is not to be deceived.

It has been argued that here the debtor is not injured, nor the funds for the other creditors rendered less available, because the indorsation given and sued on was that of a third party who took no interest in the estate, but as the Chief Justice said in *Brigham* v. *Banque Jacques Cartier*(2), at page 436:—

(1) 5 Bing. 432.

(2) 30 Can. S.C.R. 429.

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Upon a principle well established by the English courts such a payment by a third person is just as much a fraud on the general body of creditors as a payment or an agreement to pay by the insolvent debtor himself: *Wells* v. *Girling*(1); *Knight* v. *Hunt*(2); *Bradshaw* v. *Bradshaw* (3); *McKewan* v. *Sanderson*(4); *Re Milner*(5).

Pollock on Contracts (7 ed.), 293.

The one question which always remains is whether the judgment of the creditors has been influenced by the supposition "that they are treating on terms of equality as to each and all." This is not a case of a gratuitous gift made after composition. Here there was a previous secret understanding that the appellants should receive security for their debt and a direct advantage over all the others who were contracting on the assumption that all were being treated alike. The notes sued on were given in pursuance of an agreement which was void as made in fraud of the other creditors of Grossman: Art. 990 C.C.; see also *Ex parte Milner*(5).

IDINGTON J.—The appellants sued the respondent as indorser of six or seven promissory notes, remainder of ten or a dozen such, made by one Grossman and indorsed by respondent in order to satisfy the demands of appellants upon said Grossman, who had asked them to join in an agreement he was trying to obtain from a half dozen of his chief creditors for an extension of time. The agreement, as drawn up, had named one Eisen as one of the creditors intended to execute the agreement.

Eisen it turned out had no authority to sign being only an agent of the appellants.

This circumstance tends to confuse matters and the most has been made thereof.

(1) 1 Brod. & Bing. 447.
(2) 5 Bing. 432.
(3) 9 M. & W. 29.
(4) L.R. 20 Eq. 65.
(5) 15 Q.B.D. 605.

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But as appellants signed the agreement and Eisen did not and there can be doubt of what was intended to have been accomplished by the substitution of appellants for Eisen in the way of signing and in fact I think was accomplished, the agreement should be treated as one of the ordinary kind for an extension by creditors of time to a debtor, who otherwise might be forced to make an assignment as an insolvent.

On such basis I agree with the late Mr. Justice Dunlop's construction of the clause in said agreement which reads as follows:—

The first party agrees that he will not during the currency of this extension and until these liabilities are paid off give any preference or security on any of his assets no matter where situate without the consent of the second parties.

What was done was clearly a preference, and none the less obnoxious because an ingenious method was resorted to of extracting something from the assets without the assent of other creditors.

It was circuitous but partially effective.

The notes given on the basis of the extension were to have been, and I think in fact were, for three, six, nine and twelve months.

The appellants got, in substitution thereof, notes spread over some twelve months, indorsed by respondent, divided into equal sums but payable monthly. Thereby, unless (which is not pretended) the money could be conceivably got elsewhere than out of the debtor's assets mentioned in above clause, the appellants got an improper advantage over others they held themselves out as joining.

Then apart from the interpretation of the agreement the giving these notes was illegal.

It may be worth while to let those people, and others inclined to do the like, know what Vice-Chan-

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cellor Malins, an able English judge, thought was the law. He, in the case of *McKewan* v. *Sanderson*(1), at page 234, spoke thus:—

> I give no opinion as to whether this is a proper case for law or equity, and I give no opinion as to the law or the equity. That will have to be considered hereafter; but the ground of this plea is that there was an improper arrangement between the debtor and his creditor to the detriment of the other creditors, and the doctrine of this court is appealed to which was laid down so repeatedly by *Lord Eldon*, and finally in the case always referred to, of *Jackman* v. *Mitchell*(2). It is a doctrine founded on the soundest principles, namely, that whenever there are proceedings in bankruptcy or insolvency, or any arrangement between a debtor and his creditors generally, and one of the creditors stipulates either for the payment of a greater dividend to him than is paid to the other creditors, or for any collateral advantage whatever, even such as giving the right to purchase a horse, or any advantage whatever not common to the creditors, any payment made will be ordered to be repaid, any security given will be ordered to be given up, and this court will treat the whole thing as fraudulent against the other creditors; and anything done in favour of the creditor who obtains this advantage will be set aside by this court. That principle has been frequently acted upon. I refer to *Jackman* v. *Mitchell*(2), because it has been cited, but *Geere* v. *Mare*(3), is a case on the point at law; and finally, it was very much considered by Vice-Chancellor Stuart in *Mare* v. *Sandford*(4), which, as well as some other cases, arose under the same bankruptcy as *Geere* v. *Mare*(3).

