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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

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

BOOK OF AUTHORITIES OF THE AD HOC COMMITTEE OF PURCHASERS OF THE APPLICANT'S SECURITIES, INCLUDING THE REPRESENTATIVE PLAINTIFFS IN THE ONTARIO CLASS ACTION

(Motion Returnable August 28, 2012)

August 24, 2012

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7. *Re Major*, 1984 CarswellBC 588 (S.C.)
8. *Superline Fuels Inc. v. Buchanan*, 2007 NSCA 68, [2007] S.C.C.A. No. 410 (leave to appeal refused)
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10. *Stelco Inc., Re* (2005) 78 O.R. (3d) 241 (C.A)
11. *SemCanada Crude Company (Re)* (2009) 57 C.B.R. (5th) 205 (Alta.Q.B.).
12. *San Francisco Gifts Ltd. v. Oxford Properties Group Inc.* (2004) 5 C.B.R. (5th) 300 (Alta.C.A.)
13. *Ontario v. Canadian Airlines Corporation* 2001 ABQB 983 (CanLII), [2001] A.J. No. 1457, 2001 ABQB 983
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20. *Canadian Red Cross Society (Re)*, (2008) O.J. No. 4114 (S.C.J.)

21. *Re Canadian Airlines Corp.*, 2000 CanLII 28185 (Alta. Q.B.)

22. *Fredrickson v. Insurance Corp of British Columbia* [1986] B.C.J. No. 366 (C.A.), aff'd [1988] 1 S.C.R. 1089, 49 D.L.R. (4th) 160

23. *Perry v. General Security Insurance Co. of Canada,* (1984) 47 O.R. (2d) 472, 11 D.L.R. (4th) 516 (C.A.)

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TAB 1

1999 CarswellOnt 4077, 47 C.C.L.T. (2d) 213, 181 D.L.R. (4th) 37, 127 O.A.C. 338, 1 B.L.R. (3d) 1, 46 O.R. (3d) 514, 15 C.B.R. (4th) 67, [1999] O.J. No. 4749, 93 A.C.W.S. (3d) 391

NBD Bank, Canada v. Dofasco Inc.

NBD Bank, Canada, Plaintiff (Respondent) and Dofasco Inc., Percival Nicholas, John H. Rule and James T. Melville, Defendants (Dofasco Inc. Appellant)

NBD Bank, Canada, Plaintiff (Respondent) (Appellant by cross-appeal) and Dofasco Inc., Percival Nicholas, John H. Rule and James T. Melville, Defendants (James T. Melville Appellant) (James T. Melville and Dofasco Inc. Respondents by Cross-Appeal)

Ontario Court of Appeal

Krever, Carthy, Rosenberg JJ.A.

Heard: April 20, 1999
Judgment: December 15, 1999[FN*]
Docket: CA C27414, C27152

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Proceedings: affirming (1997), 34 B.L.R. (2d) 209 (Ont. Gen. Div.)

Counsel: *Michael E. Barrack* and *Glynnis P. Burt*, for defendant/appellant James T. Melville.

Jeffrey S. Leon and *David F. O'Connor*, for defendant/appellant Dofasco Inc.

Thomas J. Corbett and *K. Daniel Reason*, for plaintiff/respondent/appellant by cross appeal, NBD Bank, Canada.

Subject: Insolvency; Contracts; Corporate and Commercial; Torts

Fraud and misrepresentation --- Negligent misrepresentation (Hedley Byrne principle) — Miscellaneous issues

Bank loaned substantial funds to corporation, A Ltd — Credit facility was unsecured and subject to payment on demand — A Ltd was to notify bank if other available credit facilities fell below amount of credit facility from bank — Continuation of A Ltd required financial support from parent company D Inc — D Inc and A Ltd integrated their treasury functions at D Inc — D Inc's employees became responsible for dealing with bank on day-to-day basis — Industry suffered downturn and A Ltd also experienced lengthy strike by employees, which led to weakened financial condition — Other credit facilities of A Ltd fell below amount of credit facility from bank, but bank was not informed — M, who was vice-president and secretary and treasurer of A Ltd, advised bank that A Ltd was merely having short-term cash problems due to "ramping-up" after strike, and promised to provide cash flow statements —

A Ltd requested loan of $4 million from bank to cover cheques — M advised bank that U.S. accounts were not encumbered and were available as security to bank, and that proceeds of upcoming sale would be used to pay out bank — Bank sent letter confirming conversation with M, to M and N, who was manager of cash and banking in D Inc's treasury department — U.S. receivables were not available as security to bank as they had been pledged to other bank, and proceeds of upcoming sale were not certain given insolvent state of A Ltd — Bank spoke to N, and N confirmed that he had seen letter and that "it sounded reasonable" — Two weeks after bank loaned funds, A Ltd and D Inc announced that A Ltd was insolvent — A Ltd was restructured under Companies' Creditors Arrangement Act and emerged under new ownership — Bank received $1.6 million under restructuring, resulting in net loss of $2 million U.S. — Bank brought action against D Inc, N, and M, for damages for deceit and negligent misrepresentations — Action was allowed — Trial judge held that N and M misled bank as to A Ltd's true financial state, and that bank relied on misrepresentations in agreeing to lend funds to A Ltd — Appeals by D Inc, M and N dismissed — Under terms of credit facility there was no commitment by bank to lend — Only protection of bank was in assessment of risk of each advance — It was open to trial judge to find that in circumstances there could be no loan until loan officer had approved — D Inc knew that loan would not be funded unless bank received reply to letter — Indoor management rule did not apply in circumstances — Statute of Frauds was no defence to either M or D Inc — M and D Inc could not be considered "any other person" for purposes of s. 8 of statute, and s. 8 does not apply to negligent misrepresentation — Statute of Frauds, R.S.O. 1990, c. S.19, s. 8.

Fraud and misrepresentation --- Negligent misrepresentation (Hedley Byrne principle) — Nature and extent of duty of care — General

Bank loaned substantial funds to corporation, A Ltd — Credit facility was unsecured and subject to payment on demand — A Ltd was to notify bank if other available credit facilities fell below amount of credit facility from bank — Continuation of A Ltd required financial support from parent company D Inc — D Inc and A Ltd integrated their treasury functions at D Inc — D Inc's employees became responsible for dealing with bank on day-to-day basis — Industry suffered downturn and A Ltd also experienced lengthy strike by employees, which led to weakened financial condition — Other credit facilities of A Ltd fell below amount of credit facility from bank, but bank was not informed — M, who was vice-president and secretary and treasurer of A Ltd, advised bank that A Ltd was merely having short-term cash problems due to "ramping-up" after strike, and promised to provide cash flow statements — A Ltd requested loan of $4 million from bank to cover cheques — M advised bank that U.S. accounts were not encumbered and were available as security to bank, and that proceeds of upcoming sale would be used to pay out bank — Bank sent letter confirming conversation with M, to M and N, who was manager of cash and banking in D Inc's treasury department — U.S. receivables were not available as security to bank as they had been pledged to other bank, and proceeds of upcoming sale were not certain given insolvent state of A Ltd — Bank spoke to N, and N confirmed that he had seen letter and that "it sounded reasonable" — Two weeks after bank loaned funds, A Ltd and D Inc announced that A Ltd was insolvent — A Ltd was restructured under Companies' Creditors Arrangement Act and emerged under new ownership — Bank received $1.6 million under restructuring, resulting in net loss of $2 million U.S. — Bank brought action against D Inc, N, and M, for damages for deceit and negligent misrepresentations — Action was allowed — Trial judge held that N and M misled bank as to A Ltd's true financial state, and that bank relied on misrepresentations in agreeing to lend funds to A Ltd — Appeals by D Inc, M and N dismissed — Special relationship existed between M and bank — M was vice-president and was bank's contact with A Ltd — M held himself out as capable of making decisions on A Ltd's behalf as it related to bank's concerns about security — M must have known that carelessness on his part would result in loss by bank — M ought reasonably to have foreseen that bank would rely upon his representations, and such reliance was reasonable — M owed prima facie duty of care to bank — Allowing bank to pursue its claim against M did not undermine or subvert purposes of Companies Creditors Arrangement Act — No policy considerations existed that justified holding M not liable — No question of indeterminate liability arose in case — Trial judge was correct in holding that M owed duty of care to bank — D Inc had stepped into shoes of A Ltd for purposes of daily cash management — Sufficiently close relationship existed between D Inc and bank that, in reasonable contemplation of D Inc, carelessness on its part might cause damage to bank — No policy ground existed to limit scope of duty owed to bank — N knew that bank would be relying on his statements, and such reliance was reasonable.

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Corporations --- Directors and officers — Liabilities — Negligence

Bank loaned substantial funds to corporation, A Ltd — Credit facility was unsecured and subject to payment on demand — A Ltd was to notify bank if other available credit facilities fell below amount of credit facility from bank — Continuation of A Ltd required financial support from parent company D Inc — D Inc and A Ltd integrated their treasury functions at D Inc — D Inc's employees became responsible for dealing with bank on day-to-day basis — Industry suffered downturn and A Ltd also experienced lengthy strike by employees, which led to weakened financial condition — Other credit facilities of A Ltd fell below amount of credit facility from bank, but bank was not informed — M, who was vice-president and secretary and treasurer of A Ltd, advised bank that A Ltd was merely having short-term cash problems due to "ramping-up" after strike, and promised to provide cash flow statements — A Ltd requested loan of $4 million from bank to cover cheques — M advised bank that U.S. accounts were not encumbered and were available as security to bank, and that proceeds of upcoming sale would be used to pay out bank — U.S. receivables were not available as security to bank as they had been pledged to other bank, and proceeds of upcoming sale were not certain given insolvent state of A Ltd — Two weeks after bank loaned funds, A Ltd and D Inc announced that A Ltd was insolvent — A Ltd was restructured under Companies' Creditors Arrangement Act and emerged under new ownership — Bank received $1.6 million under restructuring, resulting in net loss of $2 million U.S. — Bank brought action against M for damages for deceit and negligent misrepresentations — Action was allowed — Trial judge held that M misled bank as to A Ltd's true financial state, and that bank relied on misrepresentations in agreeing to lend funds to A Ltd — Appeal dismissed — Bank established to trial judge's satisfaction that M's actions were themselves tortious — Officers of corporations are responsible for own tortious acts — No basis existed for protecting M from liability for his own tortious acts simply because he was acting in pursuance of interests of corporation.

Fraud and misrepresentation --- Negligent misrepresentation (Hedley Byrne principle) — Detrimental reliance

Bank loaned substantial funds to corporation, A Ltd — Credit facility was unsecured and subject to payment on demand — A Ltd was to notify bank if other available credit facilities fell below amount of credit facility from bank — Continuation of A Ltd required financial support from parent company D Inc — D Inc and A Ltd integrated their treasury functions at D Inc — D Inc's employees became responsible for dealing with bank on day-to-day basis — Industry suffered downturn and A Ltd also experienced lengthy strike by employees, which led to weakened financial condition — Other credit facilities of A Ltd fell below amount of credit facility from bank, but bank was not informed — M, who was vice-president and secretary and treasurer of A Ltd, advised bank that A Ltd was merely having short-term cash problems due to "ramping-up" after strike, and promised to provide cash flow statements — A Ltd requested loan of $4 million from bank to cover cheques — M advised bank that U.S. accounts were not encumbered and were available as security to bank, and that proceeds of upcoming sale would be used to pay out bank — Bank sent letter confirming conversation with M, to M and N, who was manager of cash and banking in D Inc's treasury department — U.S. receivables were not available as security to bank as they had been pledged to other bank, and proceeds of upcoming sale were not certain given insolvent state of A Ltd — Bank spoke to N, and N confirmed that he had seen letter and that "it sounded reasonable" — Two weeks after bank loaned funds, A Ltd and D Inc announced that A Ltd was insolvent — A Ltd was restructured under Companies' Creditors Arrangement Act and emerged under new ownership — Bank received $1.6 million under restructuring, resulting in net loss of $2 million U.S. — Bank brought action against D Inc, N, and M, for damages for deceit and negligent misrepresentations — Action was allowed — Trial judge held that N and M misled bank as to A Ltd's true financial state, and that bank relied on misrepresentations in agreeing to lend funds to A Ltd — Appeals by D Inc, M and N dismissed — Bank was concerned about A Ltd's ability to repay funds advanced under facility and was seeking information from M so that credit risk could be assessed — M's statements were designed to reassure bank and ensure that cheques cleared — Trial judge properly inferred that bank relied upon statements to its detriment and that they were one of causes of loss — Case against M did not fail simply because statements of N also contributed to bank's loss — Negligent misrepresentation of M was not required to be sole cause of bank's loss — It was not necessary for bank to prove that statements by N were only factors that induced bank to act to its detriment — N knew that standing alone

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1999 CarswellOnt 4077, 47 C.C.L.T. (2d) 213, 181 D.L.R. (4th) 37, 127 O.A.C. 338, 1 B.L.R. (3d) 1, 46 O.R. (3d) 514, 15 C.B.R. (4th) 67, [1999] O.J. No. 4749, 93 A.C.W.S. (3d) 391

A Ltd was insolvent and knew that no decision had been made about whether D Inc would commit further funds to A Ltd — N knew, or should have known, that all receivables were encumbered — N knew, or ought to have known, that M could not commit using proceeds of sale to pay out bank's loan — N knew, or ought to have known, that letter contained misrepresentations — Findings of trial judge were reasonable and established D Inc's liability — No basis existed for interfering with trial judge's finding that N affirmed truth of misrepresentations in letter.

Cases considered by *Rosenberg J.A.*:

ADGA Systems International Ltd. v. Valcom Ltd. (1999), 39 C.C.E.L. (2d) 163, 168 D.L.R. (4th) 351, 41 B.L.R. (2d) 157, 117 O.A.C. 39, 44 C.C.L.T. (2d) 174, 43 O.R. (3d) 101 (Ont. C.A.) — applied

Anderson Lumber Co. v. Canadian Conifer Ltd., 4 A.R. 282, [1977] 5 W.W.R. 41, 77 D.L.R. (3d) 126, 25 C.B.R. (N.S.) 35 (Alta. C.A.) — applied

Anns v. Merton London Borough Council (1977), [1978] A.C. 728, [1977] 2 W.L.R. 1024, (sub nom. *Anns v. London Borough of Merton)* [1977] 2 All E.R. 492 (U.K. H.L.) — applied

Banbury v. Bank of Montreal, [1918] A.C. 626, 44 D.L.R. 234, [1918-19] All E.R. Rep. 1 (U.K. H.L.) — referred to

Barclay Construction Corp. v. Bank of Montreal (1989), 41 B.C.L.R. (2d) 239, [1990] 2 W.W.R. 489, 65 D.L.R. (4th) 213, 45 B.L.R. 282 (B.C. C.A.) — referred to

Central & Eastern Trust Co. v. Rafuse, 37 C.C.L.T. 117, (sub nom. *Central Trust Co. v. Rafuse)* [1986] 2 S.C.R. 147, (sub nom. *Central Trust Co. v. Rafuse)* 31 D.L.R. (4th) 481, (sub nom. *Central Trust Co. v. Rafuse)* 69 N.R. 321, (sub nom. *Central Trust Co. v. Rafuse)* 75 N.S.R. (2d) 109, (sub nom. *Central Trust Co. v. Rafuse)* 186 A.P.R. 109, 42 R.P.R. 161, 34 B.L.R. 187, (sub nom. *Central Trust Co. c. Cordon)* [1986] R.R.A. 527 (headnote only) (S.C.C.) — considered

Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd., [1993] 8 W.W.R. 129, 11 B.L.R. (2d) 101, 12 C.L.R. (2d) 161, (sub nom. *Edgeworth Construction Ltd. v. Lea (N.D.) & Associates Ltd.)* 83 B.C.L.R. (2d) 145, 17 C.C.L.T. (2d) 101, (sub nom. *Edgeworth Construction Ltd. v. Lea (N.D.) & Associates Ltd.)* 107 D.L.R. (4th) 169, (sub nom. *Edgeworth Construction Ltd. v. Lea (N.D.) & Associates Ltd.)* [1993] 3 S.C.R. 206, (sub nom. *Edgeworth Construction Ltd. v. Lea (N.D.) & Associates Ltd.)* 157 N.R. 241, (sub nom. *Edgeworth Construction Ltd. v. Lea (N.D.) & Associates Ltd.)* 32 B.C.A.C. 221, (sub nom. *Edgeworth Construction Ltd. v. Lea (N.D.) & Associates Ltd.)* 53 W.A.C. 221 (S.C.C.) — considered

Haig v. Bamford (1976), [1977] 1 S.C.R. 466, 72 D.L.R. (3d) 68, 9 N.R. 43, 27 C.P.R. (2d) 149, [1976] 3 W.W.R. 331 (S.C.C.) — referred to

Hercules Management Ltd. v. Ernst & Young, [1997] 2 S.C.R. 165, 211 N.R. 352, 115 Man. R. (2d) 241, 139 W.A.C. 241, (sub nom. *Hercules Managements Ltd. v. Ernst & Young)* 146 D.L.R. (4th) 577, 35 C.C.L.T. (2d) 115, 31 B.L.R. (2d) 147, [1997] 8 W.W.R. 80 (S.C.C.) — applied

Inter-City Express Ltd. v. Toronto-Dominion Bank (1976), 66 D.L.R. (3d) 754 (B.C. S.C.) — referred to

Kripps v. Touche Ross & Co., 89 B.C.A.C. 288, 145 W.A.C. 288, 35 C.C.L.T. (2d) 60, [1997] 6 W.W.R. 421, 33 B.C.L.R. (3d) 254 (B.C. C.A.) — referred to

London Drugs Ltd. v. Kuehne & Nagel International Ltd. (1992), [1993] 1 W.W.R. 1, [1992] 3 S.C.R. 299, (sub

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nom. *London Drugs Ltd. v. Brassart)* 143 N.R. 1, 73 B.C.L.R. (2d) 1, 43 C.C.E.L. 1, 13 C.C.L.T. (2d) 1, (sub nom. *London Drugs Ltd. v. Brassart)* 18 B.C.A.C. 1, (sub nom. *London Drugs Ltd. v. Brassart)* 31 W.A.C. 1, 97 D.L.R. (4th) 261 (S.C.C.) — considered

Meditrust Healthcare Inc. v. Shoppers Drug Mart (1999), 124 O.A.C. 137 (Ont. C.A.) — referred to

Montreal Trust Co. of Canada v. ScotiaMcLeod Inc. (1995), 129 D.L.R. (4th) 711, 9 C.C.L.S. 97, 23 B.L.R. (2d) 165, 87 O.A.C. 129, (sub nom. *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.)* 26 O.R. (3d) 481 (Ont. C.A.) — applied

Nielsen v. Kamloops (City), [1984] 5 W.W.R. 1, [1984] 2 S.C.R. 2, 10 D.L.R. (4th) 641, 54 N.R. 1, 11 Admin. L.R. 1, 29 C.C.L.T. 97, 8 C.L.R. 1, 26 M.P.L.R. 81, 66 B.C.L.R. 273 (S.C.C.) — applied

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

Queen v. Cognos Inc., 45 C.C.E.L. 153, 93 C.L.L.C. 14,019, 99 D.L.R. (4th) 626, 60 O.A.C. 1, 14 C.C.L.T. (2d) 113, [1993] 1 S.C.R. 87, 147 N.R. 169 (S.C.C.) — applied

Said v. Butt, [1920] 3 K.B. 497, [1920] All E.R. Rep. 232, 90 L.J.K.B. 239 (Eng. K.B.) — considered

W.B. Anderson & Sons Ltd. v. Rhodes (Liverpool) Ltd., [1967] 2 All E.R. 850 (Eng. P.D.A.) — applied

Statutes considered:

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

Generally — considered

s. 50(14) [en. 1997, c. 12, s. 30] — considered

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

Generally — considered

s. 5.1(2) [en. 1997, c. 12, s. 122] — considered

Statute of Frauds, R.S.O. 1990, c. S.19

s. 8 — considered

APPEALS by D Inc, M and N from judgment reported at (1997), 34 B.L.R. (2d) 209 (Ont. Gen. Div), allowing bank's action for damages for deceit and negligent misrepresentations.

The judgment of the court was delivered by *Rosenberg J.A.*:

1 The appellants Dofasco Inc. and James T. Melville appeal from the judgment of Crane J. finding them jointly and severally liable to the respondent NBD Bank, Canada in the amount of $1,984,945.27 U.S. for negligent misrep-

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resentation. The appellants raise a number of factual and legal issues that will require a detailed summary of the facts. The essential issues in the litigation, however, concern the legal effect of several telephone calls that occurred on January 10 and 11, 1991 and a letter that was sent on January 10, 1991. These communications led to a decision by the respondent to fund cheques totaling approximately $4 million U.S. in accordance with a $20 million credit facility given by the respondent to Algoma Steel Corporation Limited. At the time, Algoma, a wholly owned subsidiary of Dofasco, was in serious financial difficulty. The trial judge found that Percival Nicholas an official at Dofasco and James Melville, Algoma's Vice-President (Finance), misled the respondent as to Algoma's true financial state. As a result of these misleading representations the respondent agreed to lend the requested $4 million. Two weeks later, Algoma and Dofasco announced that Algoma was insolvent. Algoma was subsequently able to restructure under the auspices of the *Companies Creditors Arrangment Act*, R.S.C. 1985, c. C-36 [*CCAA*] but the respondent suffered a significant loss. For the reasons that follow, I would dismiss the appeals. The respondent cross-appeals on the basis that, *inter alia*, the trial judge erred in finding that the tort of deceit was not made out. In view of my conclusions on the appeals, it is unnecessary to deal with the cross-appeal.

The Facts

The persons involved

2 The respondent, NBD Bank, Canada, is a Canadian chartered bank and is a subsidiary of NBD Bank N.A., which is based in the United States. The original agreement between Algoma and the respondent was made in October 1987. That agreement was amended from time to time. The principal witness for the respondent was Jeremy Hynes. He joined the Bank as second vice-president in September 1990 and immediately became responsible for the Algoma account. The allegedly negligent misrepresentations were made to Mr. Hynes. Mr. Hynes reported to the respondent's president, William Schmid.

3 Algoma was Canada's third largest steel producer and was based in Sault Ste. Marie. The appellant James Melville began working for Algoma as a teenager. After finishing university and law school he returned to Sault Ste. Marie and joined Algoma as a solicitor. In 1990 and 1991 he was Algoma's Vice-President (Finance), Secretary and Treasurer. He was the person at Algoma with whom Mr. Hynes dealt.

4 Algoma had a United States subsidiary, Cannelton Coal Co. It was proposing to sell Cannelton in 1991. This sale would provide necessary working capital for Algoma and was critical to any successful restructuring. The alleged negligent misrepresentations concerned the funding of cheques in the amount of $4 million, which included the Cannelton payroll.

5 The appellant Dofasco acquired ownership of the shares in Algoma in August 1988. It had invested $600 million in Algoma, but by late 1990 that investment was in peril. Initially, Algoma operated autonomously, with operations and overall responsibility left to the management and the board of Algoma. However, in July 1990, the operation of the daily cash management function for Algoma was transferred to Dofasco. John Rule, a Dofasco treasury analyst, assumed responsibility for netting out the daily payables and receivables for Algoma and its subsidiaries and, as necessary, accessing the appropriate bank facilities, including the facility at the respondent. Rule had responsibility for contacting the traders in the respondent's trading room. Rule was named as a defendant. The trial judge dismissed the claim against him.

6 Rule's superior was Percival Nicholas, the manager of cash and banking in Dofasco's treasury department. The trial judge found that Nicholas made negligent misrepresentations to Mr. Hynes. Dofasco accepted that it was vicariously liable for the actions of Nicholas.[FN1] Nicholas reported to Allen Root, the Dofasco treasurer, who in turn reported to Dofasco's vice-president finance, Bill Solski.

The Credit Facility

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7 The initial credit facility between the respondent and Algoma was taken out in 1987. That facility was unsecured, uncommitted, and subject to payment on demand. The facility was used primarily to fund, on a daily basis, cash flow requirements of Algoma's U.S. accounts with NBD Bank, N.A. Thus, if the total payables exceeded the total receivables in the U.S. accounts on any day, Algoma would borrow U.S. dollars from the respondent, which would be transferred to NBD Bank, N.A. to cover the deficiency. Paragraph (e) of the facility originally provided that Algoma was to maintain unused portions of other credit facilities with other banks in amounts sufficient to repay any advance made by the respondent. In November 1988, the respondent agreed to remove paragraph (e) on condition that Algoma would notify the respondent if the other available credit facilities fell below $20,000,000 Cdn.

8 The mechanics for accessing the facility are important. The facility contemplated that Algoma would notify the respondent by telephone that it wished to borrow money. Under the facility, the amount of the loan and the interest rate were to be agreed upon by the respondent and Algoma's Assistant Treasurer and its supervisor of cash operations. In 1990, Mr. Hynes had the authority to approve the loan on behalf of the respondent. In the normal course, other persons handled the day-to-day management of the facility.

9 As indicated, in July 1990, Dofasco and Algoma integrated their treasury functions at Dofasco. Accordingly, Dofasco employees, in particular John Rule, became responsible for dealing with the respondent on a day-to-day basis. The trial judge found that while Mr. Rule actually dealt with one of the traders in the respondent's trading room, the loan had to be approved by the loan officer, Mr. Hynes. The appellants challenge this finding and it forms one of the grounds of appeal. In short, the appellants argue that even if there were negligent misrepresentations, they did not result in any loss because the loans that caused the loss were made before any misrepresentations, as a result of the communications between Mr. Rule and the traders. I will return to the facts in support of this submission below when I deal in detail with the events of January 10 and 11, 1991.

10 Dofasco did not otherwise have a direct customer/bank relationship with the respondent. It did have a banking relationship with the respondent's parent company, NBD Bank N.A. There is some suggestion in the evidence that NBD Bank N.A. was anxious to ensure that relations between Algoma and the respondent did not adversely affect the relationship between the two parent companies. An underlying theory of the defence was that the decision to advance the $4 million was made so as not to prejudice the relationship between the two parent companies and that Mr. Hynes was not seeking information or assurances from Dofasco officials in January 1990. Rather, he was merely keeping them "in the loop" at the request of NBD Bank N.A.