The case is adopted, and cited with many others, by Sir Frederick Pollock at page 238 of his work on contracts, when dealing therein with the subject of fraudulent or illegal contracts of this character.

"Against public policy" is, I think, in this connection but another name for fraud. I agree with the law as laid down in what I quote from Malins V.-C. and hold the promissory notes sued upon herein are of the kind he describes and subject to the legal consequences he suggests.

They furnish no security upon which any one can recover or should as part of public policy be permitted to recover.

(1) L.R. 15 Eq. 229.
(2) 13 Ves. 581.
(3) 2 H. & C. 339.
(4) 1 Giff. 288.

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I cannot distinguish in principle any difference between a deed of composition and anything else of the like nature, jointly agreed upon by creditors, or a number of them, in case of a common debtor.

The Quebec law I imagine is the same despite the nice distinction said to have been made in France. I also think as the debtor gave the notes in Toronto and all else was done there except possibly the mere signing by respondent, and as it is the indorsement of a promissory note delivered there that is in question, the Ontario law is what should govern, if there is any difference.

The appeal should be dismissed with costs.

DUFF J.—The controversy which has led to this appeal arose out of an agreement, the terms of which are embodied in a memorandum dated the 4th April, 1913, between one Grossman and certain creditors of Grossman who included the appellants.

Grossman being in difficulties arranged with these creditors for an extension of time; there were other creditors whose claims were not included in the arrangement, these claims not being considered of sufficient importance to embarrass Grossman after obtaining the extension arranged for. The memorandum embodying the arrangement was executed on its date by all the parties except the appellants and one Ward. The absence of Ward's signature appears to have been accidental, since he carried out the arrangement in accordance with the understanding that he was a party to it. The appellants executed the document in the following month; and the execution of it by them was procured through an arrangement between themselves and Grossman, that Grossman was to obtain the guarantee of his brother-in-law, the respondent Ritten-

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berg, that the appellants' claim would be paid. The guarantee was given in the form of an indorsement of each of the promissory notes sued upon; and was given and accepted on the understanding that the existence of the guarantee was not to be disclosed—as in point of fact it was not—to the creditors who were parties to the extension agreement.

The respondent's defence is that the agreement to give this guarantee behind the backs of the other creditors participating in the extension arrangement being a fraud on these creditors—the fraud vitiates the agreement and deprives of all legal effect the indorsements given in execution of it.

The memorandum signed by the creditors contains a recital to the effect that the creditors named as parties have executed it; and there can be no doubt that this recital embodies an essential term of the extension agreement which was made on the understanding that the claims of all the creditors named in the instrument as drawn were to be affected by the extension. It is true that the appellants are not mentioned *eo nomine* as parties but their agent is named and it was no doubt the appellants' claim that the parties had in view. It is clearly made out in point of fact, that Grossman, the appellants and the respondent all understood that the appellants' claim was to be brought within the arrangement for giving time and that involved, as it has been many times held, the assumption that they were to stand on an equal footing with all the other parties to the extension. Any advantage, therefore, obtained by them as the price of their participation, which was not made known to the other parties, must be an advantage which they could not retain without departing from the line of conduct marked out in such circumstances by the dictates of good faith. Yet this,

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in view of the agreement between the respondent and Grossman and the appellants, must be held to have been precisely what it was intended the appellants should do. In *Ex parte Milner*(1), it was decided by the Court of Appeal that the essence of a composition arrangement between a debtor and his creditors is equality among the creditors; and that any departure from the course pointed out by this principle by which one creditor seeks to obtain an unconscionable advantage over the others must fail of its object because any arrangement having that as its object is unenforceable as being a fraud upon the other parties to the composition.

It was not suggested that the principle is any less a principle of law in the Province of Quebec than in places where the common law obtains. But it was argued by Mr. Lafleur that the principle has no application in the case of a mere agreement for extension. That is a view I cannot accept, for the core of the matter is that the inculpated transaction is a fraud upon persons to whom in the circumstances the creditor owes a duty of disclosing any such transaction. I cannot concede that the principle of equality or that this duty of disclosure is any less imperative where the creditors give merely an extension of time, than where they give up a proportionate part of their claims; and such being the case the sterility which affects a bargain for a secret advantage where a composition is in question is equally the consequence of a secret bargain having reference to an arrangement for giving time only.

An argument which at first gave me some concern arising out of the last paragraph of the memorandum requires notice. The paragraph is in the following words:—

(1) 15 Q.B.D. 605.