The strike

11 In mid-1990, Algoma's employees went on strike. The strike lasted for 112 days and was the longest strike in the company's history. Algoma, which was already in a weak financial condition, was further weakened by the strike. Even after the strike was settled (November 21, 1990), Algoma would experience short-term financing difficulties during the "ramping-up" period. At this time, the company had to pay the full cost of producing steel and had no choice but to wait the normal course of payment of sixty to ninety days before it received payment. Thus, in late 1990, Algoma had a need for cash to meet its fixed overhead costs and the costs of production following the settlement of the strike.

The fall of 1990

12 However, the short-term problems caused by the ramping-up after the strike were not Algoma's only problems. Its income had been falling steadily since 1988 while its capital expenditures had been increasing. In early 1989, Dofasco had loaned Algoma $100 million (unsecured). By 1990, the steel industry had moved into a downturn. The weakest companies, like Algoma, would be most affected by these adverse economic conditions. In Octo-

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ber 1990, Dofasco initiated a project under the code name "Liz Dodge" for "dislodging Algoma from Dofasco." In November 1990, Dofasco's chief financial officer reported to the Dofasco board that Algoma was in very serious financial trouble and that by continuing to support Algoma, Dofasco itself would be put at risk. The immediate cause of concern was a request by Algoma to increase its credit facilities with its other bankers (i.e. other than the respondent). The syndicate of bankers, led by the Royal Bank, was willing to give Algoma a new $250 million facility only if Dofasco would provide some form of guarantee. Algoma needed the increase in the credit facility in part to fund $122 million in debentures that were coming due on November 30, 1990. Dofasco refused to guarantee the loan. Instead, Dofasco purchased the debentures itself. The trial judge found that this "desperate" purchase was to give the Dofasco Board sufficient time to establish study teams on the Algoma situation to present options to the Dofasco Board at the end of January 1991. The work of these committees, including the Liz Dodge committee, took on a new urgency as a result of the November developments. The committees included experts in insolvency.

13 The trial judge found that the appellants knew that from November 1990, standing alone Algoma was no longer solvent. They recognized that Algoma had to be restructured if it were to survive.

14 The next crisis for Algoma was a $32.5 million milestone payment upon the existing syndicated bank credit facility due on December 31, 1990. Dofasco sought to defer this payment. This would require an amendment to the Royal Bank facility. Mr. Solski and Mr. Nicholas of Dofasco met with the Royal Bank and in late December, the banks agreed to the postponement. At a Dofasco Board meeting in December, a presentation was made concerning reorganization of Algoma, including a discussion of the *CCAA*. Mr. Melville was present for this presentation.

January 1991

15 On January 3, 1991, Mr. Hynes called Mr. Nicholas because he was concerned that the failure to pay the $32.5 million to the Royal Bank, which had been publicly announced, was a default. Mr. Nicholas told him that the payment was not defaulted but deferred to provide a window to Algoma for the purpose of ramping-up after the strike. Nicholas also told Hynes that Dofasco was not putting more money into Algoma and that the respondent should do whatever it had to do to get comfortable with Algoma as a stand-alone credit risk. He referred Hynes to the appellant Melville for any further inquiries.

16 The following day, Hynes spoke to Melville. Melville confirmed the deferral of the $32.5 million. He also said that Algoma had $60 million in available working credit lines, but that Algoma would need $80 million to ramp up after the strike. He said that they would be back to normal operations at the end of March. In his evidence, Mr. Melville agreed that this statement about available credit was misleading and incorrect. It would seem that Algoma was now in breach of the terms of the facility by not informing the respondent that available credit facilities had fallen below $20,000,000.

17 Mr. Melville also promised to provide statements of cash flow analysis to show how Algoma would be dealing with the demands on cash flow. The trial judge rejected Melville's evidence that he only promised to provide an analysis of how Algoma intended to use the monies borrowed from the respondent. The trial judge found that Melville knew that if he provided the cash flow forecasts to Mr. Hynes the loan facility with the respondent would be cancelled. The trial judge found that there was an implied misrepresentation to the effect that the cash flow statements would support the representation that Algoma's problems were due to the short-term ramping-up problem. In any event, Mr. Melville did not provide a cash flow statement, nor a statement of the estimated cash activity of the facility with the respondent at any time. The trial judge also referred to minutes of an Algoma Board meeting of January 7 in which there was a discussion led by Mr. Melville on a six-month cash flow forecast which indicated that a shortfall, in comparison to existing available credit lines, would occur in early February.

18 There was other evidence that the cash flow problem was even more desperate. At a meeting of the Liz Dodge committee on January 7, one of the members noted that unless Algoma could obtain access to the credit line

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with the respondent or sell pellets to Dofasco, Algoma would run out of cash that week. Mr. Nicholas had previously noted in his diary that the proposed sale of the pellets to Dofasco could be attacked by creditors in the future as an improper preference. Mr. Nicholas was now working in his day-to-day cash management function for Algoma in an atmosphere of crisis. Cash flow estimates that were normally prepared every month were now prepared every day.

19 Then, on January 9, Mr. Hynes learned from a colleague that the Royal Bank line of credit was secured. In the result, the respondent was now the only unsecured lender to Algoma. Mr. Hynes' superior instructed him to limit the facility to the current level, which on that date stood at $700,000 U.S. Mr. Hynes did not immediately pass on this information to the appellants.

January 10, 11, 1991

20 On January 10, Mr. Rule of Dofasco called the respondent's trading room and requested a loan of $4 million to cover cheques, including the Cannelton Coal payroll. Dishonouring of these cheques could impair the sale of Cannelton, which was important to any restructuring of Algoma. The trading room conversations are tape-recorded and transcripts of the relevant conversations were produced at the trial. As indicated, it is the position of the appellants that the loans were made during these conversations, before the representations by Nicholas and Melville that the trial judge found to be misleading. The substance of the conversation between Mr. Rule and the trader at 10:00 a.m. on January 10 was as follows. Mr. Rule made the request for $4 million in addition to the $700,000 outstanding. The trader replied, "Okay that shall be done and I think it looks as though its going to be 7 + 7/8." The respondent's trader then relayed the request to Mr. Hynes. Mr. Hynes conferred with his superior and they decided that the respondent would not make the loan. Fifteen minutes after the trading-room conversation, Hynes left an urgent message for Nicholas. Nicholas returned the call with Mr. Rule present to participate by way of speaker telephone. Hynes said that there was no alternative but to return the cheques since the respondent would not make the loan. Nicholas said either "you can't bounce cheques" or "hold on, let's not be rash, something can be worked out." Nicholas said Hynes should speak to Melville.

21 Mr. Hynes put in a call to Mr. Melville. The call was returned in the mid-afternoon on January 10th. Melville was confrontational and demanded that the respondent make the $4 million loan. Hynes told Melville of the respondent's concern because they had just learned about the Royal Bank security. Melville told Hynes that Royal Bank had been secured for ten years. This was only partially true. From time to time the line of credit had been secured. However, more recently the Royal Bank had taken security on the line of credit in its annual credit review, before the strike. After the conversation, Hynes again consulted with his superiors and the decision not to fund the loan was confirmed. Hynes was told to inform Dofasco of the decision.

22 Hynes called Nicholas, who urged him to speak to Melville again because Melville was "reasonable." Nicholas also told Hynes that the cheques could not be funded elsewhere because Algoma did not have sufficient margins available under the Royal Bank facility to permit more borrowing. It would seem that this is the first time that the respondent learned that Algoma was in breach of the terms of the facility. Nicholas urged Hynes to call Melville to see if something could be worked out.

23 Mr. Hynes again called Mr. Melville. The trial judge found that the most serious misrepresentations were made during this conversation. There were conflicting versions of this conversation. The trial judge accepted Mr. Hynes' evidence over that of Mr. Melville. Mr. Hynes returned to the issue that the Royal Bank had security. Mr. Melville indicated that the U.S. accounts were not encumbered and that if the respondent's discomfort was that it was the only unsecured lender, he could give it the U.S. accounts receivable. He said that there were about $2 to $3 million receivables but these were going to increase as Algoma ramped up after the strike. They also talked about the cash flows that had been promised six days earlier regarding the ramp-up as Algoma's operations returned to normal. Melville also said that he had the proceeds from the Cannelton sale coming in around March 1st and that could be used to pay out the respondent.

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24 Following the conversation, Mr. Hynes typed out a letter summarizing the conversation and faxed a copy to Mr. Melville at Algoma and Mr. Nicholas at Dofasco. The letter was as follows:

> This confirms and is further to our conversation of January 10, 1991 regarding the captioned unsecured facilities. The Bank originally provided its uncommitted facilities in return for an undertaking from Algoma that it would maintain sufficient unutilized credit facilities from its other banks to retire outstandings under NBD Bank's facilities upon request. In letters exchanged August 15, 1988 and November 4, 1988 this was modified to an undertaking by Algoma to advise the Bank if the aforementioned unutilized facilities fell below Cdn. $20,000,000. The intent hereunder was clearly to ensure that NBD Bank's unsecured position could be funded from an alternative source at any time.
>
> Today's conversations with you, John Rule and Perc Nicholas at Dofasco indicate that this reserve is not available to fund cheques written by Algoma against its U.S. Dollar account at NBD Bank, N.A. in Detroit. This places the Bank in the unforeseen position of choosing whether to return Algoma cheques to cap its exposure at current levels. In conversations last week, NBD (assuming the other unutilized facilities existed) expressed its desire to limit Algoma's use of its facilities to U.S. $8,000,000 until Algoma could provide information regarding its credit needs and cash inflows for the first quarter of 1991.
>
> Although this information has not been received and it appears unutilized alternative funds to clear cheques drawn on NBD are not available, the Bank wants to help Algoma. **In order to clear the cheques outstanding, could you please provide no later than 12:00 p.m. Friday, January 11, 1991 the following**:
>
> 1. **a list of the cheques (or cheque groups like payroll) outstanding and the date(s) they were written;**
>
> 2. **confirmation that no further cheques are being drawn on NBD until a mutually-satisfactory line of credit has been arranged;**
>
> 3. **a statement of the amount of outstanding receivables available to reduce outstandings, along with your undertaking that these lock-box proceeds will be dedicated to reducing NBD's exposure from its peak not to exceed U.S. $8,000,000;**
>
> 4. **your estimate of the U.S. receivables available going forward which are not pledged to any other lender and Algoma is willing to pledge to secure a mutually-satisfactory credit facility from NBD;**
>
> 5. **your undertaking that, if NBD temporarily provides advances to Algoma that exceed the amount of the mutually-satisfactory credit facility to be arranged, Algoma will first apply cash proceeds from the sale of its U.S. coal assets to repay said excess advances. If no facility can be agreed, the aforementioned proceeds will first be used to retire all NBD's exposure.**
>
> The preceding request does not materially deviate from the information outlined last week to assist NBD in accommodating Algoma's first quarter cash needs. It is NBD's desire to meet Algoma's banking needs during this difficult period of restructuring, if this can be accomplished without exposing the Bank to an unsecured, uncovered position without a highly probable source of repayment. NBD trusts that Algoma understands this and will provide it with the assurances needed to continue our good relationship.
>
> Please provide the requested reply as soon as possible. Thank you for your cooperation in this matter. [Emphasis added.]

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25 The trial judge found several misrepresentations by Mr. Melville in this conversation and as recorded in the letter. The U.S. receivables were not available as security to the respondent. Melville knew that they had been pledged to the Royal Bank. The representation about the Cannelton Coal proceeds was misleading since it was dependent upon Algoma still being an operating and viable entity in control of its assets. Melville knew that as early as January 22, 1991, Algoma could be declared insolvent.

26 At approximately 10:00 a.m. on January 11, Mr. Rule telephoned the respondent's trading room and spoke to Peter Evans, the respondent's senior vice-president, money market and chief trader. Dofasco relies on this conversation, because it precedes the communication between Mr. Hynes and Mr. Nicholas that was the basis of Dofasco's liability. Mr. Rule asked the trader if they can "roll the 4.7 today." Mr. Evans replied that he did not think it was a problem but he wanted to talk to Mr. Hynes because he was aware that there had been a lot of activity the previous night and he wasn't sure if Mr. Hynes had "resolved his problem." When Evans came back on the telephone he said the following:

> Here now, apparently what happened as a result of these conversations we have rolled the funds. The thing is he is going to ask for prime on it so it would go to 9-1/2%.
>
> .....
>
> Okay 4.7 for three days and then I will get Jerry [Hynes] to speak to all the interested parties, obviously resolve what ever his concerns are with them.

27 Mr. Rule replied "okay." Mr. Hynes testified and confirmed that Mr. Evans did talk to him and he had asked for the higher interest rate. Mr. Hynes spoke to Mr. Nicholas on the morning of January 11th, sometime after this conversation. This conversation formed the basis of liability of the appellant, Dofasco. Hynes asked Nicholas if he had seen the letter. He said that he had and they reviewed its contents. Nicholas said that, "it sounded reasonable to me" and, "Is this okay with Jamie [Melville]?" Hynes testified that at that point it "looked like a done deal," the only thing left was for Melville to get back to him as required in the letter. He told Nicholas that the cheques would clear. The trial judge found that as a result of this conversation Hynes waived the noon deadline set out in the letter.

28 Later in the day, Mr. Hynes received a letter from Mr. Melville. That letter merely confirmed that Algoma would not write any further cheques on the credit facility until a new or amended facility had been approved and Melville's understanding that the amount outstanding against the facility was approximately $6.4 million. The trial judge characterized this letter as "disingenuous." Mr. Hynes was concerned that this was not a response to the five points in his January 10th letter and he tried to get hold of Melville. They eventually talked around 4:40 p.m. and the conversation lasted about twenty minutes. At the end of the conversation, Mr. Hynes was satisfied that he had a deal. Melville repeated the representations about the U.S. receivables. He somewhat modified the representation about the Cannelton Coal sale, indicating that in the event the U.S. receivables were not sufficient, the Cannelton proceeds would be available to take the respondent out, subject to approval by the Board. Mr. Hynes believed that this agreement would be documented within the next three weeks to make the respondent a secured lender. Mr. Hynes took no steps to dishonour the cheques after this conversation. He testified that had he been told of Algoma's potential insolvency, the respondent would not have cleared the cheques.

29 Mr. Hynes spoke to Mr. Melville the next week about receiving the cash flow estimates. For the first time, Melville stated that he could not give the respondent the U.S. receivables without Board approval, but the Board would be meeting in two weeks to consider the new arrangement. Mr. Hynes made several attempts to get hold of Melville over the next few days, but was unsuccessful. In the meantime, he prepared the necessary paperwork that Melville would need to present to the Algoma Board.

30 On January 22nd, Dofasco's Board decided not to extend any further financial support to Algoma and to write

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off its equity interest in Algoma. On the same day, Algoma's Board decided to pursue a financial restructuring. On January 23rd, Melville sent Mr. Hynes a press release indicating that Algoma was seeking to restructure its debt and that "all reasonable forecasts show the company is unable to produce adequate cash flow to support the heavy debt load, even with the contemplated sale of Cannelton [Coal]." Mr. Hynes had never been provided with the promised cash flow forecasts. When he received the press release, Mr. Hynes tried to get hold of Nicholas. Nicholas referred him back to Melville. By this time he was very angry. He felt that he had been negotiating in good faith with Algoma and that this turn of events was "inappropriate."

31 On January 30th, the respondent made a demand of Algoma on the Facility. Algoma did not respond. On June 1, 1992, a court-ordered arrangement was entered into under the *CCAA*, whereby Algoma was restructured and emerged under new ownership. As a result of the restructuring, the respondent received approximately $1.6 million U.S., resulting in a net loss of about $2 million U.S. Under the *CCAA* arrangement, the respondent was barred from bringing an action for misrepresentation against Algoma itself.

The Trial Judge's Reasons

Liability of Mr. Melville

32 I have referred to some of the findings made by the trial judge in relation to the appellant Mr. Melville. To summarize, the trial judge found the following misrepresentations by Melville. I have placed in square brackets a very brief summary of the findings by the trial judge as to the true state of affairs.

January 4, 1991:

1. Algoma was having short term cash problems due to the "ramping up" after the strike. [Implying that this was the only problem when there was a longer term structural problem.]

2. The promise to supply cash flow statements. [Wrongly implying that the cash flow statements would support the short term "ramping up" problem.]

January 10, 1991:

1. The Royal Bank line of credit had been secured for about 10 years. [In fact, the security had only been taken in June 1990.]

2. Algoma's U.S. accounts receivable were not pledged and available as security to the respondent. [In fact, all the receivables, including the U.S. accounts, were pledged to the Royal Bank.]

3. The respondent's loan position would be paid out upon the sale of Cannelton Coal. [The truth of this representation depended upon Algoma still being an operating, viable entity in late February or March and in control of its assets. Melville was not in a position to make this representation since he knew Algoma could be insolvent by January 22, 1991 after the meetings of the Dofasco and Algoma boards. Melville did not disclose this fact to Hynes.]

Liability of Dofasco

33 Dofasco's liability turns on the representations made by Mr. Nicholas in his conversation with Mr. Hynes on the morning of January 11, 1991. The trial judge found that Mr. Nicholas affirmed the contents of the January 10th letter knowing *inter alia* that the receivables were already pledged to the Royal Bank. The trial judge made this find-

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ing, in part, because of the context set by earlier conversations with Mr. Hynes that would have led him to believe that Algoma did have something to offer the respondent to give it sufficient comfort to make the $4 million loan. In addition, the trial judge found that in the circumstances, the only non-negligent response Mr. Nicholas could make to Mr. Hynes' inquiries was to expressly disclaim. However, since he found a positive misrepresentation it is unnecessary to determine whether the failure to disclaim or disclose the true state of Algoma's financial state of affairs would alone suffice to render Dofasco liable.

The Grounds of Appeal

34 Mr. Melville and Dofasco raised many grounds of appeal. Some of them are common to the two appellants. Where possible I have grouped the common grounds together. I intend to deal with the grounds of appeal in the following order:

1. When the loans were made — the indoor management rule.

    (a) As applied to Mr. Melville

    (b) As applied to Dofasco

2. Mr. Melville's personal liability

3. The duty of care with respect to negligent misrepresentation

    (a) As applied to Mr. Melville

        i. Sufficiently close or "special" relationship (the *prima facie* duty of care)

        ii. Policy reasons for not attributing personal liability

    (b) As applied to Dofasco

4. The standard of care imposed on Dofasco

5. The *Statute of Frauds*

6. Misrepresentations by Mr. Melville

7. Negligent misrepresentation by Mr. Nicholas (Dofasco's liability)

Analysis

1. When the loans were made — the indoor management rule

(a) As applied to Mr. Melville

35 Counsel for the appellant Melville submits that although the trial judge found misrepresentations by Melville on January 4, 1991 concerning the cash flow estimates, the misrepresentations, if any, that caused the loss to the respondent were Mr. Melville's statements to Mr. Hynes on January 10th and 11th. Counsel submits that even these

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conversations did not cause any loss to the respondent, because the loans were made prior to the misrepresentations.

36 I am prepared to deal with this submission on the basis that Mr. Melville would not have been found liable based solely on the January 4th conversation. In my view, this ground of appeal cannot succeed. The trial judge dealt with this issue only as it applies to the January 10th conversation. That was sufficient to find liability on Melville's behalf. It was not sufficient for dealing with the appellant Dofasco and I will deal with that below. With respect to the January 10th trading room conversations, the trial judge made the following findings. The trading room telephone conversations did not effect the actual loan. Since it was a term of the facility that it was uncommitted, a loan officer such as Mr. Hynes would have to approve the loan. The procedure in the trading room was that when a request for funds was received, the trader would quote a rate of interest and determine the duration of the advance. The trader then took this request to the loan officer. Upon the request being approved the internal transfers would be made in the United States to cover the indebtedness in the Algoma account. In this case, when the request for $4 million U.S. was made on January 10th, the decision was made not to fund and Mr. Hynes advised Mr. Nicholas a short time later that the respondent required the $4 million to be funded elsewhere. It was after this decision was conveyed first to Mr. Nicholas and then to Mr. Melville that Mr. Melville made the misrepresentations.

37 The appellant argues that so far as Algoma was concerned, the loan was completed during the initial trading room conversation and in accordance with the indoor management rule, the respondent cannot set up its own internal procedures as a defence. In my view, that is not what occurred here. Under the terms of the facility between Algoma and the respondent, there was no commitment by the respondent to lend. It was unsecured. Its only protection, as the trial judge observed, was in the assessment of the risk of each advance. This was not something that Algoma could reasonably believe would be left to someone in the trading room. It was open to the trial judge to find that in those circumstances there could be no loan until a loan officer had approved. The subsequent course of events involving Mr. Hynes, Mr. Nicholas and Mr. Melville indicate that everyone understood that the loan had not been funded on January 10th.

(b) As applied to Dofasco

38 While the trial judge did not deal specifically with the trading room conversation on January 11th, in my view the indoor management rule had no application. By late January 10th, all of the parties were aware that unless Algoma made some satisfactory arrangement with the respondent, the $4 million loan would not be funded and the cheques would be dishonoured. The indoor management rule has no application where the other party has knowledge of the limitation on the authority: *Anderson Lumber Co. v. Canadian Conifer Ltd.* (1977), 77 D.L.R. (3d) 126 (Alta. C.A.). Dofasco knew, through Mr. Nicholas, that the loan would not be funded unless Mr. Hynes received a reply to his letter of January 10th, by noon on January 11th. It may be that Mr. Hynes waived that requirement when he spoke to Mr. Nicholas, received Mr. Nicholas' assurances and told him that the cheques would be cleared. However, that does not assist Dofasco in this case, since by that time Mr. Nicholas had made the statements upon which the trial judge imposed liability on Dofasco.

39 There is a further problem with this submission by the appellant. At the time of the conversations on the mornings of January 10 and 11, the cheques had not yet cleared. Algoma had breached its agreement with the respondent in that it had not informed the respondent that it no longer had $20 million credit available. Mr. Hynes only learned of this state of affairs on January 10th after the trading room conversation on that date. In any event, as indicated, the essential features of this facility were that it was unsecured, uncommitted, and subject to payment on demand. As late as 5:00 p.m. on January 11, the respondent with some effort could have dishonoured the cheques and thus not suffered any loss. In my view, given the terms of the facility it would have been entitled to do so, even if the loans were made during the trading room conversations on January 10 and 11. See *Barclay Construction Corp. v. Bank of Montreal* (1989), 41 B.C.L.R. (2d) 239 (B.C. C.A.) and *Inter-City Express Ltd. v. Toronto-Dominion Bank* (1976), 66 D.L.R. (3d) 754 (B.C. S.C.). The respondent did not make a demand nor dishonour the cheques and thereby continued to extend credit to Algoma because of the representations by Mr. Melville and Mr. Nicholas.

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1999 CarswellOnt 4077, 47 C.C.L.T. (2d) 213, 181 D.L.R. (4th) 37, 127 O.A.C. 338, 1 B.L.R. (3d) 1, 46 O.R. (3d) 514, 15 C.B.R. (4th) 67, [1999] O.J. No. 4749, 93 A.C.W.S. (3d) 391

40 Accordingly, I would not give effect to this ground of appeal in respect of either appellant.

2. Mr. Melville's personal liability

41 Mr. Melville argues that he should not be held personally liable for acts that he performed in his role as an officer of the company and for the benefit of the company. Counsel, in effect, put this submission on two different bases. First, he argues that the respondent should not be permitted to pierce the corporate veil to render Mr. Melville liable for acts done for the benefit of his corporate employer, in accordance with the decision in *Montreal Trust Co. of Canada v. ScotiaMcLeod Inc.* (1995), 26 O.R. (3d) 481 (Ont. C.A.). Second, he argues that in his individual capacity Mr. Melville did not owe a duty of care to the respondent. I will deal with this first submission under this heading.

42 In *ScotiaMcLeod* at pp. 490-91, Finlayson J.A. held that absent fraud, deceit, dishonesty or want of authority it is rare for officers of companies to be held personally liable for actions ostensibly carried out under a corporate name "unless it can be shown that their actions are themselves tortious or exhibit a separate identity or interest from that of the company." The short answer to the appellant's submission is that the respondent established to the trial judge's satisfaction that Mr. Melville's actions were themselves tortious. In the subsequent decision of this court in *ADGA Systems International Ltd. v. Valcom Ltd.* (1999), 43 O.R. (3d) 101 (Ont. C.A.), Carthy J.A. speaking for the court confirmed that the general rule is that officers are liable for their own tortious acts. As he said at p. 107:

> The consistent line of authority in Canada holds simply that, in all events, officers, directors and employees of corporations are responsible for their tortious conduct even though that conduct was directed in a *bona fide* manner to the best interests of the company, always subject to the *Said v. Butt* exception.[FN2]

43 In *Valcom*, the plaintiff claimed against a corporate competitor and a director and two employees of that competitor. The action was based on allegations that the competitor raided the plaintiff's employees and caused the plaintiff economic damage. Carthy J.A. held that the action could proceed against the individuals and he concluded with this comment:

> It is my conclusion that there is no principled basis for protecting the director and employees of Valcom from liability for their alleged conduct on the basis that such conduct was in pursuance of the interests of the corporation. **It may be that for policy reasons the law as to the allocation of responsibility for tortious conduct should be adjusted to provide some protection to employees, officers or directors, or all of them, in limited circumstances where, for instance, they are acting in the best interests of the corporation with parties who have voluntarily chosen to accept the ambit of risk of a limited liability company. However, the creation of such a policy should not evolve from the facts of this case where the alleged conduct was intentional and the only relationship between the corporate parties was as competitors.** Any such evolution should await facts which are apposite to the policy concerns and should probably be articulated as a definitive extension of the defence in *Said v. Butt*. Such a development would be in the direction indicated by La Forest J. in his dissenting reasons in *London Drugs* and thus may have to await further consideration by the Supreme Court. [Emphasis added.][FN3]

44 Similarly, I can see no basis for protecting Mr. Melville from liability for his tortious acts towards the respondent simply because he may have been acting in pursuance of the interests of the corporation. If he is to avoid liability, it can only be on the basis that he did not owe a duty of care to the respondent and I turn to that issue now as it affects both of the appellants.