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The First Party agrees that he will not during the currency of this extension and until these liabilities are paid off give any preference or security on any of his assets no matter where situate without the consent of the Second Parties.

It was contended by Mr. Lafleur that the preposition "on" connects "preference" as well as "security" with the succeeding phrase "any of his assets" and that consequently the respondent's guarantee is not within the contemplation of this clause. I do not find it necessary to express any opinion upon the point of construction. Assuming Mr. Lafleur's reading to be the right reading, I think, after reflection, that the respondents' rights are not in any way prejudiced by the presence of this clause. The clause, it should be noted, is not primarily directed to securing the observance of good faith among the persons executing the memorandum; it imposes primarily a duty upon the debtor who is a party to the agreement and the result of it is to disable him from giving any preference or security to any of his creditors including, of course, those who were parties to the extension agreement, but including also those who were not parties to it. The clause itself would no doubt, apart from any general principle of law, involve the persons executing the memorandum in an obligation not to concur with the debtor in any conduct which would be in violation of the letter or spirit of it. But the clause is not aptly framed to displace, and the duties and rights expressly created by, or arising by implication out of the clause, do not necessarily displace, the reciprocal obligations of good faith which the law imposes *ab extra* upon the creditors who are parties to the transaction *inter se;* and it would not be right to infer an intention to displace them for the reason already mentioned, namely, that primarily the clause is framed *alio intuito*, namely, to impose an obligation on

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the debtor; and extends to the claims of all creditors whether parties to the arrangement or not.

I think the appeal should be dismissed with costs.

Anglin J.

ANGLIN J.—By executing the agreement made between the debtor Grossman and a number of his principal creditors the appellants represented to the other creditors who were parties to it that they were giving to the debtor an extension upon the terms contained in that agreement, to which the other creditors had bound themselves, and without obtaining any preference or advantage over them. The agreement contained a recital that the creditors named in it had agreed to grant the debtor an extension only on the condition that all of them should join therein. In that agreement the appellants were first represented by their agent Eisen. Eventually they executed it in their own name. But whereas the other parties who executed the agreement accepted from the debtor, without other security, his notes at three, six, nine and twelve months the appellants insisted on their claim being liquidated in monthly instalments and upon payment thereof being secured by the indorsement of the debtor's brother-in-law. When making this arrangement they impressed upon the debtor the necessity of keeping it from the knowledge of the other creditors.

I can see no distinction in principle between an agreement for extension given by his creditors to a debtor and an agreement whereby they forego proportionate parts of their claims. Equality as between themselves and a strict adherence to the terms of the common arrangement with the debtor is an essential element in both cases. On grounds of public policy a secret bargain violating that equality is unlawful

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and additional security obtained under it is unenforceable: *Clark* v. *Ritchie*(1); *McKewan* v. *Sanderson*(2). No authority has been cited which upholds a security obtained in distinct violation of the express terms of an agreement made with other creditors such as we have before us. The present case is clearly distinguishable from *Langley* v. *Van Allen*(3), relied on by the appellant. That was a case of seeking to recover for the estate money given by the debtor to a creditor who had insisted on being paid off sooner than the other creditors. This is a case of resisting the enforcement of a security unlawfully taken.

This action was brought in Montreal, no doubt because the defendant resides there. But the notes sued upon were made at Toronto and are payable there. The extension agreement was also made at Toronto where the debtor resided and carried on business. It would therefore seem that the legality of the transaction whereby Rittenberg became an indorser must be tested according to the law of that province, which was duly proved at the trial. It may be observed, however, that a French decision cited by the appellants, reported in D. 69.1.92 and noted in Fuzier-Herman, Rep. Vo. "Atermoiement" No. 106, is there significantly referred to as having been "commandée par l'espèce," and not in conflict with the rule of equality.

The appellant's case, in my opinion, is wholly devoid of merit. The appeal should be dismissed with costs.

BRODEUR J.—Par un acte d'atermoîment daté du 14 avril 1913 entre le débiteur Grossman et certains

(1) 11 Gr. 499.
(2) L.R. 20 Eq., 65.
(3) 32 Can. S.C.R. 174.

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de ses créanciers parmi lesquels se trouvaient les appelants il avait été convenu qu'une extension de temps serait accordée au débiteur pour payer ses différents créanciers; et l'une des clauses de ce contrat comportait que le débiteur ne pourrait pas pendant le cours de cette extension

give any preference or security on any of his assets, no matter where situate,

sans le consentement de ses créanciers.

Les appelants malgré cette convention formelle, ont obtenu de leur débiteur des billets endossés par l'intimé. La question est de savoir si cet endossement est légal et ne constitue pas une préférence contraire à l'ordre public.