3. The duty of care with respect to negligent misrepresentation

(a) As applied to Mr. Melville

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45 The appellant, Melville, argues that he did not owe a duty of care in his personal capacity to the respondent in accordance with the test in *Anns v. Merton London Borough Council*, [1978] A.C. 728 (U.K. H.L.). The appellant makes two submissions in this respect. He submits that it was not reasonable or foreseeable that the respondent would be relying on him personally. Second, he submits that there are policy reasons why personal liability should not be found against him in the circumstances of this case. These submissions track the two parts of the *Anns* test as summarized by Wilson J. in *Nielsen v. Kamloops (City)*, [1984] 2 S.C.R. 2 (S.C.C.), at 10:

> (1) is there a sufficiently close relationship between the parties (the [defendant] and the person who has suffered the damage) so that, in the reasonable contemplation of the [defendant], carelessness on its part might cause damage to that person? If so,
>
> (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?

46 In *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 (S.C.C.), at 185-86, the Supreme Court of Canada held that this test applies to negligent misrepresentation. I will deal with the two submissions separately.

(i) Sufficiently close or "special" relationship (the prima facie duty of care)

47 In *Hercules Management* at p. 186-87, La Forest J., speaking for the court, referred to this first part of the *Anns* test as the *prima facie* duty of care. Determination of whether there was this *prima facie* duty of care required an inquiry as to whether there could be said to be a relationship of proximity or neighbourhood between the defendant-representer and the plaintiff-representee. He also equated it with what Iacobucci J. referred to as the "special relationship" in the earlier case of *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 (S.C.C.) and held that it subsumed two essential criteria. As he said at p. 188:

> In cases of negligent misrepresentation, the relationship between the plaintiff and the defendant arises through reliance by the plaintiff on the defendant's words. Thus, if "proximity" is meant to distinguish the cases where the defendant has a responsibility to take reasonable care of the plaintiff from those where he or she has no such responsibility, then in negligent misrepresentation cases, it must pertain to some aspect of the relationship of reliance. **To my mind, proximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable.** To use the term employed by my colleague, Iacobucci J., in *Cognos, supra*, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere. [Emphasis added.]

48 In my view, there was a special relationship between Mr. Melville and the respondent to meet the first part of the *Anns* test. Mr. Melville was Algoma's Vice-President (Finance), Secretary and Treasurer. He was the respondent's contact at Algoma. He held himself out as capable of making decisions on Algoma's behalf as it related to satisfying the respondent's concerns about its lack of security. He must have known that carelessness on his part would result in a loss by the respondent. The trial judge found that the appellant "would reasonably know and in fact did know, that Mr. Hynes and his bank trusted him and would accept and rely upon what he said to them." This finding was amply supported by the record. Thus, Mr. Melville ought reasonably to have foreseen that the respondent would rely upon his representations. The first criterion was met. For virtually the same reasons, reliance by the respondent was reasonable. In addition, there was the particular circumstance that on two occasions, Mr. Nicholas referred Mr. Hynes back to Mr. Melville to try to come to some sort of arrangement that would allow the cheques to clear. The second criterion was also met and thus the first part of the *Anns* test was met. Mr. Melville owed a *prima facie* duty of care to the respondent. In the course of argument, counsel framed this part of the *Anns* test as requiring

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an inquiry into whether the defendant reasonably relied upon Mr. Melville in his personal capacity. In my view, that kind of inquiry is better considered under the second part of the *Anns* test, which requires the court to consider whether there are any policy concerns to be taken into account to limit the *prima facie* duty of care. See *Hercules Management* at 190-91.

(ii) Policy reasons for not attributing personal liability

49 Counsel for the appellant focused most of his argument as to the application of the *Anns* test on the policy reasons for not attributing personal liability to the appellant. He suggested three reasons why the court should not find that Mr. Melville owed a duty of care to the respondent. Those reasons may be summarized as follows:

> I. it is anomalous to hold Mr. Melville personally liable when as a result of the *CCAA* process, the respondent was barred from pursuing the claim against Algoma;
>
> II. the parties, Algoma and the respondent, had allocated the risk between them by contract, and the court should not impose personal liability when the damage suffered arose out of the very dealings contemplated in the contract;
>
> III. imposition of personal liability in the circumstances of this case would result in indeterminate liability.

50 I will deal with each of these issues in turn.

I. The impact of the CCAA

51 Algoma commenced the process under the *CCAA* on February 18, 1991. The process was a lengthy one and the Plan of Arrangement was approved by Farley J. in April 1992. The Plan had previously been accepted by the overwhelming majority of creditors and others with an interest in Algoma. The Plan of Arrangement included the following term:

> **6.03 Releases**
>
> From and after the Effective Date, **each Creditor** and Shareholder of Algoma prior to the Effective Date (other than Dofasco) **will be deemed to forever release Algoma from any and all suits, claims and causes of action that it may have had against Algoma or** its directors, **officers**, employees and advisors. [Emphasis added.]

52 Thus, the respondent was barred from bringing an action against Algoma for the misrepresentations by its officer, the appellant Melville. Mr. Melville argues that permitting the respondent to pursue the same cause of action against Mr. Melville personally would subvert the *CCAA* process. He argues by analogy from the holding in *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 (S.C.C.). In that case, the defendants, employees of a warehouse company, badly damaged a transformer that the plaintiff had stored with the warehouse company. Under the contract between the plaintiff and the warehouse company the "warehouseman's" liability was limited to $40.00. It was held that the defendant employees were entitled to take advantage of the limitation of liability clause in the contract of storage between their employer and the plaintiff notwithstanding there was no privity of contract between the employees and the plaintiff. The court held that privity of contract should be relaxed having regard to the particular circumstances of the case, especially the wording of the limitation of liability in the contract. Writing for the majority of the court, Iacobucci J. found that there were sound policy reasons for relaxing the doctrine of privity. In particular, he was concerned that otherwise the plaintiff would be allowed to circumvent or escape the limitation of liability clause to which it had expressly consented. He referred with approval at pp. 441-42 to an excerpt from the reasons of Le Dain J. in *Central & Eastern Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147 (S.C.C.), at 206:

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> **A concurrent or alternative liability in tort will not be admitted if its effect would be to permit the plaintiff to circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort**. Subject to this qualification, where concurrent liability in tort and contract exists the plaintiff has the right to assert the cause of action that appears to be most advantageous to him in respect of any particular legal consequence. [Emphasis added.]

53 In my view, the appellant has not demonstrated that allowing the respondent to pursue its claim against him would undermine or subvert the purposes of the Act. As this court noted in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (Ont. C.A.), at 297, the *CCAA* is remedial legislation "intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both." It is a means of avoiding a liquidation that may yield little for the creditors, especially unsecured creditors like the respondent, and the debtor company shareholders. However, the appellant has not shown that allowing a creditor to continue an action against an officer for negligent misrepresentation would erode the effectiveness of the Act.

54 In fact, to refuse on policy grounds to impose liability on an officer of the corporation for negligent misrepresentation would contradict the policy of Parliament as demonstrated in recent amendments to the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. Those Acts now contemplate that an arrangement or proposal may include a term for compromise of certain types of claims against directors of the company except claims that "are based on allegations of misrepresentations made by directors."[FN4] L. W. Houlden and C. H. Morawetz, the editors of *The 2000 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 1999) at p. 192 are of the view that the policy behind the provision is to encourage directors of an insolvent corporation to remain in office so that the affairs of the corporation can be reorganized. I can see no similar policy interest in barring an action against an officer of the company who, prior to the insolvency, has misrepresented the financial affairs of the corporation to its creditors. It may be necessary to permit the compromise of claims against the debtor corporation, otherwise it may not be possible to successfully reorganize the corporation. The same considerations do not apply to individual officers. Rather, it would seem to me that it would be contrary to good policy to immunize officers from the consequences of their negligent statements which might otherwise be made in anticipation of being forgiven under a subsequent corporate proposal or arrangement.

55 Finally, I agree with counsel for the respondent that the analogy to *London Drugs* is flawed. In that case, upholding a strict application of the doctrine of privity of contract would have allowed the plaintiff to circumvent or escape the limitation of liability clause to which it had expressly consented. On January 10 and 11, when the respondent decided to extend credit because of Mr. Melville's misrepresentations, the respondent could not reasonably have contemplated any future limitation on its rights through a *CCAA* process. To the contrary, because of those misrepresentations, it did not contemplate any reorganization through such a process. As far as it was concerned, based on the statements made by Mr. Melville, Algoma was experiencing short-term cash flow problems due to the ramping up.

II. Allocation of risk

56 A related submission by the appellant centred on what counsel referred to as an attempt by the respondent to reallocate the risk. Counsel argues that the respondent and Algoma had made their bargain and allocated the risks in accordance with the contract. In this case, the respondent did not take any security for the lending facility. It accepted the risk of dealing with a corporation enjoying limited liability and the courts should not allow the parties to circumvent their prior risk allocation by imposing personal liability on employees.

57 This submission is similar to the submission that the respondent was attempting to circumvent the effect of the *CCAA* process. It is largely based upon the dissenting reasons of La Forest J. in *London Drugs* and his concur-

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ring reasons in *Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd.*, [1993] 3 S.C.R. 206 (S.C.C.). In the former case, he held, in part, that where there is a contractual relationship between the employer and the plaintiff, the employee should remain liable to the plaintiff only for "independent torts" committed by the employee. However, to date that approach has not attracted a majority of the Supreme Court of Canada. The majority of the Court in London Drugs held that the individual employees were entitled to take advantage of the clause limiting liability in the contract between their employer and the plaintiff to $40.00. There was, however, no question that the employees were liable to the plaintiffs for their negligence in moving the plaintiff's machinery. Iacobucci J. speaking for the majority at pp. 407-8 rejected the independent tort exception:

> Having said this, I wish simply to add what has already become evident by my conclusion. There is no general rule in Canada to the effect that an employee acting in the course of his or her employment and performing the "very essence" of his or her employer's contractual obligations with a customer does not owe a duty of care, whether one labels it "independent" or otherwise, to the employer's customer. Our law of negligence has long since moved away from a category approach when dealing with duties of care. It is now well established that the question of whether a duty of care arises will depend on the circumstances of each particular case, not on pre-determined categories and blanket rules as to who is, and who is not, under a duty to exercise reasonable care. There may well be cases where, having regard to the particular circumstances involved, an employee will not owe a duty of care to his or her employer's customer. Indeed, the respondents have provided this Court with a series of decisions where this conclusion appears to have been reached: see *Sealand of the Pacific v. Robert C. McHaffie Ltd.* (1974), 51 D.L.R. (3d) 702 (B.C.C.A.); *Moss v. Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50 (Man. C.A.); *Summitville Consolidated Mining Co. v. Klohn Leonoff Ltd.*, B.C.S.C., Van. Reg. No. C880756, July 6, 1989; and *R.M. & R. Log Ltd. v. Texada Towing Co.* (1967), 62 D.L.R. (2d) 744 (Ex. Ct.).
>
> However, this does not mean that this is the necessary result in all factual situations. Abstaining from commenting on the conclusions reached in the cases cited, I find nothing in any of them, nor have I found anything else, which supports the type of blanket rule advocated by the respondents. **At best, these decisions simply confirm that the question of whether a duty of care arises between an employee and his or her employer's customer depends on the circumstances of each particular case. The mere fact that the employee is performing the "very essence" of a contract between the plaintiff and his or her employer does not, in itself, necessarily preclude a conclusion that a duty of care was present**. [Emphasis added.]

58 Thus, according to the majority, whether or not a duty of care arises depends on the facts of the particular case. Also see *Edgeworth Construction* per McLachlin J. at pp. 218 and 222. One of the most important policy considerations is the problem of imposition of indeterminate liability, which is discussed separately below. I have not been persuaded that there are any other policy considerations specific to the facts of this case that would justify a holding that Mr. Melville was not liable. While it is true that the respondent did not take any security, its arrangement with Algoma did include certain safeguards. For example, as the facility was amended, Algoma was required to inform the respondent if unused lines of credit available to Algoma fell below $20 million. As the Vice-president (Finance), Mr. Melville should have been aware of this requirement and that Algoma was in breach of this requirement. He was also aware of all of the circumstances that put the respondent at risk. He had attended the relevant board meetings of Algoma and Dofasco. He had promised to provide cash flow forecasts to Mr. Hynes, but had failed to do so because, as found by the trial judge, he knew that if they were disclosed the respondent would have cancelled the facility. By his own conduct he had put the respondent in a vulnerable position and undermined the effectiveness of the safeguards that did exist to protect the respondent. In those circumstances, I see no policy reason for immunizing Mr. Melville from the consequences of the negligent misrepresentations that the trial judge characterized as "egregious, serious mis-statements."

III. Indeterminate liability

59 In *Hercules Managements supra* at 192, La Forest J., speaking for the court, held that "the fundamental policy consideration that must be addressed in negligent misrepresentation actions centres around the possibility that

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the defendant might be exposed to 'liability in an indeterminate amount for an indeterminate time to an indeterminate class.'" However, in *Hercules Managements* at p. 198, La Forest J. held that "in cases where the defendant knows the identity of the plaintiff (or of a class of plaintiffs) and where the defendant's statements are used for the specific purpose or transaction for which they were made, policy considerations surrounding indeterminate liability will not be of any concern since the scope of liability can readily be circumscribed." In my view, this is a complete answer to the indeterminate liability policy concerns. Mr. Melville was aware of the identity of the plaintiff and his statements were used for the very purpose and transaction for which they were made. No question of indeterminate liability arises in this case. See *Haig v. Bamford*, [1977] 1 S.C.R. 466 (S.C.C.) at 478-79.

60 Accordingly, I agree with the trial judge that the appellant Melville was properly found to owe a duty of care to the respondent.

(b) As applied to Dofasco

61 Dofasco also argues that it did not owe a duty of care to the respondent in accordance with the *Anns* test. For many of the same reasons discussed in relation to Melville, this argument must fail. Dofasco had stepped into the shoes of Algoma for the purposes of daily cash management, the very matter for which the credit facility was available. There was a sufficiently close relationship between Dofasco and the respondent that, in the reasonable contemplation of Dofasco, carelessness on its part might cause damage to the respondent. This is particularly so given that the respondent was the only bank that did not have security.

62 Dofasco has also not advanced any policy grounds to negative or limit the scope of the duty owed to the respondent. The same considerations concerning the *CCAA* and indeterminate liability apply to Dofasco as they did to Melville.

63 Dofasco also argues that imposing liability is inconsistent with commercial reality. According to the contractual relationship between the respondent and Algoma, it was for the bank to assess its own risk. The respondent assessed the risk and increased the interest rate accordingly. Dofasco argues that therefore it was not just or reasonable to find a duty of care.

64 In *Hercules Managements*, La Forest J. used terms such as "reasonable," "simple justice" and "basic fairness" in discussing the application of the *Anns* test to cases of negligent misrepresentation. These expressions must be read in context. La Forest J. adopted a rigorous analysis of the *Anns* test as it applied to negligent misrepresentation. Thus, at p. 190, he wrote that, "determining whether 'proximity' exists on a given set of facts consists in an attempt to discern whether, as a matter of simple justice, the defendant may be said to have an obligation to be mindful of the plaintiff's interest in going about his or her business." However, this forms part of his reasons for defining the scope of the *prima facie* duty in terms only of foreseeability and reliance and pushing other factors into a consideration of whether there are policy reasons for limiting the duty of care in the particular case.

65 It is worth setting out some of the discussion about the two criteria relating to the *prima facie* duty as explained by La Forest J. at p. 187-89 of *Hercules Management*:

> In order to render "proximity" a useful tool in defining when a duty of care exists in negligent misrepresentation cases, therefore, it is necessary to infuse that term with some meaning. In other words, it is necessary to set out the basis upon which one may properly reach the conclusion that proximity inheres between a representor and a representee.
>
> .....
>
> In cases of negligent misrepresentation, the relationship between the plaintiff and the defendant arises through

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> reliance by the plaintiff on the defendant's words. Thus, if "proximity" is meant to distinguish the cases where the defendant has a responsibility to take reasonable care of the plaintiff from those where he or she has no such responsibility, then in negligent misrepresentation cases, it must pertain to some aspect of the relationship of reliance. **To my mind, proximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable**. To use the term employed by my colleague, Iacobucci J., in *Cognos, supra*, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere.
>
> .....
>
> The purpose behind the *Anns/Kamloops* test is simply to ensure that enquiries into the existence of a duty of care in negligence cases is conducted in two parts: The first involves discerning whether, in a given situation, a duty of care would be imposed by law; the second demands an investigation into whether the legal duty, if found, ought to be negatived or ousted by policy considerations. In the context of actions based on negligence causing physical damage, determining whether harm to the plaintiff was reasonably foreseeable to the defendant is alone a sufficient criterion for deciding proximity or neighbourhood under the first branch of the *Anns/Kamloops* test ...
>
> In negligent misrepresentation actions, however, the plaintiff's claim stems from his or her detrimental reliance on the defendant's (negligent) statement, and it is abundantly clear that reliance on the statement or representation of another will not, in all circumstances, be reasonable. The assumption that always inheres in physical damage cases concerning the reasonableness of the plaintiff's expectations cannot, therefore, be said to inhere in reliance cases. [Emphasis added.]

66 The trial judge based his findings on the earlier decision in *Queen v. Cognos Inc. supra* and did not address the application of the *Anns* test in these terms. Thus, he did not expressly find that Dofasco ought to reasonably have foreseen that the respondent would rely on Nicholas' representation; and that reliance by the respondent would, in the particular circumstances of the case, be reasonable. On the other hand, he did find that Nicholas "knew that the plaintiff would be relying on anything he said to Mr. Hynes in these telephone conversations and that the plaintiff bank was looking to him for information." There was evidence to support this finding, which in my view disposes of the first part of this element of the *Anns* test.

67 The trial judge's reasons also support a finding that Hynes' reliance would, in the particular circumstances, be reasonable. He found that the inquiries by Mr. Hynes on behalf of the respondent were pursuant to its contractual relationship to provide credit to Algoma on the terms and conditions agreed to in the letter that led to the granting of the Facility. The letter included a term that loans would be available "subject to our continued satisfaction with Algoma's financial conditions." Since Dofasco had taken over the daily cash management function it would be reasonable for Hynes to look to Dofasco for information notwithstanding the January 3, 1991 "disclaimer" that the bank should do whatever it had to do to get comfortable with Algoma as a stand-alone credit risk. As Nicholas was in charge of the day-to-day banking function, it was reasonable for Hynes to rely upon information provided by Nicholas. The facility was directly tied to the day-to-day banking function. The trial judge described the relationship between the facility and the day-to-day banking function in this way:

> The Plaintiff's facility brought Algoma a sophisticated Cash-Net lock box system, under which Algoma, in the course of the considerable business of itself and its subsidiaries in the United States, could make optimum use of available cash by netting out of receivables and payables each day. The arrangement was that the treasury officers at Algoma and subsequently by the summer of 1990, at Dofasco on behalf of Algoma, would each morning access by computer the information of the cash in and cash out for the day. If a deficiency, they would borrow against the debit balance to zero. On those days when the receipts exceeded the payables in the system, the

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excess would pay down the outstanding indebtedness of the plaintiff. All to the effect that there was an optimum use of cash and of credit. Both banker and customer were well satisfied with the system.

68 Given this relationship it was reasonable for the respondent to look to and rely upon representations by Mr. Nicholas. It was also reasonable given the particular circumstances in early January 1991. Prior to the crucial telephone conversation between Hynes and Nicholas, Nicholas had referred Hynes to Melville on two occasions and encouraged him to work something out with him. As the trial judge said, this would at the very least leave Mr. Hynes with the impression that there was a capacity to make an arrangement that would provide the necessary comfort to the respondent. It was reasonable then, as Hynes testified, for him to get back to Nicholas to verify the agreement he thought he had reached with Melville and more importantly his understanding of the facts upon which any deal would be based. This did not necessarily impose any duty on Nicholas to respond. He might have refused to make any comment, but then this would in all likelihood have caused Hynes to refuse to clear the cheques, given that three of the five pieces of information referred to in the January 10th letter relate directly to the day-to-day cash management and the use of the facility.

69 Accordingly, in my view, the trial judge properly found that the respondent had established the necessary special relationship to render Nicholas and hence Dofasco,[FN5] liable for misrepresentations to the respondent.

4. The standard of care imposed on Dofasco

70 Dofasco also argues that the trial judge erred in placing a duty on it to fully disclose Algoma's true financial position, as if it were in a fiduciary relationship with the respondent. This submission misconstrues the trial judge's reasons. The trial judge made it clear that there was no duty to make full disclosure of all affairs of Algoma and he rejected the respondent's submission that the appellants had breached a fiduciary duty. As he said, this was a typical commercial relationship between corporations of ample resources of experience or foresight. He did hold that there was a duty "in the circumstances" to disclose highly relevant information as to the risks of lending the $4 million.[FN6] Those circumstances included the following. Nicholas was aware that Mr. Hynes was attempting to assess the risk of lending to Algoma and was looking for a probable source of repayment. He had referred Hynes to Mr. Melville to attempt to reach some kind of accommodation, although he knew that Algoma had run out of credit from other sources. He also knew or ought to have known that Algoma was in breach of its contractual obligation to disclose this fact to the respondent.

71 The trial judge referred to the following excerpt from *Cognos* at p. 123:

> In reality, the trial judge did not impose a duty to make a full disclosure on the respondent and its representative. He simply imposed a duty of care, the respect of which required, among other things and in the circumstances of this case, that the appellant be given highly relevant information about the nature and existence of the employment for which he had applied.

72 When he came to apply the law to the facts, the trial judge held that Dofasco's liability did not depend on a failure to make full disclosure, or even on a duty to disclose. Admittedly, at first blush some of the trial judge's holdings might appear inconsistent. At one point, he said that when called by Hynes to discuss the letter Nicholas had only one option in the circumstances and that was not to discuss it. Later, the trial judge said that Nicholas was "caught" and "had to disclaim." However, when the reasons are read as a whole it is my view that there is no inconsistency, nor did the trial judge impose a duty of full disclosure. He held that if Nicholas had said nothing about the letter in the telephone call with Hynes on the morning of January 11th, there would not have been any liability. Having discussed the contents of the letter in detail with Mr. Hynes, Mr. Nicholas' only option at that point was to disclaim. There was liability because, in the words of the trial judge, "Mr. Nicholas crossed the line contrary to his original intentions and did provide information and assurances to Mr. Hynes which were misrepresentations on the facts and law of this case, constituting the tort of negligent misrepresentation." Having entered the arena and pro-

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vided some information or assurances to the respondent, Mr. Nicholas was required to exercise reasonable care in making those representations. This could, depending on the circumstances, require the disclosure of information to ensure that representations made are accurate and not misleading: *Cognos* at p. 121. In my view, the trial judge did not impose an inappropriate standard of care upon Dofasco. I would not give effect to this ground of appeal.

5. The *Statute of Frauds*

73 The appellants argue that the respondent's claim is barred by s. 8 of the *Statute of Frauds*, R.S.O. 1990, c. S.19, which provides as follows:

> 8. No action shall be brought to charge a person upon or by reason of a representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade or dealings **of any other person**, to the intent or purpose that such other person may obtain money, goods or credit thereupon, unless the representation or assurance is made by a writing signed by the party to be charged therewith. [Emphasis added.]

74 I have considerable doubt that either Mr. Melville or Dofasco could be considered "any other person" for the purposes of s. 8 given that Dofasco had taken over Algoma's cash management function and Melville was Algoma's Vice-President (Finance). In any event, this section has been held not to apply to negligent misrepresentation. See *W.B. Anderson & Sons Ltd. v. Rhodes (Liverpool) Ltd.*, [1967] 2 All E.R. 850 (Eng. P.D.A.) applying *Banbury v. Bank of Montreal*, [1918] A.C. 626 (U.K. H.L.) and J. G. Fleming, *The Law of Torts*, 8th ed. (Sydney, Australia: Law Book Co., 1992) at 639. I would apply that holding to this case. In my view, the *Statute of Frauds* was no defence to this action for either appellant.

6. Misrepresentation by Melville

75 The elements of negligent misrepresentation are summarized by Iacobucci J. in *Queen v. Cognos Inc.* at p. 110 as follows:

> (1) there must be a duty of care based on a "special relationship" between the representor and the representee;
>
> (2) the representation in question must be untrue, inaccurate, or misleading;
>
> (3) the representor must have acted negligently in making said misrepresentation;
>
> (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and
>
> (5) the reliance must have been detrimental to the representee in the sense that damages resulted.

76 In addition to the question of causation in relation to the trading room conversations dealt with above, counsel for Mr. Melville made two submissions with respect to these elements. He argued that the damages resulted from the assurances given by Nicholas to Mr. Hynes after Hynes discussed the letter with him on the morning of January 11th. He points out that the January 10th letter was conditional. Hynes would agree to advance the money only if he received certain assurances from Melville by noon. He actually never received those assurances from Melville before taking the decision to clear the cheques. Thus, it was not shown that the respondent relied upon any representations by Melville and there was no detrimental reliance.

77 I would not give effect to these submissions. The trial judge found that Mr. Melville's liability depended upon the statements that he made to Mr. Hynes on January 4th and 10th. On January 4th, Melville said that Algoma was merely having short-term cash problems due to the "ramping-up" after the strike and promised to provide cash

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flow statements. The trial judge found that the former was not true and that the latter implied that the cash flow statements would support this representation. On January 10th, Melville said that the Royal Bank had been secured for about ten years, that Algoma's U.S. accounts receivable were not pledged and were available as security to the respondent and that if a new credit facility could not be effected, the respondent's loan position would be paid out of the sale of the Cannelton Coal Company sale proceeds. The trial judge found that these were misrepresentations. It was open to him to do so on this record. He referred to *Cognos* and held that all of the elements as stated there were made out in relation to Mr. Melville. It is implicit in this holding that the requisite detrimental reliance was made out.

78 The appellant's argument is focused too narrowly. Melville's statements of January 4th and 10th must be put in context. As of January 3, 1991, Mr. Hynes was concerned about Algoma's ability to repay funds advanced under the facility. Thereafter, he was seeking information from Melville so that he could assess the credit risk. Melville's statements were designed to reassure Mr. Hynes and ensure that the cheques, especially the Cannelton payroll, cleared. Those statements were the foundation for the letter and set the stage for the final conversation with Nicholas. The trial judge could properly infer that the respondent relied upon those statements to its detriment and that they were one of the causes of the loss. The respondent's case against Melville does not fail simply because Nicholas' statements also contributed to the loss. It is not the law that a particular defendant's negligent misrepresentation must be the sole cause of the plaintiff's loss. It is sufficient that the plaintiff relied upon those statements to its detriment. The respondent clearly did.

79 Accordingly, I would dismiss Mr. Melville's appeal.

7. Negligent misrepresentation by Nicholas (Dofasco's liability)

80 Dofasco submits that Nicholas made no untrue statement and the trial judge erred in imposing a duty on Dofasco, through Nicholas, to disclose the true state of Algoma's affairs. Dofasco submits that Nicholas' comment that "it sounds reasonable" was not a misrepresentation of a fact, especially given Nicholas' earlier unequivocal statement to Hynes that the respondent should do whatever it had to do to get comfortable with Algoma as a stand-alone credit risk. Dofasco also submits that there was no evidence from Hynes as to what he thought the "sounds reasonable" comment meant and it was not open to the trial judge to infer that Hynes relied upon that statement to the respondent's detriment. In any event, the only deal that Nicholas was saying was reasonable was, as set out in the letter, a request for information. Finally, Dofasco takes issue with the trial judge's finding that Hynes and Nicholas discussed each of the five numbered points in Hynes' letter to Melville item by item. This last point can be disposed of quickly. While Hynes did not recall this part of the conversation, Nicholas did. It was open to the trial judge to accept this part of Mr. Nicholas' evidence.

81 Whether or not Mr. Nicholas' statements were misrepresentations and whether or not the respondent reasonably relied upon them are findings of fact. These findings turned upon the trial judge's assessment of the credibility of the many witnesses and the inferences to be drawn from the evidence. See *Kripps v. Touche Ross & Co.* (1997), 89 B.C.A.C. 288 (B.C. C.A.) at paragraphs 88 to 104. It was not necessary, for example, for Mr. Hynes to testify that he relied upon the statements by Nicholas on the morning of January 11th. That reliance could be inferred from all the circumstances. The fact that after the conversation, Mr. Hynes took no steps to stop the cheques from clearing, notwithstanding he did not have a reply from Mr. Melville, is compelling evidence that Mr. Hynes must have relied upon the assurances he received from Mr. Nicholas. As indicated above, it was not necessary for the respondent to prove that the statements by Mr. Nicholas were the only factors that induced the respondent to act to its detriment: *Kripps v. Touche Ross & Co. supra* at para. 103. With that in mind, I will turn to the findings of fact by the trial judge.

82 A critical finding of fact made by the trial judge and a finding that is supported by the evidence is that by December 1990, the appellants knew that standing alone, Algoma was no longer solvent. That fact alone called for prudence on the part of Nicholas in dealing with the respondent. Nicholas himself had written in a memo that a pro-

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posed sale of pellets by Algoma to Dofasco could be attacked by creditors as a preference. His statements to Mr. Hynes must be measured against this background. The trial judge found that the respondent did not have sufficient information independent of the statements by Nicholas and Melville to enable it to evaluate the risk. On the other hand, Nicholas knew that standing alone Algoma was insolvent. He knew that no decision had been made about whether Dofasco would commit further funds to Algoma. He knew, or should have known, that all of the receivables, including the U.S. accounts receivable, were encumbered. He knew, or ought to have known, that Mr. Melville could not commit to using the proceeds of the Cannelton sale to pay out the respondent's loan. The proceeds from that sale were seen as crucial to any Algoma reorganization. At the very least, Nicholson knew or ought to have known that only the Algoma board could make that commitment and it was very much an open question whether Algoma would still be a viable entity when a sale was completed.

83 The appellant submits that Dofasco's liability turned entirely upon the statement by Nicholas to Hynes to the effect that what was contained in the letter sounded reasonable. Based on this submission, the appellant argues that it was unreasonable for the trial judge to find liability solely on the basis of this comment when, it argues, Hynes was merely keeping Dofasco "in the loop" to appease the respondent's parent. In my view, this is not a fair reading of the trial judge's reasons. As I read those reasons, liability was based on the entire conversation, which included a point-by-point discussion of the five items. For example, the trial judge found as follows:

> I find that Mr. Nicholas understood that Mr. Hynes was attempting to assess a risk of whether to fund the 4 million dollars outstanding. I find Mr. Nicholas despite his original intentions was drawn into the determination of this matter. I find that Mr. Nicholas, although initially intending to remain neutral with regard to the Algoma credit, did cross the line and involved himself.

84 The trial judge then reviewed the five items in the letter and concluded that Mr. Nicholas knew or ought to have known that the letter contained misrepresentations, for example, the availability of the U.S. accounts receivable. In that context, the trial judge concluded that, "Dofasco could not purport to act on the agreement of 10 January without, by implication conveying acceptance of that agreement unless, there was a specific and expressed disclaimer to the contrary." Further, Mr. Hynes' evidence was that keeping Dofasco in the loop was only one of his reasons for speaking to Mr. Nicholas. He was also attempting to have Dofasco "verify" what Melville had told him.

85 These findings were reasonably open to the trial judge and established Dofasco's liability. This court is in no position to retry the case and draw our own different inferences, as was urged by the appellant, from the literal wording of the letter. The context was all important and the trial judge who heard five weeks of evidence was in the best position to interpret the letter and the conversations between Hynes and Nicholas, especially since liability can be founded on what was implicitly represented by Nicholas: *Cognos*, at pp. 129-31. I have not been convinced that the trial judge made an overriding and palpable error of fact in concluding that Nicholas made negligent misrepresentations upon which the respondent reasonably relied to its detriment.

86 I have considered whether the conversation between Hynes and Nicholas of January 3rd in which Nicholas told Hynes that he should get comfortable with Algoma as a stand-alone risk constituted some kind of disclaimer such that it was unreasonable for Hynes to then rely upon the statements made by Nicholas one week later in the conversation of January 11th. The trial judge implicitly found to the contrary when he held that only an express disclaimer at the very time of the January 11th conversation would suffice. Again, this was a conclusion that was reasonably open to the trial judge. He found that notwithstanding the earlier disclaimer and Nicholas' own professed intention not to be drawn into making any representations about the continued viability of Algoma, he crossed the line and did make representations that he knew the respondent would rely upon. It was reasonable for Hynes to rely upon the representations in the January 11th conversation in the circumstances, some of which I have reviewed above. In addition to those circumstances, there was also the fact that Mr. Nicholas was the first person to inform Hynes that Algoma did not have credit available from other lenders. It was during this conversation, on January 10th, that Nicholas expressed great concern about the cheques not clearing, stating according to Hynes that "you can't bounce cheques." The entire context would reasonably leave Hynes with the impression that Nicholas and Dofasco

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were acutely aware of the Algoma situation and were taking a keen interest in its financial affairs, notwithstanding the earlier "disclaimer." There was nothing in the conversations of January 10 and 11 to suggest that Mr. Nicholas was not at the time assuming responsibility for what he was representing to the respondent: *Cognos supra* at 116.

87 As to the standard of care, I have already dealt with this question above. More generally, it is not a fair characterization that the trial judge imposed a duty upon Nicholas to disclose the true state of Algoma's financial affairs. The duty of care imposed by the trial judge was the duty to "exercise such reasonable care as the circumstances require to ensure that representations made are accurate and not misleading" as referred to in *Cognos* at p. 121. In *Cognos* at p. 123, the court recognized that in some circumstances a "failure to divulge highly relevant information is a pertinent consideration in determining whether a misrepresentation was negligently made." In any event, the trial judge found that Nicholas "affirmed in the circumstances of this case." This can only mean that the trial judge found that Nicholas affirmed the truth of the misrepresentations in the January 10th letter. I can see no basis for interfering with this finding of fact.

88 Accordingly, I would dismiss Dofasco's appeal.

The Cross-Appeal

89 The respondent raised two issues in its cross-appeal. Both were contingent on the appellants' success in their appeals. In light of my conclusions, it is unnecessary to deal with the cross-appeal.

Disposition

90 Accordingly, I would dismiss the appeals with costs. I would dismiss the cross-appeal without costs.

Appeals dismissed.

FN* Leave to appeal refused (April 6, 2000), Doc. 27754 (S.C.C.).

FN1 The claim against Nicholas, who was also named as a defendant, was therefore dismissed.

FN2 *Said v. Butt*, [1920] 3 K.B. 497 (Eng. K.B.) holds that where the corporate officer acting *bona fide* within the scope of his authority procures or causes the breach of a contract between the employer and a third person, he does not thereby become liable to an action of tort at the suit of the person whose contract has been broken. It has no application to the facts of this case.

FN3 Similarly, see *Meditrust Healthcare Inc. v. Shoppers Drug Mart*, a judgment of the Ontario Court of Appeal, delivered September 9, 1999, [reported(1999), 124 O.A.C. 137 (Ont. C.A.)]

FN4 Section 5.1(2) of the *CCAA* and s. 50(14) of the *Bankruptcy and Insolvency Act*.

FN5 As indicated, Dofasco accepted that it was vicariously liable if Nicholas were found to be negligent.

FN6 When the trial judge's reasons are read as a whole, I have considerable doubt that the trial judge imposed any liability on the basis of non-disclosure. It seems to me that a fair reading of his reasons shows that the trial judge imposed liability on the appellants for their positive misrepresentations.

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TAB 2

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2000 CarswellOnt 4837, [2001] G.S.T.C. 2, 10 B.L.R. (3d) 221, 25 C.B.R. (4th) 216

BlueStar Battery Systems International Corp., Re

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

In the Matter of a Plan of Compromise or Arrangement of BlueStar Battery Systems International Corp. and BlueStar Systems Canada Corp.

Ontario Superior Court of Justice [Commercial List]

Farley J.

Heard: October 31, 2000
Judgment: November 6, 2000
Docket: 00-CL-3860

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Counsel: *Kevin Dias*, for Her Majesty the Queen in Right of Canada (Canada Customs and Revenue Agency).

Derrick Tay and *Orestes Pasparakis*, for BlueStar Applicants.

Brent MacPherson, for PricewaterhouseCoopers Inc. (Monitor of Applicants).

Daniel R. Dowdall and *Alex A. Ilchenko*, for Finova Capital (Canada) Corp.

Steven Golick, for Enertek Mexico S. de R.L. de C.V.

Robert A. Klotz, for Bradley, Curtis Streelman and MDM Marketing Inc.

Subject: Corporate and Commercial; Goods and Services Tax (GST); Insolvency

Taxation --- Goods and services tax — Administration and enforcement — Directors' liability — General

Corporation owed in excess of $42,000,000 to unsecured creditors, including $1,096,684 in outstanding GST liability — Corporation filed plan of arrangement under Companies' Creditors Arrangement Act (CCAA) on September 5, 2000, with sanction hearing scheduled for October 31, 2000 — On October 26, creditors, including Minister, approved plan — On October 30, Minister brought motion for order declaring that claims against directors for outstanding GST liability were not compromised by plan, or for declaration that plan was not fair and reasonable, and for order granting leave to register certificate for amount of GST liability in Federal Court — Motion dismissed — Minister could not claim benefit of s. 5.1(3) of CCAA in circumstances — Plan of arrangement provided that all

unsecured creditors accepted plan "in full and final satisfaction of their proven claims", including claims against directors — Minister was unsecured creditor by virtue of s. 18.4 of CCAA — Section 323(2) of Excise Tax Act provides that director is not liable unless certificate for amount of corporation's GST liability has been registered in Federal Court and execution returned unsatisfied — Approval of plan meant that Minister's claim for GST was fully satisfied, so that no directors' liability could arise — Time for crystallizing directors' liability had passed and order granting leave to register certificate at this point would have no effect — If Minister had perfected claim against directors in timely manner, directors might still have included compromise of claims against them in plan of arrangement under s. 5.1(1) of CCAA — Section 5.1(3) of CCAA vests court with discretion to declare that claim against directors not be compromised where compromise would not be fair and reasonable — Fact that Minister was only creditor with potential claim against corporation's directors would not alone be sufficient grounds for exercise of discretion in Minister's favour — Exercise of discretion might have been appropriate had Minister served motion on more timely basis, to allow each director opportunity to refute allegation that he had knowledge of corporation's broken promises and late filing of GST returns — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 5.1, 5.1(1), 5.1(3), 18(4), 18.3(1), 18.3(2) — Excise Tax Act, R.S.C. 1985, c. E-15, ss. 222, 323(1), 323(2).

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

Corporation owed in excess of $42,000,000 to unsecured creditors, including $1,096,684 in outstanding GST liability — Corporation filed plan of arrangement under Companies' Creditors Arrangement Act (CCAA) on September 5, 2000, with sanction hearing scheduled for October 31, 2000 — On October 26, creditors, including Minister, approved plan — On October 30, Minister brought motion for order declaring that claims against directors for outstanding GST liability were not compromised by plan, or for declaration that plan was not fair and reasonable, and for order granting leave to register certification for amount of GST liability in Federal Court — Motion dismissed — Minister could not claim benefit of s. 5.1(3) of CCAA in circumstances — Plan of arrangement provided that all unsecured creditors accepted plan "in full and final satisfaction of their proven claims", including claims against directors — Minister was unsecured creditor by virtue of s. 18.4 of CCAA — Section 323(2) of Excise Tax Act provides that director is not liable unless certificate for amount of corporation's GST liability has been registered in Federal Court and execution returned unsatisfied — Approval of plan meant that Minister's claim for GST was fully satisfied, so that no directors' liability could arise — Time for crystallizing directors' liability had passed and order granting leave to register certification at this point would have no effect — If Minister had perfected claim against directors in timely manner, directors might still have included compromise of claims against them in plan of arrangement pursuant to s. 5.1(1) of CCAA — Section 5.1(3) of CCAA vests court with discretion to declare that claim against directors not be compromised where compromise would not be fair and reasonable — Fact that Minister was only creditor with potential claim against corporation's directors would not alone be sufficient grounds to invoke exercise of discretion in Minister's favour — Exercise of discretion might have been appropriate had Minister served motion on more timely basis, to allow each director opportunity to refute allegation that he had knowledge of corporation's broken promises and late filing of GST returns — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 5.1, 5.1(1), 5.1(3), 18(4) — Excise Tax Act, R.S.C. 1985, c. E-15 [am. 1990, c. 45, s. 12], s. 323(2).

Cases considered by *Farley J.*:

Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303 (Ont. C.A.) — considered

Browne v. Southern Canada Power Co. (1941), 23 C.B.R. 131, 71 Que. K.B. 136 (Que. C.A.) — considered

Central Guaranty Trustco Ltd., Re (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) — considered

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Keddy Motor Inns Ltd., Re (1992), 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 110 N.S.R. (2d) 246, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 299 A.P.R. 246 (N.S. C.A.) — considered

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

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16

Generally — considered

Canada Business Corporations Act, R.S.C. 1985, c. C-44

Generally — considered

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

Generally — considered

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

s. 5.1(1) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2)(a) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2)(b) [en. 1997, c. 12, s. 122] — considered

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

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 18.3(2) [en. 1997, c. 12, s. 125] — considered

s. 18.4 [en. 1997, c. 12, s. 125] — considered

Excise Tax Act, R.S.C. 1985, c. E-15 [am. 1990, c. 45, s. 12]

Pt. IX — considered

s. 222 — considered

s. 227(4) [rep. & sub. 1994, c. 9, s. 13(2)] — considered

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s. 227(4.1) [en. 1994, c. 9, s. 13(2)] — considered

s. 323(1) [rep. & sub. 1997, c. 10, s. 239(1)] — considered

s. 323(2) [am. 1992, c. 27, s. 90(1)(p)] — considered

s. 323(2)(a) — considered

MOTION by Minister for order declaring that claims against directors were not compromised by corporation's plan of arrangement, or for declaration that plan was not fair and reasonable, and for order granting leave to register certification for amount of corporation's GST liability.

***Farley J.*:**

1 Canada Customs and Revenue Agency ("RevCan") by material dated October 30, 2000 moved for an order declaring that the claims against the directors of the Applicants not be compromised by this Court's sanction of the Plan of Arrangement made pursuant to the *Companies' Creditors Arrangement Act* ("CCAA"). This Plan was filed on September 5, 2000, the same day that the Applicants sought protection under the CCAA. The sanction hearing had been long scheduled for October 31, 2000. On that date I approved the Plan vis-à-vis the Applicants; however I reserved judgement on RevCan's late blooming motion. I now deal with it as if it were being dealt with coincident with the sanction hearing (that is the fact that I approved the Plan vis-à-vis the Applicants a few days ago is to be ignored). I was advised that it does not appear that s. 5.1 of the CCAA has been judicially commented on before. It may be that my analysis herein will be of some assistance — or at least a starting point for discussion — in understanding this section of the CCAA.

2 For the sake of easy reference I have reproduced s. 5.1 in its entirety below:

> 5.1(1) Claims against directors — compromise — A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> (2) Exception — A provision for the compromise of claims against directors may not include claims that
>
> (a) relate to contractual rights of one or more creditors; or
>
> (b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> (3) Powers of court — The court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.
>
> (4) Resignation or removal of directors — Where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the debtor company shall be deemed to be a director for the purposes of this section.

3 RevCan asked for the alternative relief of a declaration that the Plan was not fair and reasonable in the circumstances in that it precluded unsecured creditors of the Applicants from pursuing claims against the directors. RevCan sought the additional relief of an order granting it leave to register in the Federal Court a certification for the amount

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of the Goods and Services Tax ("GST") liability of BlueStar Systems Canada Corp. ("BSCC") and to obtain an execution for that amount from the Federal Court pursuant to s. 323 (2)(a) of the *Excise Tax Act* and leave to direct the Sheriff to attempt to satisfy that execution against assets of BSCC that were not protected by my CCAA stay order of September 5, 2000.

4 RevCan submitted that it was entitled to such relief for the following grounds. BSCC is indebted for GST liability for the period September 1999 to September 2000 in the amount of $1,096,684. While new management took control of the operations of BSCC beginning in February 2000, BSCC continued to fail to remit the GST it was required to remit pursuant to the *Excise Tax Act*. From March 2000 through the end of August 2000, BSCC representatives made numerous promises to RevCan representatives in respect of paying the outstanding GST liability but did not do so. GST returns for January — May 2000 were only filed at the end of August 2000. While not sworn to, RevCan asserts that the Applicants, their counsel and the Monitor were put on notice of RevCan's position several weeks before the hearing.

5 Sections 5.4 and 5.9 of the Plan that was approved by the unsecured creditors of the Applicants would compromise RevCan's claims against the directors of the Applicants. At the meeting of the unsecured creditors on October 26, 2000, the RevCan representative raised the concerns of RevCan and asked that the meeting consider amendments to the Plan. After consulting with representatives from BSCC, the chairman of the meeting, an officer of the Monitor, ruled that as BSCC did not wish to make any amendments to the Plan, the meeting would not consider such amendments. RevCan indicates that the Applicants never provided it with any explanation as to why the restructuring of both corporations could not proceed under the Plan without having the claims against the directors compromised by the Plan.

6 The meeting was attended by 222 unsecured creditors, either in person or by proxy. Three unsecured creditors abstained from voting. The 219 who voted represented claims totalling $42,286,376.82. A total of 211 unsecured creditors with claims totalling $41,877,271.70 voted to approve the Plan, representing 96.3% in number and 99.0% in value of those voting. RevCan did not vote against the Plan or abstain from voting; rather RevCan voted in favour of the unamended Plan. I would also point out that RevCan did not advance a competing CCAA Plan including one which would not wipe out the liability of the directors.

7 The Initial Order of September 5, 2000 contained a "come back" clause. Any creditor, including RevCan, would have been at liberty to move in court before the Plan was voted upon to attempt to amend the Plan. However once a vote has been taken, there are fairly definite restrictions upon amending a CCAA plan. See *Re Central Guaranty Trustco Ltd.* (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) at p. 143; *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]), at pp. 174-5; *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.) at p. 15. I shall deal later with the question of whether the present case falls within the "exceptional circumstances only" condition of the Court of Appeal in Algoma as to an amendment.

8 One might view RevCan's motion as one challenging the classification of creditors; in other words RevCan appears in essence to wish to be put into a separate class from the rest of the unsecured creditors. I think it fair to observe that it appears that RevCan is the only unsecured creditor to be affected by the inclusion of the compromise of directors liability in the Plan. However, where an initial order of the Court places creditors into certain classes (or in the present case puts them all into a single class), the proper procedure for attacking the classification is by way of appeal of the classification order, and "not the sanctioning order": see *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.) at pp. 251-2. In the present case, since the classification order was contained in the Initial Order effectively obtained on an *ex parte* basis since RevCan was not then present, RevCan could have utilized the "come back" clause on a timely basis instead of going to appeal. It is unfortunate for RevCan that it did not do so.

9 Under the CCAA, all Crown claims, including secured claims, rank as unsecured claims: see s. 18.4. Therefore RevCan's claim for unpaid GST is unsecured. In addition, the CCAA specifically eliminates the "deemed trust" in favour of GST found in s. 222 of the *Excise Tax Act*; but in contrast it does not interfere with the deemed trust

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provisions found in s. 227(4) and (4.1) of the *Excise Tax Act*[FN*]: see s. 18.3(1)(2)[FN**].

10 Director liability for GST arises pursuant to s. 323(1) of the *Excise Tax Act* which provides:

> s. 323 (1) Where a corporation fails to remit an amount of net tax as required under subsection 228 (2) or (2.3), the directors of the corporation at the time the corporation was required to remit the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest thereon or penalties relating thereto.

However that legislation goes on to provide that:

> s. 323(2) A director of a corporation is not liable under subsection (1) unless
>
> (a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 316 and execution for that amount has been returned unsatisfied in whole or in part;
>
> (b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
>
> (c) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the date of the assignment or receiving order.

Only s. 323 (2)(a) would be of any relevance in the present analysis.

11 The Applicants point out that pursuant to the Plan, in respect of which RevCan voted in favour, unsecured creditors, including RevCan, accepted "in full and final satisfaction of their Proven Claims" the consideration provided for under the Plan. The Applicants further reason that since RevCan's claim for GST has been fully satisfied, then pursuant to s. 323 (2)(a) of the *Excise Tax Act*, no director liability could arise in respect of same. On that basis, in respect of GST, RevCan's claim is satisfied by operation of law, and in particular the terms of the *Excise Tax Act*, upon confirmation of the Plan. On that basis, the directors of the applicants do not need to rely on s. 5.1 (1) of the CCAA to include "provision for the compromise of claims against directors of the company". Given that one may puzzle over why the directors in the present case included an excusatory provision in the Plan vis-à-vis themselves when such a claim for GST is a derivative claim relating to the original or foundation liability of BSCC. Perhaps their concern was that RevCan in the seven weeks between the Initial Order of September 5, 2000 and the vote on October 26, 2000 might have obtained leave to register the certificate for BSCC's GST liability in the Federal Court and obtained an execution for that amount pursuant to s. 323 (2)(a) of the *Excise Tax Act* and leave to direct the Sheriff to attempt to satisfy the execution against assets of BSCC unprotected from the stay. If that had taken place, then it seems to me that the Court would have to take a look at the Plan as a whole and on a single point of time basis. In other words, one would not necessarily conclude that the Plan *first* compromised the claims against BSCC in full satisfaction of the proven claims, including the proven claim of RevCan, *before* moving on to consider RevCan's then perfected claim (as opposed to the inchoate one we actually have in this case) against the directors.

12 Thus it appears to me that RevCan, not having put itself into position where it could (and did) perfect its derivative claims against the directors as set out in s. 323 (2)(a) of the *Excise Tax Act* never had a claim against the directors which could survive the sanction of the Plan vis-à-vis the Applicants. Nothing that this Court could do at the present time (that is, at time when considering the CCAA sanction motion) could crystalize a RevCan claim against the directors. RevCan would have to take additional multiple steps over some period of time to establish a

claim against the directors. RevCan was alert to this concern, yet it did nothing to initiate even the first step in the procedure. In these circumstances, even if this Court's leave were effective in any way to protect RevCan's claim, it would not seem to me that RevCan has established any basis for the exercise of this Court's discretion in that regard. It would also be remiss of me not to observe here that this would prevail even if RevCan had not for whatever unexplained reason voted in favour of the (complete) Plan (complete in the sense of compromising claims against the Applicants *and the directors*).

13 I would note that RevCan raised certain passages of K.D. McGuiness, *The Law of Guarantee* (2nd ed., 1996; Toronto, Carswell) in support of its position: specifically s. 10.114 at pp. 601-2 (including the somewhat dated and inaccurate view of the CCAA as set forth in *Browne v. Southern Canada Power Co.* (1941), 23 C.B.R. 131 (Que. C.A.)). Suffice it to say that the present case is not a surety claim release one.

14 What then *if* RevCan here had in fact perfected its claim against the directors? Would the directors have been able to utilize s. 5.1 of the CCAA as a safe haven? It would appear to me that the directors would have been entitled (s. 5.1 (1)) to have included in the Plan a compromise of their liability included in the Plan and would not be disqualified (s. 5.1 (2)) from doing so. This disqualification from utilizing s. 5.1 (1) as is found in s. 5.1 (2) relates to (a) contractual rights of a creditor, such as a guarantee by a director for example, or (b) claims based on allegations of misrepresentations made by directors to creditors or of wrongful' or oppressive conduct by directors. Firstly there was nothing in this case to suggest that there was any sort of a contract (including a guarantee) from any of the directors. Secondly there was no allegation of any misrepresentation by any director nor was there any allegation of wrongful or oppressive conduct by any director. It would seem to me that while the reference in s. 5.1 (2) is to "directors", it would seem that the disqualification should relate to those of the directors who may fall within (a) or (b) thereof. As to the (b) category, there was no allegation against any director in the RevCan material; it appears that all of the RevCan dealing and difficulties with respect to either promises or getting information were restricted to non-directors at BSCC. However it seems to me that the directors of any corporation in difficulty and contemplating a CCAA plan would be unwise to engage in a game of hide and go seek since the language of s. 5.1 (2)(b) appears wide enough to encompass those situations where the directors stand idly by and do nothing to correct any misstatements or other wrongful or oppressive conduct of others in the corporation (either other directors acting qua directors, or officers or underlings). There was no evidence presented that the directors here had knowledge or ought to have had knowledge of such here. One may have the greatest of suspicion that they did or ought to have had such knowledge. This could have been crystallized if RevCan had put the directors on notice of the promises to pay GST. It would seem to me at first glance that the oppression claims cases which arise pursuant to corporate legislation such as the *Canada Business Corporations Act* and the *Business Corporations Act* (Ontario) would be of assistance in defining "oppressive conduct". Similarly it would appear that "wrongful conduct" would be conduct which would be tortious (or akin thereto) as well as any conduct which was illegal.