Les appelants prétendent qu'en vertu de la convention le débiteur ne pouvait pas donner de préférence ou de garantie sur aucun de ses biens mais que le fait pour eux d'avoir obtenu ce consentement ne constituait pas une violation de cette convention.

Cette clause formelle qui se trouve dans l'acte ne pouvait pas permettre aux différents créanciers d'obtenir de leur débiteur des avantages spéciaux. Cette clause, suivant moi, avait pour but d'empêcher le débiteur, pendent l'existence de l'atermoiement, de donner à aucun autre créancier des privilèges ou des garanties sur ses biens. Alors on ne voulait pas que le débiteur qui aurait contracté de nouvelles dettes put donner à ses nouveaux créanciers des faveurs particulières sur les biens qui étaient le gage de ses créanciers antérieurs.

Mais cette disposition particulière du contrat pouvait-elle empêcher les créanciers qui la signaient d'obtenir à leur tour de leur débiteur des avantages particuliers?

Je dis que non.

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La loi exige que tous les créanciers dans les concordats ou dans les atermoîments soient tous mis sur le même pied. Elle proscrit tout avantage consenti à l'égard d'un seul créancier. Fuzier-Herman, verbo "Atermoiement" No. 96. Il est d'ordre public, il est dans l'interêt de la bonne foi des contrats, que ces actes soient faits sans qu'aucun créancier soit plus avantagé que l'autre. C'est là un principe bien établi dans notre droit et qui a été reconnu par la jurisprudence dans la cause de *Brigham* v. *La Banque Jacques-Cartier*(1) où il a été décidé qu'un billet promissoire donné pour garantir le montant d'une préférence est absolument nul.

Les appelants ont tenté de démontrer que les règles concernant le concordat et l'atermoiement étaient différentes et ils ont cité à cette fin une cause rapportée dans Fuzier-Herman, Répertoire, vo. atermoiement, No. 106.

La décision qui est invoquée par les appelants doit être considérée comme décision d'espèce, vu que Fuzier-Herman déclare lui-même qu'il ne faudrait pas la considérer comme contraire à la doctrine qui exige que les avantages consentis à l'égard d'un créancier soient prohibés.

En supposant que la prétention des appelants serait bien fondée sous ce rapport, il ne faudrait pas s'appuyer trop fortement sur les autorités françaises, vu que les dispositions de leur code de commerce diffèrent quelque peu d'avec les dispositions de notre droit. En principe général, les concordats comme les atermoiements doivent être faits avec la meilleure foi du monde entre les différents créanciers qui les signent. Le débiteur alors ne doit pas avantager aucun de ces créanciers; mais ils doivent toujours être maintenus

(1) 30 Can. S.C.R. 429.

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sur le même pied. Il ne doit pas donner à l'un des garanties qu'il ne donnerait pas aux autres, à moins que ces derniers ne soient mis au courant de ces avantages particuliers; et alors tout acte ou endossement qui serait fait par le débiteur et qui serait de nature à détruire cette égalité qui doit exister entre tous les créanciers est suivant moi illégal, contraire à l'ordre public et doit être mis de côté.

Les cours inférieures en sont venues à cette conclusion et les jugements qu'elles ont rendus doivent être confirmés avec dépens.

Appeal dismissed with costs.

Solicitors for the appellants: *Lamothe, Gadbois & Nantel.*

Solicitor for the respondent: *R. G. deLorimier.*

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TAB 15

HMANALY E§80
Houlden & Morawetz Analysis E§80

Bankruptcy and Insolvency Law of Canada, 4th Edition

THE BANKRUPTCY AND INSOLVENCY ACT

Proposals (ss. 50-66)
L.W. Houlden and Geoffrey B. Morawetz

E§80 — Secret Agreements with Creditors

E§80 — Secret Agreements with Creditors

See ss. 50, 50.1, 50.2, 50.3, 50.4, 50.5, 50.6, 51, 52, 53, 54, 54.1, 55, 56, 57, 57.1, 58, 59, 60, 61, 62, 62.1, 63, 64, 64.1, 64.2, 65, 65.1, 65.11, 65.12, 65.13, 65.2, 65.21, 65.22, 65.3, 66

(1) — *Generally*

In a proposal, all creditors of the same class must be treated equally. A secret bargain which violates that equality is a fraud upon the other creditors and is illegal and unenforceable: *Laferté v. Peladeau* (1929), 11 C.B.R. 89 (Que. S.C.); *Re Hobart & Duclos* (1931), 13 C.B.R. 56 (Que. C.A.); *Glense v. St-Marie* (1943), 26 C.B.R. 125 (Que. S.C.); *Re Cicoria* (2000), 21 C.B.R. (4th) 232, 138 O.A.C. 342, 2000 CarswellOnt 4906 (C.A.).