15 What then of s. 5.1 (3)? This is not a disqualification provision which automatically applies. Rather this provision establishes that the Court may use its discretion to "declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances". It is key to note that this declaration does not affect the Plan then in question vis-à-vis the applicant corporation. In Sammi Atlas Inc., *supra*, I noted at p. 174:

> ... In *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.) the Court of Appeal observed at p. 15 that the court's jurisdiction to amend a plan should "be exercised sparingly and in exceptional circumstances only" even if the amendment were merely technical and did not prejudice the interests of the corporation or its creditors and then only where there is jurisdiction under the CCAA to make the amendment requested, ...

However this s. 5.1 (3) declaration when viewed as an amendment (or equivalent to an amendment) of a plan is something which this amendment to the CCAA (enacted subsequent to the Algoma case) specifically authorizes, but in any even since the declaration only applies to the compromise as it relates to the directors, it does "not prejudice the interests of the corporation or its creditors".

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16 Given that s. 5.1 (1) provides that the compromise of claims against directors be as to those claims "that relate to the obligations of the company unless the directors are by law liable in their capacity as directors for the payment of such other factors" and given the exception disqualifications of s. 5.1 (2), one would reasonably conclude that the most usual type of claim would be that imposed by statute whereby the director qua director is obliged as well as the corporation to pay a government. Then the fact that RevCan is "singled" out in this Plan in question with respect to its GST claim, would not appear on this ground alone to be sufficient to invoke the Court's discretion in RevCan's favour. However if RevCan had served its motion on a more timely basis so as to allow the directors sufficient opportunity to dispute RevCan's allegations concerning broken promises, then if RevCan's allegations were unrefuted or unchallenged, given the magnitude of the GST claim over an extended period of a year which unlikely would have escaped the notice of a reasonable director, and given the repeated and broken promises to pay the GST and the lack of advance notice to RevCan before obtaining the Initial Order which precluded RevCan from taking any preliminary enforcement proceedings (it being recognized that RevCan has to walk the tightrope between collecting taxes when due and allowing delinquent companies some leeway so that they might attempt to get over temporary difficulties without that opportunity being precluded by draconian collection techniques otherwise available to RevCan), I might well have been inclined to give such a declaration that the GST claim against the directors not be compromised on the basis that such a compromise would not have been full and reasonable in the circumstances. I think it also worth noting that s. 5.1 (3) provides that "a claim" not be compromised, as opposed to all claims as may otherwise have been included pursuant to s. 5.1 (1). It would also seem to me that the language of this provision is sufficiently wide enough to be able to pick and choose amongst the directors and further that any individual claim may be segmented so that it may be partially excepted.

17 In the end result however RevCan's motion is dismissed. Even if this were not a matter of first instance I would not award any costs against RevCan in these circumstances.

Motion dismissed.

FN* *Sic.* Should be *Income Tax Act* — ed.

FN** *Sic.* Should be s. 18.3(1), (2) — ed.

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TAB 3

2010 CarswellOnt 1754, 2010 ONSC 1708, 81 C.C.P.B. 56, 63 C.B.R. (5th) 44

Nortel Networks Corp., Re

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

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

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: March 3-5, 2010
Judgment: March 26, 2010
Docket: 09-CL-7950

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Counsel: Derrick Tay, Jennifer Stam, Suzanne Wood for Applicants

Lyndon Barnes, Adam Hirsh for Nortel Directors

Benjamin Zarnett, Gale Rubenstein, C. Armstrong, Melaney Wagner for Monitor, Ernst & Young Inc.

Arthur O. Jacques for Nortel Canada Current Employees

Deborah McPhail for Superintendent of Financial Services (non-PBGF)

Mark Zigler, Susan Philpott for Former and Long-Term Disability Employees

Ken Rosenberg, M. Starnino for Superintendent of Financial Services in its capacity as Administrator of the Pension Benefit Guarantee Fund

S. Richard Orzy, Richard B. Swan for Informal Nortel Noteholder Group

Alex MacFarlane, Mark Dunsmuir for Unsecured Creditors' Committee of Nortel Networks Inc.

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Leanne Williams for Flextronics Inc.

Barry Wadsworth for CAW-Canada

Pamela Huff for Northern Trust Company, Canada

Joel P. Rochon, Sakie Tambakos for Opposing Former and Long-Term Disability Employees

Robin B. Schwill for Nortel Networks UK Limited (In Administration)

Sorin Gabriel Radulescu for himself

Guy Martin for himself, Marie Josee Perrault

Peter Burns for himself

Stan and Barbara Arnelien for themselves

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

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

N Corp. was insolvent major telecommunications company which continued to provide pension and other benefits to former employees, retired employees (retirees) and employees on long-term disability (LTD employees) on discretionary basis — N Corp. was granted stay of proceedings under Companies' Creditors Arrangement Act (CCCA), but cessation of payments was inevitable — To reduce or eliminate uncertainty, risk of litigation and disruption in transition of benefits and to provide for early payments to terminated employees and maintain quantum and validity of pension and health and welfare trust (HWT) claims as ordinary, unsecured claims, N Corp. negotiated settlement agreement (SA) with Monitor appointed under CCAA, representatives of former employees, LTD employees and settlement counsel, and union — SA provided, among other things, for funding and payment of pensions and benefits under HWT until specified dates, for ranking of allowable pension claims pari passu with claims of unsecured creditors, and for express exclusion of HWT benefits from preferential or priority claim or trust — SA contained Bankruptcy and Insolvency Act (BIA) clause providing that subsequent amendments to BIA changing current, relative priorities of claims against N Corp. did not preclude party to SA from arguing applicability of amendment to claims ceded in SA — While most parties supported SA, committee of N Corp.'s unsecured creditors (Committee) and informal N Corp. noteholder group (Noteholders) opposed SA on basis of BIA clause — Applicants brought motion for court approval of SA — Motion dismissed — SA was consistent with spirit and purpose of CCAA but could not be approved in current form as BIA clause in SA was not fair and reasonable in circumstances and resulted in agreement that provided neither certainty nor finality of fundamental priority issue — BIA clause created uncertainty and potential for fundamental alteration of SA — Practical effect of BIA clause was that issue was not fully resolved and clause was somewhat inequitable to other unsecured creditors who were entitled to know, with certainty and finality, effect of SA — Comprehensive settlement of claims in magnitude and complexity contemplated by SA should not provide opportunity to re-trade deal after fact — BIA clause failed to recognize interests of other creditors whose claims ranked equally with claims of former employees and LTD employees — Effect of SA was to give former and LTD employees preferred treatment for certain claims, notwithstanding that priority was not provided for in statute and was not recognized in case law.

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

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Creditor approval

N Corp. was insolvent major telecommunications company which continued to provide pension and other benefits to former employees, retired employees (retirees) and employees on long-term disability (LTD employees) on discretionary basis — N Corp. was granted stay of proceedings under Companies' Creditors Arrangement Act (CCCA), but cessation of payments was inevitable — To reduce or eliminate uncertainty, risk of litigation and disruption in transition of benefits and to provide for early payments to terminated employees and maintain quantum and validity of pension and health and welfare trust (HWT) claims as ordinary, unsecured claims, N Corp. negotiated settlement agreement (SA) with Monitor appointed under CCAA, representatives of former employees, LTD employees and settlement counsel, and union — SA provided, among other things, for funding and payment of pensions and benefits under HWT until specified dates, for ranking of allowable pension claims pari passu with claims of unsecured creditors, and for express exclusion of HWT benefits from preferential or priority claim or trust — SA contained Bankruptcy and Insolvency Act (BIA) clause providing that subsequent amendments to BIA changing current, relative priorities of claims against N Corp. did not preclude party to SA from arguing applicability of amendment to claims ceded in SA — While most parties supported SA, committee of N Corp.'s unsecured creditors (Committee) and informal N Corp. noteholder group (Noteholders) opposed SA on basis of BIA clause — Applicants brought motion for court approval of SA — Motion dismissed — SA was consistent with spirit and purpose of CCAA but could not be approved in current form as BIA clause in SA was not fair and reasonable in circumstances and resulted in agreement that provided neither certainty nor finality of fundamental priority issue — BIA clause created uncertainty and potential for fundamental alteration of SA — Practical effect of BIA clause was that issue was not fully resolved and clause was somewhat inequitable to other unsecured creditors who were entitled to know, with certainty and finality, effect of SA — Comprehensive settlement of claims in magnitude and complexity contemplated by SA should not provide opportunity to re-trade deal after fact — BIA clause failed to recognize interests of other creditors whose claims ranked equally with claims of former employees and LTD employees — Effect of SA was to give former and LTD employees preferred treatment for certain claims, notwithstanding that priority was not provided for in statute and was not recognized in case law.

Pensions --- Payment of pension — Bankruptcy or insolvency of employer — Miscellaneous

N Corp. was insolvent major telecommunications company which continued to provide pension and other benefits to former employees, retired employees (retirees) and employees on long-term disability (LTD employees) on discretionary basis — N Corp. was granted stay of proceedings under Companies' Creditors Arrangement Act (CCCA), but cessation of payments was inevitable — To reduce or eliminate uncertainty, risk of litigation and disruption in transition of benefits and to provide for early payments to terminated employees and maintain quantum and validity of pension and health and welfare trust (HWT) claims as ordinary, unsecured claims, N Corp. negotiated settlement agreement (SA) with Monitor appointed under CCAA, representatives of former employees, LTD employees and settlement counsel, and union — SA provided, among other things, for funding and payment of pensions and benefits under HWT until specified dates, for ranking of allowable pension claims pari passu with claims of unsecured creditors, and for express exclusion of HWT benefits from preferential or priority claim or trust — SA contained Bankruptcy and Insolvency Act (BIA) clause providing that subsequent amendments to BIA changing current, relative priorities of claims against N Corp. did not preclude party to SA from arguing applicability of amendment to claims ceded in SA — While most parties supported SA, committee of N Corp.'s unsecured creditors (Committee) and informal N Corp. noteholder group (Noteholders) opposed SA on basis of BIA clause — Applicants brought motion for court approval of SA — Motion dismissed — SA was consistent with spirit and purpose of CCAA but could not be approved in current form as BIA clause in SA was not fair and reasonable in circumstances and resulted in agreement that provided neither certainty nor finality of fundamental priority issue — BIA clause created uncertainty and potential for fundamental alteration of SA — Practical effect of BIA clause was that issue was not fully resolved and clause was somewhat inequitable to other unsecured creditors who were entitled to know, with certainty and finality, effect of SA — Comprehensive settlement of claims in magnitude and complexity contemplated by SA should not provide opportunity to re-trade deal after fact — BIA clause failed to recognize interests of other creditors whose claims ranked equally with claims of former employees and LTD employees — Effect of SA

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was to give former and LTD employees preferred treatment for certain claims, notwithstanding that priority was not provided for in statute and was not recognized in case law.

Pensions --- Payment of pension — Disability benefits

N Corp. was insolvent major telecommunications company which continued to provide pension and other benefits to former employees, retired employees (retirees) and employees on long-term disability (LTD employees) on discretionary basis — N Corp. was granted stay of proceedings under Companies' Creditors Arrangement Act (CCCA), but cessation of payments was inevitable — To reduce or eliminate uncertainty, risk of litigation and disruption in transition of benefits and to provide for early payments to terminated employees and maintain quantum and validity of pension and health and welfare trust (HWT) claims as ordinary, unsecured claims, N Corp. negotiated settlement agreement (SA) with Monitor appointed under CCAA, representatives of former employees, LTD employees and settlement counsel, and union — SA provided, among other things, for funding and payment of pensions and benefits under HWT until specified dates, for ranking of allowable pension claims pari passu with claims of unsecured creditors, and for express exclusion of HWT benefits from preferential or priority claim or trust — SA contained Bankruptcy and Insolvency Act (BIA) clause providing that subsequent amendments to BIA changing current, relative priorities of claims against N Corp. did not preclude party to SA from arguing applicability of amendment to claims ceded in SA — While most parties supported SA, committee of N Corp.'s unsecured creditors (Committee) and informal N Corp. noteholder group (Noteholders) opposed SA on basis of BIA clause — Applicants brought motion for court approval of SA — Motion dismissed — SA was consistent with spirit and purpose of CCAA but could not be approved in current form as BIA clause in SA was not fair and reasonable in circumstances and resulted in agreement that provided neither certainty nor finality of fundamental priority issue — BIA clause created uncertainty and potential for fundamental alteration of SA — Practical effect of BIA clause was that issue was not fully resolved and clause was somewhat inequitable to other unsecured creditors who were entitled to know, with certainty and finality, effect of SA — Comprehensive settlement of claims in magnitude and complexity contemplated by SA should not provide opportunity to re-trade deal after fact — BIA clause failed to recognize interests of other creditors whose claims ranked equally with claims of former employees and LTD employees — Effect of SA was to give former and LTD employees preferred treatment for certain claims, notwithstanding that priority was not provided for in statute and was not recognized in case law.

Cases considered by *Morawetz J.*:

Air Canada, Re (2003), 2003 CarswellOnt 5296, 47 C.B.R. (4th) 163 (Ont. S.C.J. [Commercial List]) — referred to

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

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 CarswellOnt 5432, 2008 CarswellOnt 5433, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 390 N.R. 393 (note) (S.C.C.) — referred to

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

Calpine Canada Energy Ltd., Re (2007), 35 C.B.R. (5th) 27, 410 W.A.C. 25, 417 A.R. 25, 2007 ABCA 266, 2007 CarswellAlta 1097, 80 Alta. L.R. (4th) 60, 33 B.L.R. (4th) 94 (Alta. C.A. [In Chambers]) — referred to

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

Grace Canada Inc., Re (2008), 50 C.B.R. (5th) 25, 2008 CarswellOnt 6284 (Ont. S.C.J. [Commercial List]) — considered

Grace Canada Inc., Re (2010), 2010 CarswellOnt 67, 2010 ONSC 161 (Ont. S.C.J. [Commercial List]) — referred to

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 3530, 55 C.B.R. (5th) 114, 75 C.C.P.B. 220 (Ont. S.C.J. [Commercial List]) — considered

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4467, 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) — considered

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 8166 (Ont. S.C.J. [Commercial List]) — referred to

Nortel Networks Corp., Re (2010), 2010 CarswellOnt 1044, 2010 ONSC 1096 (Ont. S.C.J. [Commercial List]) — referred to

Stelco Inc., Re (2005), 204 O.A.C. 216, 78 O.R. (3d) 254, 2005 CarswellOnt 6283, 15 C.B.R. (5th) 288 (Ont. C.A.) — considered

Wandlyn Inns Ltd., Re (1992), 15 C.B.R. (3d) 316, 1992 CarswellNB 37 (N.B. Q.B.) — considered

Statutes considered:

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

Generally — referred to

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

Generally — referred to

s. 5.1(2) [en. 1997, c. 12, s. 122] — referred to

s. 11(4) — referred to

Pension Benefits Act, R.S.O. 1990, c. P.8

Generally — referred to

MOTION by insolvent corporation for court approval of settlement agreement under Companies' Creditors Arrangement Act.

***Morawetz J.*:**

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Introduction

1 On January 14, 2009, Nortel Networks Corporation ("NNC"), Nortel Networks Limited "(NNL"), Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation (collectively, the "Applicants") were granted a stay of proceedings pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") and Ernst & Young Inc. was appointed as Monitor.

2 The Applicants have historically operated a number of pension, benefit and other plans (both funded and unfunded) for their employees and pensioners, including:

(i) Pension benefits through two registered pension plans, the Nortel Networks Limited Managerial and Non-Negotiated Pension Plan and the Nortel Networks Negotiated Pension Plan (the "Pension Plans"); and

(ii) Medical, dental, life insurance, long-term disability and survivor income and transition benefits paid, except for survivor termination benefits, through Nortel's Health and Welfare Trust (the "HWT").

3 Since the CCAA filing, the Applicants have continued to provide medical, dental and other benefits, through the HWT, to pensioners and employees on long-term disability ("Former and LTD Employees") and active employees ("HWT Payments") and have continued all current service contributions and special payments to the Pension Plans ("Pension Payments").

4 Pension Payments and HWT Payments made by the Applicants to the Former and LTD Employees while under CCAA protection are largely discretionary. As a result of Nortel's insolvency and the significant reduction in the size of Nortel's operations, the unfortunate reality is that, at some point, cessation of such payments is inevitable. The Applicants have attempted to address this situation by entering into a settlement agreement (the "Settlement Agreement") dated as of February 8, 2010, among the Applicants, the Monitor, the Former Employees' Representatives (on their own behalf and on behalf of the parties they represent), the LTD Representative (on her own behalf and on behalf of the parties she represents), Representative Settlement Counsel and the CAW-Canada (the "Settlement Parties").

5 The Applicants have brought this motion for approval of the Settlement Agreement. From the standpoint of the Applicants, the purpose of the Settlement Agreement is to provide for a smooth transition for the termination of Pension Payments and HWT Payments. The Applicants take the position that the Settlement Agreement represents the best efforts of the Settlement Parties to negotiate an agreement and is consistent with the spirit and purpose of the CCAA.

6 The essential terms of the Settlement Agreement are as follows:

(a) until December 31, 2010, medical, dental and life insurance benefits will be funded on a pay-as-you-go basis to the Former and LTD Employees;

(b) until December 31, 2010, LTD Employees and those entitled to receive survivor income benefits will receive income benefits on a pay-as-you-go basis;

(c) the Applicants will continue to make current service payments and special payments to the Pension Plans in the same manner as they have been doing over the course of the proceedings under the CCAA, through to March 31, 2010, in the aggregate amount of $2,216,254 per month and that thereafter and through to September 30, 2010, the Applicants shall make only current service payments to the Pension Plans, in the aggregate

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amount of $379,837 per month;

(d) any allowable pension claims, in these or subsequent proceedings, concerning any Nortel Worldwide Entity, including the Applicants, shall rank *pari passu* with ordinary, unsecured creditors of Nortel, and no part of any such HWT claims shall rank as a preferential or priority claim or shall be the subject of a constructive trust or trust of any nature or kind;

(e) proofs of claim asserting priority already filed by any of the Settlement Parties, or the Superintendent on behalf of the Pension Benefits Guarantee Fund are disallowed in regard to the claim for priority;

(f) any allowable HWT claims made in these or subsequent proceedings shall rank *pari passu* with ordinary unsecured creditors of Nortel;

(g) the Settlement Agreement does not extinguish the claims of the Former and LTD Employees;

(h) Nortel and, *inter alia*, its successors, advisors, directors and officers, are released from all future claims regarding Pension Plans and the HWT, provided that nothing in the release shall release a director of the Applicants from any matter referred to in subsection 5.1(2) of the CCAA or with respect to fraud on the part of any Releasee, with respect to that Releasee only;

(i) upon the expiry of all appeals and rights of appeal in respect thereof, Representative Settlement Counsel will withdraw their application for leave to appeal the decision of the Court of Appeal, dated November 26, 2009, to the Supreme Court of Canada on a with prejudice basis;[FN1]

(j) a CCAA plan of arrangement in the Nortel proceedings will not be proposed or approved if that plan does not treat the Pension and HWT claimants *pari passu* to the other ordinary, unsecured creditors ("Clause H.1"); and

(k) if there is a subsequent amendment to the *Bankruptcy and Insolvency Act* ("BIA") that "changes the current, relative priorities of the claims against Nortel, no party is precluded by this Settlement Agreement from arguing the applicability" of that amendment to the claims ceded in this Agreement ("Clause H.2").

7 The Settlement Agreement does *not* relate to a distribution of the HWT as the Settlement Parties have agreed to work towards developing a Court-approved distribution of the HWT corpus in 2010.

8 The Applicants' motion is supported by the Settlement Parties and by the Board of Directors of Nortel.

9 The Official Committee of Unsecured Creditors of Nortel Networks Inc. ("UCC"), the informal Nortel Noteholder Group (the "Noteholders"), and a group of 37 LTD Employees (the "Opposing LTD Employees") oppose the Settlement Agreement.

10 The UCC and Noteholders oppose the Settlement Agreement, principally as a result of the inclusion of Clause H.2.

11 The Opposing LTD Employees oppose the Settlement Agreement, principally as a result of the inclusion of the third party releases referenced in [6h] above.

The Facts

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A. Status of Nortel's Restructuring

12 Although it was originally hoped that the Applicants would be able to restructure their business, in June 2009 the decision was made to change direction and pursue sales of Nortel's various businesses.

13 In response to Nortel's change in strategic direction and the impending sales, Nortel announced on August 14, 2009 a number of organizational updates and changes including the creation of groups to support transitional services and management during the sales process.

14 Since June 2009, Nortel has closed two major sales and announced a third. As a result of those transactions, approximately 13,000 Nortel employees have been or will be transferred to purchaser companies. That includes approximately 3,500 Canadian employees.

15 Due to the ongoing sales of Nortel's business units and the streamlining of Nortel's operations, it is expected that by the close of 2010, the Applicants' workforce will be reduced to only 475 employees. There is a need to wind-down and rationalize benefits and pension processes.

16 Given Nortel's insolvency, the significant reduction in Nortel's operations and the complexity and size of the Pension Plans, both Nortel and the Monitor believe that the continuation and funding of the Pension Plans and continued funding of medical, dental and other benefits is not a viable option.

B. The Settlement Agreement

17 On February 8, 2010 the Applicants announced that a settlement had been reached on issues related to the Pension Plans, and the HWT and certain employment related issues.

18 Recognizing the importance of providing notice to those who will be impacted by the Settlement Agreement, including the Former Employees, the LTD Employees, unionized employees, continuing employees and the provincial pension plan regulators ("Affected Parties"), Nortel brought a motion to this Court seeking the approval of an extensive notice and opposition process.

19 On February 9, 2010, this Court approved the notice program for the announcement and disclosure of the Settlement (the "Notice Order").

20 As more fully described in the Monitor's Thirty-Sixth, Thirty-Ninth and Thirty-Ninth Supplementary Reports, the Settlement Parties have taken a number of steps to notify the Affected Parties about the Settlement.

21 In addition to the Settlement Agreement, the Applicants, the Monitor and the Superintendent, in his capacity as administrator of the Pension Benefits Guarantee Fund, entered into a letter agreement on February 8, 2010, with respect to certain matters pertaining to the Pension Plans (the "Letter Agreement").

22 The Letter Agreement provides that the Superintendent will not oppose an order approving the Settlement Agreement ("Settlement Approval Order"). Additionally, the Monitor and the Applicants will take steps to complete an orderly transfer of the Pension Plans to a new administrator to be appointed by the Superintendent effective October 1, 2010. Finally, the Superintendent will not oppose any employee incentive program that the Monitor deems reasonable and necessary or the creation of a trust with respect to claims or potential claims against persons who accept directorships of a Nortel Worldwide Entity in order to facilitate the restructuring.

Positions of the Parties on the Settlement Agreement

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The Applicants

23 The Applicants take the position that the Settlement is fair and reasonable and balances the interests of the parties and other affected constituencies equitably. In this regard, counsel submits that the Settlement:

(a) eliminates uncertainty about the continuation and termination of benefits to pensioners, LTD Employees and survivors, thereby reducing hardship and disruption;

(b) eliminates the risk of costly and protracted litigation regarding Pension Claims and HWT Claims, leading to reduced costs, uncertainty and potential disruption to the development of a Plan;

(c) prevents disruption in the transition of benefits for current employees;

(d) provides early payments to terminated employees in respect of their termination and severance claims where such employees would otherwise have had to wait for the completion of a claims process and distribution out of the estates;

(e) assists with the commitment and retention of remaining employees essential to complete the Applicants' restructuring; and

(f) does not eliminate Pension Claims or HWT Claims against the Applicants, but maintains their quantum and validity as ordinary and unsecured claims.

24 Alternatively, absent the approval of the Settlement Agreement, counsel to the Applicants submits that the Applicants are not required to honour such benefits or make such payments and such benefits could cease immediately. This would cause undue hardship to beneficiaries and increased uncertainty for the Applicants and other stakeholders.

25 The Applicants state that a central objective in the Settlement Agreement is to allow the Former and LTD Employees to transition to other sources of support.

26 In the absence of the approval of the Settlement Agreement or some other agreement, a cessation of benefits will occur on March 31, 2010 which would have an immediate negative impact on Former and LTD Employees. The Applicants submit that extending payments to the end of 2010 is the best available option to allow recipients to order their affairs.

27 Counsel to the Applicants submits that the Settlement Agreement brings Nortel closer to finalizing a plan of arrangement, which is consistent with the sprit and purpose of the CCAA. The Settlement Agreement resolves uncertainties associated with the outstanding Former and LTD Employee claims. The Settlement Agreement balances certainty with clarity, removing litigation risk over priority of claims, which properly balances the interests of the parties, including both creditors and debtors.

28 Regarding the priority of claims going forward, the Applicants submit that because a deemed trust, such as the HWT, is not enforceable in bankruptcy, the Former and LTD Employees are by default *pari passu* with other unsecured creditors.

29 In response to the Noteholders' concern that bankruptcy prior to October 2010 would create pension liabilities on the estate, the Applicants committed that they would not voluntarily enter into bankruptcy proceedings prior

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to October 2010. Further, counsel to the Applicants submits the court determines whether a bankruptcy order should be made if involuntary proceedings are commenced.

30 Further, counsel to the Applicants submits that the court has the jurisdiction to release third parties under a Settlement Agreement where the releases (1) are connected to a resolution of the debtor's claims, (2) will benefit creditors generally and (3) are not overly broad or offensive to public policy. See *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 92 O.R. (3d) 513 (Ont. C.A.), [*Metcalfe*] at para. 71, leave to appeal refused, (S.C.C.) and *Grace Canada Inc., Re* (Ont. S.C.J. [Commercial List]) [*Grace 2008*] at para. 40.

31 The Applicants submit that a settlement of the type put forward should be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all the circumstances. Elements of fairness and reasonableness include balancing the interests of parties, including any objecting creditor or creditors, equitably (although not necessarily equally); and ensuring that the agreement is beneficial to the debtor and its stakeholders generally, as per *Air Canada, Re* (Ont. S.C.J. [Commercial List]) [*Air Canada*]. The Applicants assert that this test is met.

The Monitor

32 The Monitor supports the Settlement Agreement, submitting that it is necessary to allow the Applicants to wind down operations and to develop a plan of arrangement. The Monitor submits that the Settlement Agreement provides certainty, and does so with input from employee stakeholders. These stakeholders are represented by Employee Representatives as mandated by the court and these Employee Representatives were given the authority to approve such settlements on behalf of their constituents.

33 The Monitor submits that Clause H.2 was bargained for, and that the employees did give up rights in order to have that clause in the Settlement Agreement; particularly, it asserts that Clause H.1 is the counterpoint to Clause H.2. In this regard, the Settlement Agreement is fair and reasonable.

34 The Monitor asserts that the court may either (1) approve the Settlement Agreement, (2) not approve the Settlement Agreement, or (3) not approve the Settlement Agreement but provide practical comments on the applicability of Clause H.2.

Former and LTD Employees

35 The Former Employees' Representatives' constituents number an estimated 19,458 people. The LTD Employees number an estimated 350 people between the LTD Employee's Representative and the CAW-Canada, less the 37 people in the Opposing LTD Employee group.

36 Representative Counsel to the Former and LTD Employees acknowledges that Nortel is insolvent, and that much uncertainty and risk comes from insolvency. They urge that the Settlement Agreement be considered within the scope of this reality. The alternative to the Settlement Agreement is costly litigation and significant uncertainty.

37 Representative Counsel submits that the Settlement Agreement is fair and reasonable for all creditors, but especially the represented employees. Counsel notes that employees under Nortel are unique creditors under these proceedings, as they are not sophisticated creditors and their personal welfare depends on receiving distributions from Nortel. The Former and LTD Employees assert that this is the best agreement they could have negotiated.

38 Representative Counsel submits that bargaining away of the right to litigate against directors and officers of the corporation, as well at the trustee of the HWT, are examples of the concessions that have been made. They also point to the giving up of the right to make priority claims upon distribution of Nortel's estate and the HWT, although the claim itself is not extinguished. In exchange, the Former and LTD Employees will receive guaranteed coverage

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until the end of 2010. The Former and LTD Employees submit that having money in hand today is better than uncertainty going forward, and that, on balance, this Settlement Agreement is fair and reasonable.

39 In response to allegations that third party releases unacceptably compromise employees' rights, Representative Counsel accepts that this was a concession, but submits that it was satisfactory because the claims given up are risky, costly and very uncertain. The releases do not go beyond s. 5.1(2) of the CCAA, which disallows releases relating to misrepresentations and wrongful or oppressive conduct by directors. Releases as to deemed trust claims are also very uncertain and were acceptably given up in exchange for other considerations.

40 The Former and LTD Employees submit that the inclusion of Clause H.2 was essential to their approval of the Settlement Agreement. They characterize Clause H.2 as a no prejudice clause to protect the employees by not releasing any future potential benefit. Removing Clause H.2 from the Settlement Agreement would be not the approval of an agreement, but rather the creation of an entirely new Settlement Agreement. Counsel submits that without Clause H.2, the Former and LTD Employees would not be signatories.

CAW

41 The CAW supports the Settlement Agreement. It characterizes the agreement as Nortel's recognition that it has a moral and legal obligation to its employees, whose rights are limited by the laws in this country. The Settlement Agreement temporarily alleviates the stress and uncertainty its constituents feel over the winding up of their benefits and is satisfied with this result.

42 The CAW notes that some members feel they were not properly apprised of the facts, but all available information has been disclosed, and the concessions made by the employee groups were not made lightly.

Board of Directors

43 The Board of Directors of Nortel supports the Settlement Agreement on the basis that it is a practical resolution with compromises on both sides.

Opposing LTD Employees

44 Mr. Rochon appeared as counsel for the Opposing LTD Employees, notwithstanding that these individuals did not opt out of having Representative Counsel or were represented by the CAW. The submissions of the Opposing LTD Employees were compelling and the court extends it appreciation to Mr. Rochon and his team in coordinating the representatives of this group.

45 The Opposing LTD Employees put forward the position that the cessation of their benefits will lead to extreme hardship. Counsel submits that the Settlement Agreement conflicts with the spirit and purpose of the CCAA because the LTD Employees are giving up legal rights in relation to a $100 million shortfall of benefits. They urge the court to consider the unique circumstances of the LTD Employees as they are the people hardest hit by the cessation of benefits.

46 The Opposing LTD Employees assert that the HWT is a true trust, and submit that breaches of that trust create liabilities and that the claim should not be released. Specifically, they point to a $37 million shortfall in the HWT that they should be able to pursue.

47 Regarding the third party releases, the Opposing LTD Employees assert that Nortel is attempting to avoid the distraction of third party litigation, rather than look out for the best interests of the Former and LTD Employees. The

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Opposing LTD Employees urge the court not to release the only individuals the Former and LTD Employees can hold accountable for any breaches of trust. Counsel submits that Nortel has a common law duty to fund the HWT, which the Former and LTD Employees should be allowed to pursue.

48 Counsel asserts that allowing these releases (a) is not necessary and essential to the restructuring of the debtor, (b) does not relate to the insolvency process, (c) is not required for the success of the Settlement Agreement, (d) does not meet the requirement that each party contribute to the plan in a material way and (e) is overly broad and therefore not fair and reasonable.

49 Finally, the Opposing LTD Employees oppose the *pari passu* treatment they will be subjected to under the Settlement Agreement, as they have a true trust which should grant them priority in the distribution process. Counsel was not able to provide legal authority for such a submission.

50 A number of Opposing LTD Employees made in person submissions. They do not share the view that Nortel will act in their best interests, nor do they feel that the Employee Representatives or Representative Counsel have acted in their best interests. They shared feelings of uncertainty, helplessness and despair. There is affidavit evidence that certain individuals will be unable to support themselves once their benefits run out, and they will not have time to order their affairs. They expressed frustration and disappointment in the CCAA process.

UCC

51 The UCC was appointed as the representative for creditors in the U.S. Chapter 11 proceedings. It represents creditors who have significant claims against the Applicants. The UCC opposes the motion, based on the inclusion of Clause H.2, but otherwise the UCC supports the Settlement Agreement.

52 Clause H.2, the UCC submits, removes the essential element of finality that a settlement agreement is supposed to include. The UCC characterizes Clause H.2 as a take back provision; if activated, the Former and LTD Employees have compromised nothing, to the detriment of other unsecured creditors. A reservation of rights removes the finality of the Settlement Agreement.

53 The UCC claims it, not Nortel, bears the risk of Clause H.2. As the largest unsecured creditor, counsel submits that a future change to the BIA could subsume the UCC's claim to the Former and LTD Employees and the UCC could end up with nothing at all, depending on Nortel's asset sales.

Noteholders

54 The Noteholders are significant creditors of the Applicants. The Noteholders oppose the settlement because of Clause H.2, for substantially the same reasons as the UCC.

55 Counsel to the Noteholders submits that the inclusion of H.2 is prejudicial to the non-employee unsecured creditors, including the Noteholders. Counsel submits that the effect of the Settlement Agreement is to elevate the Former and LTD Employees, providing them a payout of $57 million over nine months while everyone else continues to wait, and preserves their rights in the event the laws are amended in future. Counsel to the Noteholders submits that the Noteholders forego millions of dollars while remaining exposed to future claims.

56 The Noteholders assert that a proper settlement agreement must have two elements: a real compromise, and resolution of the matters in contention. In this case, counsel submits that there is no resolution because there is no finality in that Clause H.2 creates ambiguity about the future. The very object of a Settlement Agreement, assert the Noteholders, is to avoid litigation by withdrawing claims, which this agreement does not do.

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Superintendent

57 The Superintendent does not oppose the relief sought, but this position is based on the form of the Settlement Agreement that is before the Court.

Northern Trust

58 Northern Trust, the trustee of the pension plans and HWT, takes no position on the Settlement Agreement as it takes instructions from Nortel. Northern Trust indicates that an oversight left its name off the third party release and asks for an amendment to include it as a party released by the Settlement Agreement.

Law and Analysis

A. Representation and Notice Were Proper

59 It is well settled that the Former Employees' Representatives and the LTD Representative (collectively, the "Settlement Employee Representatives") and Representative Counsel have the authority to represent the Former Employees and the LTD Beneficiaries for purposes of entering into the Settlement Agreement on their behalf: *see Grace 2008*, *supra* at para 32.

60 The court appointed the Settlement Employee Representatives and the Representative Settlement Counsel. These appointment orders have not been varied or appealed. Unionized employees continue to be represented by the CAW. The Orders appointing the Settlement Employee Representatives expressly gave them authority to represent their constituencies "for the purpose of settling or compromising claims" in these Proceedings. Former Employees and LTD Employees were given the right to opt out of their representation by Representative Settlement Counsel. After provision of notice, only one former employee and one active employee exercised the opt-out right.

B. Effect of the Settlement Approval Order

61 In addition to the binding effect of the Settlement Agreement, many additional parties will be bound and affected by the Settlement Approval Order. Counsel to the Applicants submits that the binding nature of the Settlement Approval Order on all affected parties is a crucial element to the Settlement itself. In order to ensure all Affected Parties had notice, the Applicants obtained court approval of their proposed notice program.

62 Even absent such extensive noticing, virtually all employees of the Applicants are represented in these proceedings. In addition to the representative authority of the Settlement Employee Representatives and Representative Counsel as noted above, Orders were made authorizing a Nortel Canada Continuing Employees' Representative and Nortel Canada Continuing Employees' Representative Counsel to represent the interests of continuing employees on this motion.

63 I previously indicated that "the overriding objective of appointing representative counsel for employees is to ensure that the employees have representation in the CCAA process": Nortel Networks Corp., Re (Ont. S.C.J. [Commercial List]) at para 16. I am satisfied that this objective has been achieved.

64 The Record establishes that the Monitor has undertaken a comprehensive notice process which has included such notice to not only the Former Employees, the LTD Employees, the unionized employees and the continuing employees but also the provincial pension regulators and has given the opportunity for any affected person to file Notices of Appearance and appear before this court on this motion.

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65 I am satisfied that the notice process was properly implemented by the Monitor.

66 I am satisfied that Representative Counsel has represented their constituents' interests in accordance with their mandate, specifically, in connection with the negotiation of the Settlement Agreement and the draft Settlement Approval Order and appearance on this Motion. There have been intense discussions, correspondence and negotiations among Representative Counsel, the Monitor, the Applicants, the Superintendent, counsel to the Board of the Applicants, the Noteholder Group and the Committee with a view to developing a comprehensive settlement. NCCE's Representative Counsel have been apprised of the settlement discussions and served with notice of this Motion. Representatives have held Webinar sessions and published press releases to inform their constituents about the Settlement Agreement and this Motion.

C. Jurisdiction to Approve the Settlement Agreement

67 The CCAA is a flexible statute that is skeletal in nature. It has been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". Nortel Networks Corp., Re (Ont. S.C.J. [Commercial List]) at paras. 28-29, citing *Metcalfe*, *supra*, at paras. 44 and 61.

68 Three sources for the court's authority to approve pre-plan agreements have been recognized:

(a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;

(b) the power of the court to make an order "on such terms as it may impose" pursuant to s. 11(4) of the CCAA; and

(c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects: see Nortel Networks Corp., Re (Ont. S.C.J. [Commercial List]) at para. 30, citing Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (Ont. Gen. Div. [Commercial List]) [Canadian Red Cross] at para. 43; *Metcalfe*, *supra* at para. 44.

69 In *Stelco Inc., Re* (2005), 78 O.R. (3d) 254 (Ont. C.A.), the Ontario Court of Appeal considered the court's jurisdiction under the CCAA to approve agreements, determining at para. 14 that it is not limited to preserving the *status quo*. Further, agreements made prior to the finalization of a plan or compromise are valid orders for the court to approve: *Grace 2008*, *supra* at para. 34.

70 In these proceedings, this court has confirmed its jurisdiction to approve major transactions, including settlement agreements, during the stay period defined in the Initial Order and prior to the proposal of any plan of compromise or arrangement: see, for example, Nortel Networks Corp., Re (Ont. S.C.J. [Commercial List]); Nortel Networks Corp., Re (Ont. S.C.J. [Commercial List]) and *Nortel Networks Corp., Re*, 2010 ONSC 1096 (Ont. S.C.J. [Commercial List]).

71 I am satisfied that this court has jurisdiction to approve transactions, including settlements, in the course of overseeing proceedings during a CCAA stay period and prior to any plan of arrangement being proposed to creditors: see Calpine Canada Energy Ltd., Re (Alta. C.A. [In Chambers]) [Calpine] at para. 23, affirming (Alta. Q.B.); Canadian Red Cross, *supra*; Air Canada, *supra*; *Grace 2008*, *supra*, and Grace Canada Inc., Re (Ont. S.C.J. [Commercial List]) [*Grace 2010*], leave to appeal to the C.A. refused February 19, 2010; *Nortel Networks Corp., Re*, 2010 ONSC 1096 (Ont. S.C.J. [Commercial List]).

D. Should the Settlement Agreement Be Approved?

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72 Having been satisfied that this court has the jurisdiction to approve the Settlement Agreement, I must consider whether the Settlement Agreement *should* be approved.

73 A Settlement Agreement can be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all circumstances. What makes a settlement agreement fair and reasonable is its balancing of the interests of all parties; its equitable treatment of the parries, including creditors who are not signatories to a settlement agreement; and its benefit to the Applicant and its stakeholders generally.

i) Sprit and Purpose

74 The CCAA is a flexible instrument; part of its purpose is to allow debtors to balance the conflicting interests of stakeholders. The Former and LTD Employees are significant creditors and have a unique interest in the settlement of their claims. This Settlement Agreement brings these creditors closer to ultimate settlement while accommodating their special circumstances. It is consistent with the spirit and purpose of the CCAA.

ii) Balancing of Parties' Interests

75 There is no doubt that the Settlement Agreement is comprehensive and that it has support from a number of constituents when considered in its totality.

76 There is, however, opposition from certain constituents on two aspects of the proposed Settlement Agreement: (1) the Opposing LTD Employees take exception to the inclusion of the third party releases; (2) the UCC and Noteholder Groups take exception to the inclusion of Clause H.2.

Third Party Releases

77 Representative Counsel, after examining documentation pertaining to the Pension Plans and HWT, advised the Former Employees' Representatives and Disabled Employees' Representative that claims against directors of Nortel for failing to properly fund the Pension Plans were unlikely to succeed. Further, Representative Counsel advised that claims against directors or others named in the Third Party Releases to fund the Pension Plans were risky and could take years to resolve, perhaps unsuccessfully. This assisted the Former Employees' Representatives and the Disabled Employees' Representative in agreeing to the Third Party Releases.

78 The conclusions reached and the recommendations made by both the Monitor and Representative Counsel are consistent. They have been arrived at after considerable study of the issues and, in my view, it is appropriate to give significant weight to their positions.

79 In Grace 2008, *supra*, and Grace 2010, *supra*, I indicated that a Settlement Agreement entered into with Representative Counsel that contains third party releases is fair and reasonable where the releases are necessary and connected to a resolution of claims against the debtor, will benefit creditors generally and are not overly broad or offensive to public policy.

80 In this particular case, I am satisfied that the releases are necessary and connected to a resolution of claims against the Applicants.

81 The releases benefit creditors generally as they reduces the risk of litigation against the Applicants and their directors, protect the Applicants against potential contribution claims and indemnity claims by certain parties, including directors, officers and the HWT Trustee; and reduce the risk of delay caused by potentially complex litiga-

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tion and associated depletion of assets to fund potentially significant litigation costs.

82 Further, in my view, the releases are not overly broad or offensive to public policy. The claims being released specifically relate to the subject matter of the Settlement Agreement. The parties granting the release receive consideration in the form of both immediate compensation and the maintenance of their rights in respect to the distribution of claims.

Clause H.2

83 The second aspect of the Settlement Agreement that is opposed is the provision known as Clause H.2. Clause H.2 provides that, in the event of a bankruptcy of the Applicants, and notwithstanding any provision of the Settlement Agreement, if there are any amendments to the BIA that change the current, relative priorities of the claims against the Applicants, no party is precluded from arguing the applicability or non-applicability of any such amendment in relation to any such claim.

84 The Noteholders and UCC assert that Clause H.2 causes the Settlement Agreement to not be a "settlement" in the true and proper sense of that term due to a lack of certainty and finality. They emphasize that Clause H.2 has the effect of undercutting the essential compromises of the Settlement Agreement in imposing an unfair risk on the non-employee creditors of NNL, including NNI, after substantial consideration has been paid to the employees.

85 This position is, in my view, well founded. The inclusion of the Clause H.2 creates, rather than eliminates, uncertainty. It creates the potential for a fundamental alteration of the Settlement Agreement.

86 The effect of the Settlement Agreement is to give the Former and LTD Employees preferred treatment for certain claims, notwithstanding that priority is not provided for in the statute nor has it been recognized in case law. In exchange for this enhanced treatment, the Former Employees and LTD Beneficiaries have made certain concessions.

87 The Former and LTD Employees recognize that substantially all of these concessions could be clawed back through Clause H.2. Specifically, they acknowledge that future Pension and HWT Claims will rank *pari passu* with the claims of other ordinary unsecured creditors, but then go on to say that should the BIA be amended, they may assert once again a priority claim.

88 Clause H.2 results in an agreement that does not provide certainty and does not provide finality of a fundamental priority issue.

89 The Settlement Parties, as well as the Noteholders and the UCC, recognize that there are benefits associated with resolving a number of employee-related issues, but the practical effect of Clause H.2 is that the issue is not fully resolved. In my view, Clause H.2 is somewhat inequitable from the standpoint of the other unsecured creditors of the Applicants. If the creditors are to be bound by the Settlement Agreement, they are entitled to know, with certainty and finality, the effect of the Settlement Agreement.

90 It is not, in my view, reasonable to require creditors to, in effect, make concessions in favour of the Former and LTD Employees today, and be subject to the uncertainty of unknown legislation in the future.

91 One of the fundamental purposes of the CCAA is to facilitate a process for a compromise of debt. A compromise needs certainty and finality. Clause H.2 does not accomplish this objective. The inclusion of Clause H.2 does not recognize that at some point settlement negotiations cease and parties bound by the settlement have to accept the outcome. A comprehensive settlement of claims in the magnitude and complexity contemplated by the Settlement Agreement should not provide an opportunity to re-trade the deal after the fact.

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92 The Settlement Agreement should be fair and reasonable in all the circumstances. It should balance the interests of the Settlement Parties and other affected constituencies equitably and should be beneficial to the Applicants and their stakeholders generally.

93 It seems to me that Clause H.2 fails to recognize the interests of the other creditors of the Applicants. These creditors have claims that rank equally with the claims of the Former Employees and LTD Employees. Each have unsecured claims against the Applicants. The Settlement Agreement provides for a transfer of funds to the benefit of the Former Employees and LTD Employees at the expense of the remaining creditors. The establishment of the Payments Charge crystallized this agreed upon preference, but Clause H.2 has the effect of not providing any certainty of outcome to the remaining creditors.

94 I do not consider Clause H.2 to be fair and reasonable in the circumstances.

95 In light of this conclusion, the Settlement Agreement cannot be approved in its current form.

96 Counsel to the Noteholder Group also made submissions that three other provisions of the Settlement Agreement were unreasonable and unfair, namely:

(i) ongoing exposure to potential liability for pension claims if a bankruptcy order is made before October 1, 2010;

(ii) provisions allowing payments made to employees to be credited against employees' claims made, rather than from future distributions or not to be credited at all; and

(iii) lack of clarity as to whether the proposed order is binding on the Superintendent in all of his capacities under the *Pension Benefits Act* and other applicable law, and not merely in his capacity as Administrator on behalf of the Pension Benefits Guarantee Fund.

97 The third concern was resolved at the hearing with the acknowledgement by counsel to the Superintendent that the proposed order would be binding on the Superintendent in all of his capacities.

98 With respect to the concern regarding the potential liability for pension claims if a bankruptcy order is made prior to October 1, 2010, counsel for the Applicants undertook that the Applicants would not take any steps to file a voluntary assignment into bankruptcy prior to October 1, 2010. Although such acknowledgment does not bind creditors from commencing involuntary bankruptcy proceedings during this time period, the granting of any bankruptcy order is preceded by a court hearing. The Noteholders would be in a position to make submissions on this point, if so advised. This concern of the Noteholders is not one that would cause me to conclude that the Settlement Agreement was unreasonable and unfair.

99 Finally, the Noteholder Group raised concerns with respect to the provision which would allow payments made to employees to be credited against employees' claims made, rather than from future distributions, or not to be credited at all. I do not view this provision as being unreasonable and unfair. Rather, it is a term of the Settlement Agreement that has been negotiated by the Settlement Parties. I do note that the proposed treatment with respect to any payments does provide certainty and finality and, in my view, represents a reasonable compromise in the circumstances.

Disposition

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100 I recognize that the proposed Settlement Agreement was arrived at after hard-fought and lengthy negotiations. There are many positive aspects of the Settlement Agreement. I have no doubt that the parties to the Settlement Agreement consider that it represents the best agreement achievable under the circumstances. However, it is my conclusion that the inclusion of Clause H.2 results in a flawed agreement that cannot be approved.

101 I am mindful of the submission of counsel to the Former and LTD Employees that if the Settlement Agreement were approved, with Clause H.2 excluded, this would substantively alter the Settlement Agreement and would, in effect, be a creation of a settlement and not the approval of one.

102 In addition, counsel to the Superintendent indicated that the approval of the Superintendent was limited to the proposed Settlement Agreement and would not constitute approval of any altered agreement.

103 In *Grace 2008*, *supra*, I commented that a line-by-line analysis was inappropriate and that approval of a settlement agreement was to be undertaken in its entirety or not at all, at para. 74. A similar position was taken by the New Brunswick Court of Queen's Bench in *Wandlyn Inns Limited (Re)* (1992), 15 C.B.R. (3d) 316 (N.B. Q.B.). I see no reason or basis to deviate from this position.

104 Accordingly, the motion is dismissed.

105 In view of the timing of the timing of the release of this decision and the functional funding deadline of March 31, 2010, the court will make every effort to accommodate the parties if further directions are required.

106 Finally, I would like to express my appreciation to all counsel and in person parties for the quality of written and oral submissions.

Motion dismissed.

FN1 On March 25, 2010, the Supreme Court of Canada released the following: *Donald Sproule et al. v. Nortel Networks Corporation et al.* (Ont.) (Civil) (By Leave) (33491) (The motions for directions and to expedite the application for leave to appeal are dismissed. The application for leave to appeal is dismissed with no order as to costs./La requête en vue d'obtenir des directives et la requête visant à accélérer la procédure de demande d'autorisation d'appel sont rejetées. La demande d'autorisation d'appel est rejetée; aucune ordonnance n'est rendue concernant les dépens.): <http://scc.lexum.umontreal.ca/en/news_release/2010/10-03-25.3a/10-03-25.3a.html>

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TAB 4

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2004 CarswellSask 50, 2004 SKQB 8, 244 Sask. R. 155, 4 C.B.R. (5th) 211

Minds Eye Entertainment Ltd. v. Royal Bank

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

IN THE MATTER OF A PROPOSED PLAN OF ARRANGEMENT FOR THE CREDITORS OF MINDS EYE ENTERTAINMENT LTD. AND ITS SUBSIDIARIES

MINDS EYE ENTERTAINMENT LTD. And Its Subsidiaries (APPLICANTS) and ROYAL BANK OF CANADA, INVESTMENT SASKATCHEWAN INC., CANADA IMPERIAL BANK OF COMMERCE, BUSINESS DEVELOPMENT BANK OF CANADA, and CROCUS INVESTMENT FUND (RESPONDENTS)

Saskatchewan Court of Queen's Bench

Matheson J.

Judgment: January 9, 2004[FN*]
Docket: Regina Q.B.C. 1548/03

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Counsel: Conrad D. Hadubiak for Minds Eye Entertainment Ltd.

Katherine E. Ducey for Northwest Communications Ltd.

Christopher J. Ramsay for Royal Bank of Canada

John R. Sandrelli for Magdalene Productions Inc.

Subject: Insolvency

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues

M Ltd.'s application for order sanctioning plan of compromise approved by creditors of M Ltd. allowed subject to revisions directed by court — Bank's agreement to subordinate its security interest in M Ltd.'s collateral to extent of creditor N Ltd.'s right to receive certain payments did not establish N Ltd. as secured creditor — Companies' Creditors Arrangement Act does not authorize release from liability of third parties — Consequently, release of third parties in proposed plan was ordered struck.

Bankruptcy and insolvency --- Priorities of claims — Unsecured claims — General principles

M Ltd.'s application for order sanctioning plan of compromise approved by creditors of M Ltd. allowed subject to revisions directed by court — Bank's agreement to subordinate its security interest in M Ltd.'s collateral to extent of creditor N Ltd.'s right to receive certain payments did not establish N Ltd. as secured creditor — Companies' Creditors Arrangement Act does not authorize release from liability of third parties — Consequently, release of third parties in proposed plan was ordered struck.

Cases considered by *Matheson J.*:

Ball Machinery Sales Ltd., Re (2002), 2002 CarswellOnt 2742, 37 C.B.R. (4th) 39 (Ont. S.C.J.) — considered

Statutes considered:

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

Generally — referred to

s. 4 — referred to

s. 5 — referred to

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

s. 5.1(2) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2)(a) [en. 1997, c. 12, s. 122] — considered

s. 5.1(2)(b) [en. 1997, c. 12, s. 122] — considered

APPLICATION by debtor for order sanctioning plan of compromise under *Companies' Creditors Arrangement Act.*

***Matheson J.*:**

1 Minds Eye Entertainment Ltd. ("Minds Eye") has applied for an Order sanctioning a Plan of Compromise ("the Plan") approved by the creditors of Minds Eye at a meeting held on December 19, 2003.

2 Certain objections have been raised, however, with respect to the Plan.

Objection by Northwest Communications Ltd. ("Northwest"):

3 Northwest has objected to being included in the class of unsecured creditors. Northwest has asserted that it is a secured creditor and that it should be included in the Tax Credit Secured Creditors Class, which consists of Canadian Imperial Bank of Commerce and Royal Bank of Canada ("Royal Bank").

4 Minds Eye and Royal Bank insist that Northwest is not a secured creditor, but if it should be deemed so, it should only be included in the General Secured Creditor Class. In particular, Minds Eye has pointed out that the corporations in the Tax Credit Secured Creditors Class possess a first charge on all of Minds Eye's assets, where as the security interest asserted by Northwest relates only to one particular type of collateral: the Just Cause television series.