If, where there has been a secret bargain with certain creditors, the proposal is accepted by creditors and approved by the court, a creditor who had no knowledge of the bargain can apply for an order annulling the proposal: *Re Milner* (1885), 15 Q.B.D. 605, 54 L.J.Q.B. 425, 53 L.T. 652, 2 Morr. 190, 33 W.R. 867 (C.A.); *Re Cobourg Felt Hat Co.*, 28 O.W.N. 131, 5 C.B.R. 622, [1925] 2 D.L.R. 997 (S.C.).

If moneys have been paid pursuant to a secret agreement, the debtor can recover the money back from the creditor: *Atkinson v. Denby* (1861), 7 H. & N. 934, 31 L.J. Ex. 362, 7 L.T. 93, 10 W.R. 389 (Ex. Ch.); *Re Lenzberg* (1877), 7 Ch.D. 650.

An agreement between the debtor and a large secured creditor by which the debtor agreed to assist the creditor in working out its security and this was well known to creditors and was disclosed to the court when the proposal was approved by the court is not a secret bargain: *Anderson v. Canadian Imperial Bank of Commerce* (1999), 11 C.B.R. (4th) 157, 199 CarswellOnt 1896 (Ont. Gen. Div.).

(2) — *Secret Benefit from a Third Party*

The fact that the secret benefit is being furnished by a third party is immaterial; it is just as much a fraud on creditors as a payment or an agreement to pay something additional by the debtor: *Brigham v. La Banque Jacques-Cartier* (1900), 30 S.C.R. 436; *Hochberger v. Rittenberg* (1916), 54 S.C.R. 480, 36 D.L.R. 450.

If a guarantee of a third party is given to obtain a consent of a creditor to a proposal; the guarantee is unenforceable: *Prévoyance v. Giroux* (1932), 14 C.B.R. 174 (Que. C.A.); *Sadler Mfg. Co. v. Golt,* [1955] Que. S.C. 69, 35 C.B.R. 67.

(3) — *Agreement Made After Approval of Proposal for Payment of Creditor's Claim*

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If, after the acceptance of a proposal by creditors and approval by the court, the debtor agrees as the price of obtaining goods from a creditor that the creditor's claim under the proposal will be paid in full, when other creditors under the proposal are only receiving 35¢ on the dollar, the agreement is not void; such an agreement is not a secret bargain: *Chamandy Brothers Ltd. v. Albert* (1928), 10 C.B.R. 32 (Ont. C.A.). If, however, a secret agreement is made between the debtor and an inspector, the representative of a large partially secured creditor, for payment in full of the creditor's claim, although the proposal called for a compromise of the claim, the agreement is unenforceable and the creditor is bound by the terms of the proposal: *Re Cicoria* (2000), 18 C.B.R. (4th) 202, 2002 CarswellOnt 2697 (Ont. Bktcy.), affirmed (2000), 21 C.B.R. (4th) 232, 138 O.A.C. 342, 2000 CarswellOnt 4906 (C.A.).

(4) — *Secret Purchase of a Creditor's Claim*

In *Newlands Textiles Inc. v. Carrier* (1983), 47 C.B.R. (N.S.) 148 (Ont. S.C.), a creditor was opposed to a proposal. After the proposal was accepted by creditors but before a court approval, an officer of the debtor company personally purchased the claim of the objecting creditor for $15,000 cash and a promissory note for $15,000. When the note was not paid, an action was brought by the objecting creditor to enforce payment. It was held that the note was invalid and unenforceable on the ground that the giving of the note constituted a secret bargain. With respect, this seems wrong. When the officer purchased the claim, he stepped into the shoes of the creditor; he was receiving no different treatment under the proposal than other creditors. If, by purchasing claims, the officer had been able to procure the necessary majority of creditors in favour of the proposal, that is a matter that might have been relevant on the application for court approval, but the equal treatment of creditors, which is the reason for the rule against secret bargains, was not being violated.

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APPLICATION UNDER THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED
AND IN THE MATTER OF THE NOTICES OF INTENTION TO MAKE A PROPOSAL OF **YG LIMITED PARTNERSHIP AND YSL RESIDENCES INC.**

Court File No.: 31-2734090

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced at Toronto

JOINT BOOK OF AUTHORITIES OF THE "CLASS A LPs"
(Sanction Hearing: June 23, 2021)

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