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5 The claim of Northwest to be a secured creditor arises from an agreement dated July 30, 2002, between the producers of Just Cause, Minds Eye, Royal Bank and three companies - one of which was Northwest - referred to in the agreement as Pledgeholders. The agreement recited that the producers and Minds Eye had granted to Royal Bank a security interest in the collateral referred to in the agreement (generally everything relating to Just Cause) but that the producers, Minds Eye and Royal Bank desired that the Pledgeholders act as Pledgeholders on behalf of Royal Bank of any of the collateral which came into their possession.

6 The asserted security interest, according to Northwest, arises from the statement in clause 6 of the agreement that

> 6. . . . RBC [Royal Bank of Canada] acknowledges and agrees that RBC's rights and security interest with respect to the Series and Collateral shall be subject to the Pledgeholders' rights to receive payment for Pledgeholders' normal charges for labour and services ordered by and rendered to the Producer or Guarantors, and the materials ordered by and furnished to the Producer or Guarantors, solely in connection with the Collateral. . .

7 Northwest has acknowledged that the foregoing does not constitute a direct grant by Minds Eye to Northwest of a security interest in the collateral. Nevertheless, Northwest has insisted that because Minds Eye was a party to the agreement Northwest therefore became a secured creditor of Minds Eye.

8 Royal Bank agreed to subordinate its security interest in the collateral to the extent of the Pledgeholders right to receive certain payments. Minds Eye consented to the subordination, but there was no grant of any security interest by Minds Eye to the Pledgeholders. That is emphasized by paragraph 4 of the agreement.

> 4. Pledgeholders acknowledge that as of the date hereof (it) has no charges, liens or encumbrances against the Collateral.

Northwest is therefore not a secured creditor of Minds Eye.

Release Clauses In Plan:

9 Magdalene Productions Ltd. has objected to the wording of clause 4.16 of the Plan, entitled "Releases", and to clause 6.2, entitled "Effect Of Court Sanctioned Order", on the basis that they purport to release from liability not only Minds Eye and its related companies, and the directors thereof, but also third parties.

10 The *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "Act") does not authorize, it has been submitted, the release from liability of third parties.

11 Sections 4 and 5 of the Act authorize compromises between a petitioning company and its unsecured and secured creditors. If a compromise is approved, and sanctioned by the court, it necessarily entails the release of the company from liability to such creditors except to the extent as agreed in the compromise arrangement.

12 Section 5.1 of the Act was added to extend to any directors of the petitioning company the benefit of any compromise, provided, as set out in subsection (2) of s. 5.1, that the compromise, and release from further liability, does not include claims (a) related to contractual rights of one or more creditors, or (b) which are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by the directors.

13 But the Act does not, it has been submitted, extend to releasing third parties from liability; nor, it has been asserted, should it, because third parties do not provide any consideration to the compromise arrangement.

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14 Minds Eye has pointed out that in *Ball Machinery Sales Ltd., Re* (2002), 37 C.B.R. (4th) 39 (Ont. S.C.J.), Aercon Construction Group Inc., a creditor of Ball Machinery, objected to a proposed release clause; it wished to preserve its right to pursue a breach of trust claim against certain officers and directors of Ball Machinery. A new form of release was then drafted. The redrafted release clause covered not only directors but also officers and employees of Ball Machinery. Nevertheless, it expressly excluded claims arising from the wrongful conduct of directors, officers and employees, and it was therefore acceptable to Aercon. The question as to whether the Act authorized the extended release was apparently not addressed.

15 As a result of the foregoing, the releases contained in clause 4.16 and clause 6.2 of the Plan must be revised to limit the extent thereof to Minds Eye and its directors, and, with respect to the directors, expressly limiting the releases as set out in s. 5.1(2) of the Act.

16 Minds Eye has established that it has complied with all statutory requirements and that the Plan is fair and reasonable. Therefore an Order will issue, in the form of the draft order filed on January 8, 2004, subject to effecting the foregoing revisions to clauses 4.16 and 6.2, approving the Plan.

Order accordingly.

FN* Affirmed *Minds Eye Entertainment Ltd. v. Royal Bank* (2004), 1 C.B.R. (5th) 89, (sub nom. *Minds Eye Entertainment Ltd., Re)* 249 Sask. R. 139, 2004 SKCA 41, 2004 CarswellSask 192 (Sask. C.A.); leave to appeal refused *Minds Eye Entertainment Ltd. v. Royal Bank* (2004), 2004 CarswellSask 797, 2004 CarswellSask 798 (S.C.C.).

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TAB 5

2000 CarswellAlta 662, 2000 ABQB 442, [2000] A.W.L.D. 654, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201, [2000] A.J. No. 771, 98 A.C.W.S. (3d) 334

Canadian Airlines Corp., Re

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

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

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

Alberta Court of Queen's Bench

Paperny J.

Heard: June 5-19, 2000
Judgment: June 27, 2000[FN*]
Docket: Calgary 0001-05071

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2000 CarswellAlta 662, 2000 ABQB 442, [2000] A.W.L.D. 654, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201, [2000] A.J. No. 771, 98 A.C.W.S. (3d) 334

P. Pastewka, for JHHD Aircraft Leasing No. 1 and No. 2.

J. Thom, for Royal Bank of Canada.

J. Medhurst-Tivadar, for Canada Customs and Revenue Agency.

R. Wilkins, Q.C., for Calgary and Edmonton Airport Authority.

Subject: Corporate and Commercial; Insolvency

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

Airline brought application for approval of plan of arrangement under Companies' Creditors Arrangement Act — Investment corporation brought counter-application for declaration that plan constituted merger or transfer of airline's assets to AC Corp., that plan would not affect investment corporation, and directing repurchase of notes pursuant to trust indenture, and that actions of airline and AC Corp. in formulating plan were oppressive and unfairly prejudicial to them — Application granted; counter-application dismissed — All statutory conditions were fulfilled and plan was fair and reasonable — Fairness did not require equal treatment of all creditors — Aim of plan was to allow airline to sustain operations and permanently adjust debt structure to reflect current market for asset values and carrying costs, in return for AC Corp. providing guarantee of restructured obligations — Plan was not oppressive to minority shareholders who, in alternative bankruptcy scenario, would receive less than under plan — Reorganization of share capital did not cancel minority shareholders' shares, and did not violate s. 167 of Business Corporations Act of Alberta — Act contemplated reorganizations in which insolvent corporation would eliminate interests of common shareholders, without requiring shareholder approval — Proposed transaction was not "sale, lease or exchange" of airline's property which required shareholder approval — Requirements for "related party transaction" under Policy 9.1 of Ontario Securities Commission were waived, since plan was fair and reasonable — Plan resulted in no substantial injustice to minority creditors, and represented reasonable balancing of all interests — Evidence did not support investment corporation's position that alternative existed which would render better return for minority shareholders — In insolvency situation, oppression of minority shareholder interests must be assessed against altered financial and legal landscape, which may result in shareholders' no longer having true interest to be protected — Financial support and corporate integration provided by other airline was not assumption of benefit by other airline to detriment of airline, but benefited airline and its stakeholders — Investment corporation was not oppressed — Corporate reorganization provisions in plan could not be severed from debt restructuring — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1(2) — Business Corporations Act, S.A. 1981, c. B-15, s. 167.

Cases considered by *Paperny J.*:

Alabama, New Orleans, Texas & Pacific Junction Railway, Re (1890), [1891] 1 Ch. 213, 60 L.J. Ch. 221, [1886-90] All E.R. Rep. Ext. 1143, 64 L.T. 127, 7 T.L.R. 171, 2 Meg. 377 (Eng. C.A.) — referred to

Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 1 (Ont. Gen. Div.) — referred to

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Bruce Agra Foods Inc. v. Everfresh Beverages Inc. (Receiver of) (1996), 45 C.B.R. (3d) 169, 22 O.T.C. 247 (Ont. Gen. Div.) — referred to

Cadillac Fairview Inc., Re (February 6, 1995), Doc. B348/94 (Ont. Gen. Div. [Commercial List]) — considered

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Campeau Corp., Re (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) — referred to

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) — referred to

Crabtree (Succession de) c. Barrette, 47 C.C.E.L. 1, 10 B.L.R. (2d) 1, (sub nom. *Barrette v. Crabtree (Succession de))* 53 Q.A.C. 279, (sub nom. *Barrette v. Crabtree (Succession de))* 150 N.R. 272, (sub nom. *Barrette v. Crabtree Estate)* 101 D.L.R. (4th) 66, (sub nom. *Barrette v. Crabtree Estate)* [1993] 1 S.C.R. 1027 (S.C.C.) — referred to

Diligenti v. RWMD Operations Kelowna Ltd. (1976), 1 B.C.L.R. 36 (B.C. S.C.) — referred to

First Edmonton Place Ltd. v. 315888 Alberta Ltd. (1988), 60 Alta. L.R. (2d) 122, 40 B.L.R. 28 (Alta. Q.B.) — referred to

Hochberger v. Rittenberg (1916), 54 S.C.R. 480, 36 D.L.R. 450 (S.C.C.) — referred to

Keddy Motor Inns Ltd., Re (1992), 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 110 N.S.R. (2d) 246, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 299 A.P.R. 246 (N.S. C.A.) — referred to

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

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

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

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

Repap British Columbia Inc., Re (1998), 1 C.B.R. (4th) 49, 50 B.C.L.R. (3d) 133 (B.C. S.C.) — considered

Royal Oak Mines Inc., Re (1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List]) — considered

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Statutes considered:

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Air Canada Public Participation Act, R.S.C. 1985, c. 35 (4th Supp.)

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Business Corporations Act, S.A. 1981, c. B-15

Generally — referred to

s. 167 [am. 1996, c. 32, s. 1(4)] — considered

s. 167(1) [am. 1996, c. 32, s. 1(4)] — considered

s. 167(1)(e) — considered

s. 167(1)(f) — considered

s. 167(1)(g.1) [en. 1996, c. 32, s. 1(4)] — considered

s. 183 — considered

s. 185 — considered

s. 185(2) — considered

s. 185(7) — considered

s. 234 — considered

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Generally — considered

s. 2 "debtor company" — referred to

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

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s. 6 [am. 1992, c. 27, s. 90(1)(f); am. 1996, c. 6, s. 167(1)(d)] — considered

s. 12 — referred to

Competition Act, R.S.C. 1985, c. C-34

Generally — referred to

APPLICATION by airline for approval of plan of arrangement; COUNTER-APPLICATION by investment corporation for declaration that plan constituted merger or transfer of airline's assets to AC Corp., that plan would not affect investment corporation, and directing repurchase of notes pursuant to trust indenture, and that actions of airline and AC Corp. in formulating plan were oppressive and unfairly prejudicial; COUNTER-APPLICATION by minority shareholders.

***Paperny J.*:**

I. Introduction

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

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

3 Canadian has asked this court to sanction its plan under s. 6 of the CCAA. The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all the stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan represent a fair and reasonable compromise that will permit a viable commercial entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.

II. Background

Canadian Airlines and its Subsidiaries

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

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

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

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

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

Events Leading up to the CCAA Proceedings

9 Canadian's financial difficulties significantly predate these proceedings.

10 In the early 1990s, Canadian experienced significant losses from operations and deteriorating liquidity. It completed a financial restructuring in 1994 (the "1994 Restructuring") which involved employees contributing $200,000,000 in new equity in return for receipt of entitlements to common shares. In addition, Aurora Airline Investments, Inc. ("Aurora"), a subsidiary of AMR Corporation ("AMR"), subscribed for $246,000,000 in preferred shares of CAIL. Other AMR subsidiaries entered into comprehensive services and marketing arrangements with CAIL. The governments of Canada, British Columbia and Alberta provided an aggregate of $120,000,000 in loan guarantees. Senior creditors, junior creditors and shareholders of CAC and CAIL and its subsidiaries converted approximately $712,000,000 of obligations into common shares of CAC or

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convertible notes issued jointly by CAC and CAIL and/or received warrants entitling the holder to purchase common shares.

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

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

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

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

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

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

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

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

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

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

Initial Discussions with Air Canada

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

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

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

Offer by Onex

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

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

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

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

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

Offer by 853350

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

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

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

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

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

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

a) the doubts which were publicly raised as to Canadian's ability to survive made Canadian's efforts to secure additional financing through various sale-leaseback transactions more difficult;

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b) sales for future air travel were down by approximately 10% compared to 1998;

c) CAIL's liquidity position, which stood at approximately $84 million (consolidated cash and available credit) as at September 30, 1999, reached a critical point in late December, 1999 when it was about to go negative.

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

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

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

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

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

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

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

42 Following implementation of the moratorium, Canadian with Air Canada embarked on efforts to restructure significant obligations by consent. The further damage to public confidence which a CCAA filing could produce required Canadian

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to secure a substantial measure of creditor support in advance of any public filing for court protection.

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

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

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

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

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

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

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

The Restructuring Plan

50 The Plan has three principal aims described by Canadian:

(a) provide near term liquidity so that Canadian can sustain operations;

(b) allow for the return of aircraft not required by Canadian; and

(c) permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset values and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

51 The proposed treatment of stakeholders is as follows:

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

Also unaffected by the Plan are those aircraft lessors, conditional vendors and secured creditors holding security over CAIL's aircraft who have entered into agreements with CAIL and/or Air Canada with respect to the restructur-

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ing of CAIL's obligations. A number of such agreements, which were initially contained in the form of letters of intent ("LOIs"), were entered into prior to the commencement of the CCAA proceedings, while a total of 17 LOIs were completed after that date. In its Second and Fourth Reports the Monitor reported to the court on these agreements. The LOIs entered into after the proceedings commenced were reviewed and approved by the court on April 14, 2000 and May 10, 2000.

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

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

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

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

> The Offeror intends to conduct the Debt Restructuring in such a manner as to seek to ensure that the unionized employees of Canadian, the suppliers of new credit (including trade credit) and the members of the flying public are left unaffected.
>
> The Offeror is of the view that the pursuit of these three principles is essential in order to ensure that the long term value of Canadian is preserved.

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

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

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

The Affected Unsecured Creditors fall into the following categories:

> a. Claims of holders of or related to the Unsecured Notes (the "Unsecured Noteholders");
>
> b. Claims in respect of certain outstanding or threatened litigation involving Canadian;

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c. Claims arising from the termination, breach or repudiation of certain contracts, leases or agreements to which Canadian is a party other than aircraft financing or lease arrangements;

d. Claims in respect of deficiencies arising from the termination or re-negotiation of aircraft financing or lease arrangements;

e. Claims of tax authorities against Canadian; and

f. Claims in respect of the under-secured or unsecured portion of amounts due to the Senior Secured Noteholders.

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

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

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

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

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

57 Four shareholders of CAC also oppose the plan. Neil Baker, a Toronto resident, acquired 132,500 common shares at a cost of $83,475.00 on or about May 5, 2000. Mr. Baker sought to commence proceedings to "remedy an injustice to the minority holders of the common shares". Roger Midiaty, Michael Salter and Hal Metheral are individual shareholders who were added as parties at their request during the proceedings. Mr. Midiaty resides in Calgary, Alberta and holds 827 CAC shares

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which he has held since 1994. Mr. Metheral is also a Calgary resident and holds approximately 14,900 CAC shares in his RRSP and has held them since approximately 1994 or 1995. Mr. Salter is a resident of Scottsdale, Arizona and is the beneficial owner of 250 shares of CAC and is a joint beneficial owner of 250 shares with his wife. These shareholders will be referred in the Decision throughout as the "Minority Shareholders".

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

III. Analysis

59 Section 6 of the CCAA provides that:

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

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

> (1) there must be compliance with all statutory requirements;
>
> (2) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and
>
> (3) the plan must be fair and reasonable.

61 A leading articulation of this three-part test appears in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 182-3, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) and has been regularly followed, see for example *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 172 and *Re T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 7. Each of these criteria are reviewed in turn below.

1. Statutory Requirements

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

> (a) the applicant comes within the definition of "debtor company" in section 2 of the CCAA;
>
> (b) the applicant or affiliated debtor companies have total claims within the meaning of section 12 of the CCAA in

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excess of $5,000,000;

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

(d) the creditors were properly classified;

(e) the meetings of creditors were properly constituted;

(f) the voting was properly carried out; and

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

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

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

(b) CAC and CAIL have total claims that would be claims provable in bankruptcy within the meaning of section 12 of the CCAA in excess of $5,000,000.

(c) In accordance with the April 7, 2000 Order of this court, a Notice of Meeting and a disclosure statement (which included copies of the Plan and the March 24th and April 7th Orders of this court) were sent to the Affected Creditors, the directors and officers of the Petitioners, the Monitor and persons who had served a Notice of Appearance, on April 25, 2000.

(d) As confirmed by the May 12, 2000 ruling of this court (leave to appeal denied May 29, 2000), the creditors have been properly classified.

(e) Further, as detailed in the Monitor's Fifth Report to the Court and confirmed by the June 14, 2000 decision of this court in respect of a challenge by Resurgence Asset Management LLC ("Resurgence"), the meetings of creditors were properly constituted, the voting was properly carried out and the Plan was approved by the requisite double majorities in each class. The composition of the majority of the unsecured creditor class is addressed below under the heading "Fair and Reasonable".

2. Matters Unauthorized

64 This criterion has not been widely discussed in the reported cases. As recognized by Blair J. in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) and Farley J. in *Re Cadillac Fairview Inc.* (February 6, 1995), Doc. B348/94 (Ont. Gen. Div. [Commercial List]), within the CCAA process the court must rely on the reports of the Monitor as well as the parties in ensuring nothing contrary to the CCAA has occurred or is contemplated by the plan.

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

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a. Legality of proposed share capital reorganization

66 Subsection 185(2) of the ABCA provides:

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

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

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

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

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

Section 167 of the ABCA

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

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

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

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71 The relevant portions of section 167 provide as follows:

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

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

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

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

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

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

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

76 The rationale for allowing such a reorganization appears plain; the corporation is insolvent, which means that on liquidation the shareholders would get nothing. In those circumstances, as described further below under the heading "Fair and Reasonable", there is nothing unfair or unreasonable in the court effecting changes in such situations without shareholder

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approval. Indeed, it would be unfair to the creditors and other stakeholders to permit the shareholders (whose interest has the lowest priority) to have any ability to block a reorganization.

77 The Petitioners were unable to provide any case law addressing the use of section 185 as proposed under the Plan. They relied upon the decisions of *Re Royal Oak Mines Inc.* (1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List]) and *T. Eaton Co., supra* in which Farley J.of the Ontario Superior Court of Justice emphasized that shareholders are at the bottom of the hierarchy of interests in liquidation or liquidation related scenarios.

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

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

Section 183 of the ABCA

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

81 I disagree with this creative characterization. The proposed transaction is a reorganization as contemplated by section 185 of the ABCA. As recognized in *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.) aff'd (1988), 70 C.B.R. (N.S.) xxxii (S.C.C.), the fact that the same end might be achieved under another section does not exclude the section to be relied on. A statute may well offer several alternatives to achieve a similar end.

Ontario Securities Commission Policy 9.1

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

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

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

b. Release

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

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provisions of the CCAA.

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

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

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

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

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

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

90 In my view it is appropriate to amend the proposed release to expressly comply with section 5. 1(2) of the CCAA and

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

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

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

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

3. Fair and Reasonable

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

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

95 The legislation, while conferring broad discretion on the court, offers little guidance. However, the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and, in many instances, a much broader constituency of affected persons. Parliament has recognized that reorganization, if commercially feasible, is in most cases preferable, economically and socially, to liquidation: *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), [1989] 2 W.W.R. 566 (Alta. Q.B.) at 574; *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, [1989] 3 W.W.R. 363 (B.C. C.A.) at 368.

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

a. The composition of the unsecured vote;

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2000 CarswellAlta 662, 2000 ABQB 442, [2000] A.W.L.D. 654, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201, [2000] A.J. No. 771, 98 A.C.W.S. (3d) 334

b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;

c. Alternatives available to the Plan and bankruptcy;

d. Oppression;

e. Unfairness to Shareholders of CAC; and

f. The public interest.

a. Composition of the unsecured vote

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

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

98 However, given the manner of voting under the CCAA, the court must be cognizant of the treatment of minorities within a class: see for example *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.) and *Re Alabama, New Orleans, Texas & Pacific Junction Railway* (1890), 60 L.J. Ch. 221 (Eng. C.A.). The court can address this by ensuring creditors' claims are properly classified. As well, it is sometimes appropriate to tabulate the vote of a particular class so the results can be assessed from a fairness perspective. In this case, the classification was challenged by Resurgence and I dismissed that application. The vote was also tabulated in this case and the results demonstrate that the votes of Air Canada and the Senior Secured Noteholders, who voted their deficiency in the unsecured class, were decisive.

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

1. For the resolution to approve the Plan: 73 votes (65% in number) representing $494,762,304 in claims (76% in value);

2. Against the resolution: 39 votes (35% in number) representing $156,360,363 in claims (24% in value); and

3. Abstentions: 15 representing $968,036 in value.

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

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

102 In *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 192-3 aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), dissenting priority mortgagees argued the plan violated the principle of equality due to an agreement between

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the debtor company and another priority mortgagee which essentially amounted to a preference in exchange for voting in favour of the plan. Trainor J. found that the agreement was freely disclosed and commercially reasonable and went on to approve the plan, using the three part test. The British Columbia Court of Appeal upheld this result and in commenting on the minority complaint McEachern J.A. stated at page 206:

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

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

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

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

106 The authorities which address minority creditors' complaints speak of "substantial injustice" (*Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.), "confiscation" of rights (*Re Campeau Corp.* (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.); *Re SkyDome Corp.* (March 21, 1999), Doc. 98-CL-3179 (Ont. Gen. Div. [Commercial List])) and majorities

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"feasting upon" the rights of the minority (*Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.). Although it cannot be disputed that the group of Unsecured Noteholders represented by Resurgence are being asked to accept a significant reduction of their claims, as are all of the affected unsecured creditors, I do not see a "substantial injustice", nor view their rights as having been "confiscated" or "feasted upon" by being required to succumb to the wishes of the majority in their class. No bad faith has been demonstrated in this case. Rather, the treatment of Resurgence, along with all other affected unsecured creditors, represents a reasonable balancing of interests. While the court is directed to consider whether there is an injustice being worked within a class, it must also determine whether there is an injustice with respect the stakeholders as a whole. Even if a plan might at first blush appear to have that effect, when viewed in relation to all other parties, it may nonetheless be considered appropriate and be approved: *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 1 (Ont. Gen. Div.) and *Re Northland Properties Ltd., supra* at 9.

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

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

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

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

b. Receipts on liquidation or bankruptcy

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

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

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

114 While there were numerous questions to which the Monitor was asked to respond, there were several areas in which Resurgence and the Minority Shareholders took particular issue: pension plan surplus, CRAL, international routes and tax pools. The dissenting groups asserted that these assets represented overlooked value to the company on a liquidation basis or on a going concern basis.

Pension Plan Surplus

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

1) The summaries of the solvency surplus/deficit positions indicated a cumulative net deficit position for the seven registered plans, after consideration of contingent liabilities;

2) The possibility, based on the previous splitting out of the seven plans from a single plan in 1988, that the plans could be held to be consolidated for financial purposes, which would remove any potential solvency surplus since the total estimated contingent liabilities exceeded the total estimated solvency surplus;

3) The actual calculations were prepared by CAIL's actuaries and actuaries representing the unions could conclude liabilities were greater; and

4) CAIL did not have a legal opinion confirming that surpluses belonged to CAIL.

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

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

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

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

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

CRAL

121 The Monitor's liquidation analysis as at March 31, 2000 of CRAL determined that in a distress situation, after payments were made to its creditors, there would be a deficiency of approximately $30 million to pay Canadian Regional's unsecured creditors, which include a claim of approximately $56.5 million due to Canadian. In arriving at this conclusion, the Monitor reviewed internally prepared unaudited financial statements of CRAL as of March 31, 2000, the Houlihan Lokey

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Howard and Zukin, distress valuation dated January 21, 2000 and the Simat Helliesen and Eichner valuation of selected CAIL assets dated January 31, 2000 for certain aircraft related materials and engines, rotables and spares. The Avitas Inc., and Avmark Inc. reports were used for the distress values on CRAL's aircraft and the CRAL aircraft lease documentation. The Monitor also performed its own analysis of CRAL's liquidation value, which involved analysis of the reports provided and details of its analysis were outlined in the Liquidation Analysis.

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

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

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

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

International Routes

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

127 Evidence was led that on June 23, 1999 Air Canada made an offer to purchase CAIL's international routes for $400 million cash plus $125 million for aircraft spares and inventory, along with the assumption of certain debt and lease obligations for the aircraft required for the international routes. CAIL evaluated the Air Canada offer and concluded that the proposed purchase price was insufficient to permit it to continue carrying on business in the absence of its international routes. Mr. Carty testified that something in the range of $2 billion would be required.

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

129 Resurgence complained that despite this evidence of offers for purchase and actual sales of international routes and other evidence of sales of slots, the Monitor did not include Canadian's international routes in the Liquidation Analysis and only attributed a total of $66 million for all intangibles of Canadian. There is some evidence that slots at some foreign airports may be bought or sold in some fashion. However, there is insufficient evidence to attribute any value to other slots which CAIL has at foreign airports. It would appear given the regulation of the airline industry, in particular, the *Aeronautics*

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Act and the *Canada Transportation Act*, that international routes for a Canadian air carrier only have full value to the extent of federal government support for the transfer or sale, and its preparedness to allow the then-current license holder to sell rather than act unilaterally to change the designation. The federal government was prepared to allow CAIL to sell its Toronto — Tokyo route to Air Canada in light of CAIL's severe financial difficulty and the certainty of cessation of operations during the Christmas holiday season in the absence of such a sale.

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

Tax Pools

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

Capital Loss Pools

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

Undepreciated capital cost ("UCC")

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

Operating Losses

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

Fuel tax rebates

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

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

c. Alternatives to the Plan

137 When presented with a plan, affected stakeholders must weigh their options in the light of commercial reality. Those options are typically liquidation measured against the plan proposed. If not put forward, a hope for a different or more favourable plan is not an option and no basis upon which to assess fairness. On a purposive approach to the CCAA, what is fair and reasonable must be assessed against the effect of the Plan on the creditors and their various claims, in the context of their response to the plan. Stakeholders are expected to decide their fate based on realistic, commercially viable alternatives (generally seen as the prime motivating factor in any business decision) and not on speculative desires or hope for the future. As Farley J. stated in *T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 6:

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

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

d. Oppression

Oppression and the CCAA

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

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

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

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

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

143 Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: *Royal Oak Mines Ltd., supra*, para. 4., *Re Cadillac Fairview Inc.* (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), and *T. Eaton Company, supra.*

144 To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.

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

Oppression allegations by Resurgence

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

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

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

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

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

151 Next, Air Canada made it clear beginning in the fall of 1999 that Canadian would have to complete a financial restructuring so as to permit Air Canada to acquire CAIL on a financially sound basis and as a wholly owned subsidiary. Following the implementation of the moratorium, absent which Canadian could not have continued to operate, Canadian and Air Canada commenced efforts to restructure significant obligations by consent. They perceived that further damage to public confidence that a CCAA filing could produce, required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection. Before the Petitioners started the CCAA proceedings on March 24, 2000, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

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

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

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

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

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

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

12 to 14 cents on the dollar.

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

e. Unfairness to Shareholders

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

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

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

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

163 The Minority Shareholders base their expectation to remain as shareholders on the actions of Air Canada in acquiring only 82% of the CAC shares before integrating certain of the airlines' operations. Mr. Baker (who purchased *after* the Plan was filed with the Court and almost six months after the take over bid by Air Canada) suggested that the contents of the bid circular misrepresented Air Canada's future intentions to its shareholders. The two dollar price offered and paid per share in the bid must be viewed somewhat skeptically and in the context in which the bid arose. It does not support the speculative view that some shareholders hold, that somehow, despite insolvency, their shares have some value on a going concern basis. In any event, any claim for misrepresentation that Minority Shareholders might have arising from the take over bid circular against Air Canada or 853350, if any, is unaffected by the Plan and may be pursued after the stay is lifted.

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

165 The Minority Shareholders raise concerns about assets that are ascribed limited or no value in the Monitor's report as

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does Resurgence (although to support an opposite proposition). Considerable argument was directed to the future operational savings and profitability forecasted for Air Canada, its subsidiaries and CAIL and its subsidiaries. Mr. Peterson estimated it to be in the order of $650 to $800 million on an annual basis, commencing in 2001. The Minority Shareholders point to the tax pools of a restructured company that they submit will be of great value once CAIL becomes profitable as anticipated. They point to a pension surplus that at the very least has value by virtue of the contribution holidays that it affords. They also look to the value of the compromised claims of the restructuring itself which they submit are in the order of $449 million. They submit these cumulative benefits add value, currently or at least realizable in the future. In sharp contrast to the Resurgence position that these acts constitute oppressive behaviour, the Minority Shareholders view them as enhancing the value of their shares. They go so far as to suggest that there may well be a current going concern value of the CAC shares that has been conveniently ignored or unquantified and that the Petitioners must put evidence before the court as to what that value is.

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

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

168 The Minority Shareholders' submission attempts to compare and contrast the rights and expectations of the CAIL preferred shares as against the CAC common shares. This is not a meaningful exercise; the Petitioners are not submitting that the Preferred Shares have value and the evidence demonstrates unequivocally that they do not. The Preferred Shares are merely being utilized as a corporate vehicle to allow CAIL to become a wholly owned subsidiary of Air Canada. For example, the same result could have been achieved by issuing new shares rather than changing the designation of 853350's Preferred Shares in CAIL.

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

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

e. The Public Interest

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

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

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

173 In *Re Repap British Columbia Inc.* (1998), 1 C.B.R. (4th) 49 (B.C. S.C.) the court noted that the fairness of the plan must be measured against the overall economic and business environment and against the interests of the citizens of British Columbia who are affected as "shareholders" of the company, and creditors, of suppliers, employees and competitors of the company. The court approved the plan even though it was unable to conclude that it was necessarily fair and reasonable. In *Re Quintette Coal Ltd., supra*, Thackray J. acknowledged the significance of the coal mine to the British Columbia economy, its importance to the people who lived and worked in the region and to the employees of the company and their families. Other cases in which the court considered the public interest in determining whether to sanction a plan under the CCAA include *Re Canadian Red Cross Society / Société Canadienne de la Croix-Rouge* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) and *Algoma Steel Corp. v. Royal Bank* (April 16, 1992), Doc. Toronto B62/91-A (Ont. Gen. Div.)

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

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

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

177 The representations of the Government of Canada are also compelling. Approximately one year ago, CAIL approached the Transport Department to inquire as to what solution could be found to salvage their ailing company. The Government saw fit to issue an order in council, pursuant to section 47 of the *Transportation Act*, which allowed an opportunity for CAIL to approach other entities to see if a permanent solution could be found. A standing committee in the House of Commons reviewed a framework for the restructuring of the airline industry, recommendations were made and undertakings

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were given by Air Canada. The Government was driven by a mandate to protect consumers and promote competition. It submitted that the Plan is a major component of the industry restructuring. Bill C-26, which addresses the restructuring of the industry, has passed through the House of Commons and is presently before the Senate. The Competition Bureau has accepted that Air Canada has the only offer on the table and has worked very closely with the parties to ensure that the interests of consumers, employees, small carriers, and smaller communities will be protected.

178 In summary, in assessing whether a plan is fair and reasonable, courts have emphasized that perfection is not required: see for example *Re Wandlyn Inns Ltd.* (1992), 15 C.B.R. (3d) 316 (N.B. Q.B.), *Quintette Coal*, *supra* and *Repap*, *supra*. Rather, various rights and remedies must be sacrificed to varying degrees to result in a reasonable, viable compromise for all concerned. The court is required to view the "big picture" of the plan and assess its impact as a whole. I return to *Algoma Steel v. Royal Bank*, *supra* at 9 in which Farley J. endorsed this approach:

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

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

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

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

IV. Conclusion

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

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

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

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

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

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Application granted; counter-applications dismissed.

FN* Leave to appeal refused 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, [2000] 10 W.W.R. 314, 2000 ABCA 238, 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]).

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TAB 6

1992 CarswellOnt 163, 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303

Algoma Steel Corp. v. Royal Bank

ALGOMA STEEL CORPORATION, LIMITED v. ROYAL BANK OF CANADA, MONTREAL TRUST COMPANY (Trustee of certain debentures issued by Algoma Steel Corporation, Limited under a certain trust indenture) and ROYAL BANK OF CANADA, CANADIAN IMPERIAL BANK OF COMMERCE, HONGKONG BANK OF CANADA, and TORONTO DOMINION BANK (in their capacity as holders of certain of the debentures issued pursuant to said trust indenture)

Ontario Court of Appeal

Krever, McKinlay and Labrosse JJ.A.

Heard: April 21-23, 1992
Judgment: April 30, 1992
Docket: Doc. CA C11707

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Counsel: *D.J.T. Mungovan* and *Debbie A. Campbell* , for Kelsey-Hayes Canada Limited and Kelsey-Hayes Company.

M.E. Royce and *M.E. Barrack* , for Algoma Steel Corporation, Limited.

W.L.N. Somerville, Q.C. , and *B.H. Bresner* , for Royal Insurance Company of Canada.

R.N. Robertson, Q.C. , and *W.A. Apps* , for Dofasco Inc.

Subject: Corporate and Commercial; Insolvency

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

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

One of the creditors of the debtor company subject to a plan of arrangement under the *Companies' Creditors Arrangement Act* ("CCAA"), was involved in product liability litigation in the U.S. The creditor, the defendant in the U.S. litigation, alleged that the steel used in the defective part was a defective product manufactured by the debtor company. The creditor sought to claim contribution or indemnity from the debtor company in order to be able to pursue, under s. 132 of the *Insurance Act* (Ont.), the proceeds of the debtor company's product liability insurance policy.

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After the creditor notified the debtor company of its claim, the debtor company responded by valuing the claim at one dollar. The creditor applied to the court, under s. 12(2)(iii) of the CCAA, for a determination of the amount of its claim. The value of the claim was confirmed.

In the CCAA proceedings, an order was made prohibiting the commencement or proceeding with any action or proceeding against the debtor company without leave of the court. The creditor brought a motion for leave to appeal and, if granted, an appeal from the order dismissing its motion for the valuation of its claim and for leave to bring proceedings against the debtor company.

Held:

Leave to appeal was granted and the appeal was allowed; leave to proceed granted.

Generally, a plan of arrangement is consensual and the result of agreement. If it is fair and reasonable, according to the court, it is not to be interfered with by the court unless (a) the CCAA authorizes the court to affect the plan and (b) there are compelling reasons justifying the court's action. The court should not interfere where to do so would prejudice the interests of the company or the creditors. Where no prejudice would result and the needs of justice are to be met, the court may act if the CCAA authorizes intervention. Section 11(*c*), depending on the language of the plan itself, enables the court, in an appropriate case, to amend the plan.

In this case, the necessary amendment to the plan would be minor. Further, to secure the integrity of the plan, only insurance proceeds that might become available to the debtor company were to be the subject of any recovery against the company to which the creditor might prove entitlement. To accomplish this, the order provided that neither the assets of the debtor company (other than the insurance proceeds), nor the assets of any other company that might become responsible for the liabilities of the debtor under the plan would be available to satisfy any judgment obtained by the creditor against the debtor company.

Statutes considered:

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

s. 11(c)

s. 12(2)(a)(iii)

Insurance Act, R.S.O. 1990, c. I.8 —

s. 132

s. 132(1)

Motion for leave to appeal and an appeal under the *Companies' Creditors Arrangement Act* .

Per curiam:

1 This is a motion for leave to appeal and, if leave is granted, an appeal, under the provisions of the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36 (the "C.C.A.A."), from the order of Farley J. dismissing a motion for the valuation of the claim of Kelsey-Hayes Canada Limited ("Kelsey-Hayes") and for leave to bring proceedings against The Algoma Steel Corporation Limited ("Algoma"), the subject of a plan of arrangement under the C.C.A.A.

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2 Kelsey-Hayes is involved in product-liability litigation in Missouri as a result of serious personal injuries suffered by a child when a wheel broke away from a Dodge truck and struck him. The wheel was manufactured by Kelsey-Hayes, against whom a Missouri jury awarded a verdict in excess of $4 million U.S. That verdict was set aside by the trial judge on the basis that Chrysler Corporation, the truck's manufacturer, had been improperly dismissed from the action at an earlier stage. The setting aside of the verdict was appealed to the Missouri Court of Appeals, but judgment on the appeal has been reserved. Kelsey-Hayes, the defendant in the Missouri litigation, alleges that the steel used for the manufacture of the errant wheel was a defective product of Algoma and seeks to claim contribution or indemnity from Algoma in order to be able to pursue, under s. 132 of the *Insurance Act* , R.S.O. 1990, c. I.8, the proceeds of a product-liability insurance policy by which Algoma is insured by the Royal Insurance Company of Canada ("Royal"). It also seeks relief under the plan of arrangement in respect of the amount of any liability Algoma may have to it in excess of the policy limits.

3 In the C.C.A.A. proceedings, an order was made by Montgomery J. in the terms of s. 11(*c*) of the C.C.A.A. that no action or other proceeding may be proceeded with or commenced against Algoma except with the leave of the court. It is common ground that Kelsey-Hayes, by reason of its claim against Algoma, is a known designated unsecured creditor of Algoma, as defined in the plan of arrangement. The plan of arrangement, which has been voted on by all classes of affected creditors, and sanctioned, subject to the outcome of this appeal, by an order of Farley J. dated April 26, 1992, provides that upon payment by Algoma to a trustee of a certain sum in payment of the claims of the specified unsecured creditors, "all Claims of Specified Unsecured Creditors will be released, discharged and cancelled."

4 After Kelsey-Hayes notified Algoma of the litigation in Missouri, of its allegation of defective steel against Algoma, and of its claim in the amount of the Missouri verdict, Algoma responded by valuing the claim at the sum of $1. Kelsey-Hayes thereupon applied to the court, under the provisions of s. 12(2)(*a*)(iii) of the C.C.A.A., for the determination of the amount of its claim. Before the application was heard, Kelsey-Hayes enlarged the relief sought to include that described above and Royal was brought into the proceedings. Mr. Justice Farley held that he had no authority to permit Kelsey-Hayes to proceed against Algoma and went on to confirm the valuation of the claim at $1. The essential issue in this appeal is whether, under the C.C.A.A., the fact that the plan of arrangement now exists prevents the court from permitting Algoma from being proceeded against by Kelsey-Hayes even to the limited extent of the insurance proceeds.

5 We are of the view that, however weak the evidence available on the application may have been with respect to the origin of the steel used in the manufacture of the wheel, and thus the case against Algoma, it cannot be said that the case is without any foundation or is frivolous. The fact that s. 12(2)(iii) provides that the amount of a creditor's claim, if not admitted by the company, "shall be determined by the court on summary application by the company or by the creditor," does not compel the court to determine the valuation summarily. The provision simply authorizes the proceedings to be brought summarily, that is, by way of originating notice of motion or application rather than by the lengthier, and more complicated, procedure of an action. In an appropriate case, therefore, there is no reason why the determination cannot be made after a trial either of an issue or an action, in the course of which production and discovery would be available. In the absence of such a trial, it cannot be said, in our view, that the valuation of the claim of Kelsey-Hayes against Algoma in the sum of $1 is correct.

6 The more difficult question is whether the court has jurisdiction to authorize proceedings now that the plan of arrangement is in place. It is submitted that it does not, because of the need for commercial certainty and because to do so would be to amend the plan of arrangement (which extinguishes the claims of all designated unsecured creditors, of which Kelsey-Hayes is certainly one). The plan of arrangement is a matter of contract, it is argued, and the court's jurisdiction is limited to sanctioning or refusing to sanction the arrangement arrived at contractually. There is much merit in this argument, but, in our view, it is not a complete answer.

7 Kelsey-Hayes does not deny that if the language of the plan of arrangement quoted above, extinguishing the

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claims of designated unsecured creditors, is unambiguous, as we believe it is, to grant the relief which it seeks would require an amendment by the court of the plan of arrangement. We accept the submission that, generally speaking, the plan of arrangement is consensual and the result of agreement and that if it is fair and reasonable (an issue for the court to decide) it is not to be interfered with by the court unless (a) the Act authorizes the court to affect the plan and (b) there are compelling reasons justifying the court's action. Generally speaking again, the court ought not to interfere where to do so would prejudice the interests of the company or the creditors. But where no prejudice would result and the needs of justice are to be met, the court may act if the C.C.A.A., properly interpreted, authorizes intervention. In this connection, it may be relevant that, although it is hardly conclusive, Algoma's management information circular to creditors, shareholders and employees, which accompanied the proposed plan of arrangement, advised those persons, under the heading "Court Approval of the Plan" as follows:

> The authority of the Court is very broad under both the CCAA and the OBCA — Algoma has been advised by counsel that the Court will consider, among other things, the fairness and reasonableness of the Plan. The Court may approve the Plan as proposed *or as amended in any manner that the Court may direct* and subject to compliance with such terms and conditions, if any, as the Court thinks fit.

[Emphasis added.] We agree that the circular's statement that the court may direct an amendment of the plan does not, as a matter of law, make it so. The C.C.A.A. must be the authority for the jurisdiction and the critical issue is whether there is any provision in the Act that fairly gives rise to a power in the court to amend. In our view, there is such a provision and that provision, s. 11(*c*), depending on the language of the plan itself, may by necessary inference, in an appropriate case, enable the court to make an order, the technical effect of which is that the plan is amended. The relevant portion of the section reads as follows:

> whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> . . . . .
>
> (*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company *except with the leave of the court* and subject to such terms as the court imposes.

[Emphasis added.]

8 As we have already pointed out, an order in the terms of this provision was made early in the proceedings by Montgomery J. The effect of the enactment and the order is to empower the court to grant leave to take proceedings against Algoma in appropriate circumstances. It was submitted that this power, having regard to the commercial realities reflected by the C.C.A.A., is one that may be exercised only before the creditors have voted to accept the plan of arrangement. No authority could be cited to support such a circumscription of the court's jurisdiction, unqualifiedly conferred by the statute. Nor, as a matter of principle, is there any reason to suggest that the scheme created by the C.C.A.A. contemplates a role for the court as a mere rubber stamp or one that is simply administrative rather than judicial. On the other hand, we have no doubt that, given the primacy accorded by the Act to agreement among the affected actors, the jurisdiction of the court is to be exercised sparingly and in exceptional circumstances only, if the result of the exercise is to amend the plan, even in merely a technical way. In this case, for example, it would be an unacceptable exercise of jurisdiction if the effect of granting leave to Kelsey-Hayes to proceed against Algoma would be to render vulnerable to possible execution any assets other than insurance proceeds, if any, that may be available under the policy by which Royal insured Algoma against product liability. If the leave granted could be so limited, and that is the difficulty that must be addressed, the plan of arrangement which, in its terms, extinguishes the claims of designated unsecured creditors, would undergo amendment in an insignificant and technical way only, as far as the other creditors are concerned.

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9 The concern of prejudice must now be considered and the question asked whether any interests would be affected detrimentally if Kelsey-Hayes were permitted to claim against Algoma to the extent only of recourse to the insurance proceeds. If to give leave had the effect of giving potential access to assets over and above the policy limits, there would indeed be prejudice to several interests and, moreover, the plan of arrangement would be significantly amended. On the premise that only the insurance proceeds were to be made potentially available to satisfy any judgment that Kelsey-Hayes may be awarded in its claim over against Algoma, it cannot be said that any interest is affected adversely except possibly that of Royal and that of Dofasco Inc. ("Dofasco"). It is to that issue that we now turn.

10 The potential liability of Royal to Kelsey-Hayes as insurer of Algoma arises out of the provisions of s.132(1) of the *Insurance Act* , which read as follows:

> Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against the person in respect of the person's liability, and an execution against the person in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.

Royal is potentially answerable to Kelsey-Hayes, a third party with respect to Algoma's policy of insurance only by virtue of this statutory provision but, in any third party claim against it, its liability is "subject to the same equities as the insurer would have if the judgment had been satisfied." Prejudice, in a legal sense, as far as Royal is concerned is non-existent.

11 The question of prejudice to Dofasco is more difficult. Its interest arises in this way. As part of the comprehensive restructuring scheme, of which the plan of arrangement is the central part, Algoma's assets are to be transferred to a new corporate entity, referred to in argument as New Algoma, in which Algoma's shareholders and creditors (whose claims are being compromised and otherwise discharged) are to receive shares. The funds to make this possible are to be supplied by Dofasco in the sum of $30 million. In return, Dofasco is to obtain Algoma's tax loss in the sum of $150 million. The result of these transactions as contemplated by the comprehensive scheme is that Algoma is to become devoid of assets and creditors, in short, that Algoma is to be made a "clean corporation," or a mere shell with a tax loss carryforward. Dofasco filed no material, and on the appeal filed no factum, showing any prejudice which it might suffer if leave to proceed is granted. Instead, in oral argument, it submitted that any such order would impair the integrity of the plan of arrangement and reduce the certainty that was necessary for the plan's success. In our view, no impairment will occur if an order is made subject to sufficient safeguards to limit any possible recovery to the insurance proceeds. We think a safeguard can be provided. The difficulty is in the language of s. 132 of the *Insurance Act* , which requires, as a condition precedent to a direct action against the insurer, that an execution against the insured be returned unsatisfied.

12 This very requirement makes the purpose of the section clear. It is to provide direct access to an insurer, by a person incurring the liability referred to in the section, in a situation where the insured is judgment proof, thus circumventing the normal operation of insurance contracts, which is solely to indemnify the insured against loss. To interpret the section in such a way as to apply only in the narrow situation where the insured is judgment proof (and therefore almost certainly insolvent), but not in situations where either the insured or its creditors have taken proceedings pursuant to federal insolvency statutes, would be to frustrate its objectives in a large percentage of situations where it would otherwise apply.

13 If the plaintiff in this case were successful in the Missouri action against Kelsey-Hayes and Kelsey-Hayes were successful in a permitted claim over for indemnity or contribution from Algoma, there could be no question that, notionally, the condition precedent of an unsatisfied judgment would be met because, prior to the plan, Algoma was insolvent and the commencement of proceedings under the C.C.A.A. rendered it judgment proof. To secure the certainty of the integrity of the plan, which Dofasco argues it needs in order to discharge its role in the scheme, we

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make clear our intention that only any insurance proceeds that may become available to Algoma are to be the subject of any recovery against Algoma that Kelsey-Hayes may prove that it is entitled to. That is to be accomplished by providing in our order that neither the assets of Algoma (other than the insurance proceeds) nor the assets of any other corporation which may become responsible in any way for any liabilities of Algoma by virtue of the operation of the plan of arrangement or the more comprehensive scheme of restructuring, or any condition precedent thereto, shall be available to satisfy any judgment obtained as a result of any proceedings by Kelsey-Hayes against Algoma.

14 The justice of permitting an amendment to the plan as inconsequential as the one we permit in these exceptional circumstances is illustrated by the hypothetical case put in argument. Suppose a visitor had become quadriplegic as a result of an injury on the premises of Algoma under circumstances in which Algoma as occupier might be liable and suppose Algoma's potential liability was insured against by an appropriate insurance policy. To restrict the injured person, a known designated unsecured creditor under the terms of the plan of arrangement, to his or her compromised claim valued, without a trial, in a summary proceeding, would, in our view, be unacceptable. The actual situation before the court is analogous.

15 For these reasons, we grant leave to appeal, allow the appeal, set aside the order of Farley J. dated April 9, 1992, and grant leave to Kelsey-Hayes to proceed as it may be advised in the terms set out above.

Leave to appeal granted; appeal allowed; leave to proceed granted.

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TAB 7

1984 CarswellBC 588, 54 C.B.R. (N.S.) 28, 56 B.C.L.R. 342, [1984] 6 W.W.R. 435

Major, Re

Re MAJOR

British Columbia Supreme Court

Wood J.

Heard: August 22 and 30, 1984
Judgment: September 7, 1984
Judgment: August 30, 1984
Docket: Vancouver No. 1188/84

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Counsel: *A.S. Angus*, for applicants Pannu.

P.J. Stanford, for respondents trustee in bankruptcy and Gestas Corporation Ltd.

J.D. Truscott, for Law Society of British Columbia, intervener.

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

Bankruptcy --- Property of bankrupt — Choses in action — Insurance policies of bankrupt — Liability insurance.

Practice --- Judgments and orders — Declaratory judgments or orders — Availability — General.

Property of bankrupt — Assets vesting in trustee — Insurance policies and claims — Proceeds of solicitor's professional liability insurance — Applicants suing solicitor for breach of fiduciary duty — Solicitor's assignment into bankruptcy not affecting beneficial interest of third parties under insurance policy — Applicants obtaining declaration that liability insurance proceeds payable to them, not to bankrupt's estate, in event action successful.

The applicants were plaintiffs in an action in which they claimed damages for breach of a fiduciary duty alleged to have been owed to them by the bankrupt when he acted as their solicitor in a real estate transaction. The solicitor made an assignment for the general benefit of creditors, however there were no funds in the bankrupt estate available for distribution to the unsecured creditors. The applicants sought an order pursuant to s. 49 of the Bankruptcy Act permitting them to continue the action against the bankrupt, and also sought a declaration that they, not the bankrupt's estate, should enjoy the benefit of a policy of professional liability insurance issued to the Law Society of British Columbia in the event that they either settled their action or obtained judgment against the bankrupt at trial. The trustee of the bankrupt estate argued that the application for declaratory relief was premature or, in the alterna-

tive, that the bankrupt's estate was entitled to any proceeds payable under the policy.

Held:

Declaration granted.

The applicants were entitled to know whether the judgment sought against the bankrupt, if obtained, would result in anything more than symbolic relief, and the early determination of that issue was of great practical importance. The declaratory relief sought was not premature and the court had the discretion to grant such relief if the applicants were otherwise entitled to it. To permit the estate of the bankrupt to receive the proceeds of the insurance policy would result in an injustice to the applicants for whose benefits one would have expected that the insurance policy was intended. Such an undesirable result was avoided by the express wording of the insuring agreement. The interests of justice and the spirit of the agreement demanded that the applicants should have the declaration they sought. The beneficial interest of a third party under an insurance policy which can be enforced against an insurer in a court of equity, cannot be effected by the assignment into bankruptcy of the insured who had no proprietary interest in the proceeds of that insurance. The applicants were entitled to solicitor-and-client costs against the trustee and, if the estate of the bankrupt did not have sufficient funds to meet those costs, they were to be paid by the trustee personally.

Cases considered:

Employer's Liability Assur. Corp. v. Lefaivre, [1930] S.C.R. 1, 11 C.B.R. 290, [1930] 1 D.L.R. 689 — *applied*

Gandy v. Gandy (1885), 30 Ch. D. 57 (C.A.) — *applied*

Harrington Motor Co., Re; Ex parte Chaplin, [1928] Ch. 105 (C.A.) — *considered*

Post Office v. Norwich Union Fire Ins. Soc., [1967] 2 Q.B. 363, [1967] 2 W.L.R. 709, [1967] 1 All E.R. 577 (C.A.) — *considered*

Prov. Treas. for Man. v. Min. of Fin. for Can.; A.G. Man. v. Min. of Fin. for Can., [1943] S.C.R. 370, 24 C.B.R. 320, [1943] 3 D.L.R. 673 — *referred to*

Solosky v. R., [1980] 1 S.C.R. 821, 16 C.R. (3d) 294, 50 C.C.C. (2d) 495, 105 D.L.R. (3d) 745, 30 N.R. 380, affirming [1978] 2 F.C. 632, 41 C.C.C. (2d) 49, 86 D.L.R. (3d) 316, 22 N.R. 34 — *applied*

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3, s. 49.

Rules considered:

British Columbia Supreme Court Rules, Sched. C.

Application for ordering continuing action against bankrupt solicitor and for declaration of entitlement to proceeds of bankrupt's professional liability insurance.

***Wood J.* (Memorandum to counsel):**

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1 This matter originally came on for hearing before me on 22nd August 1984 in the presence of counsel for the applicants and the respondents, the trustee in bankruptcy and the Gestas Corporation, both of whom were represented by the same counsel. After some argument, I became concerned that the application raised issues of some considerable importance and concern for the Law Society of British Columbia. I directed that proceedings be adjourned and that counsel contact the law society with my invitation to intervene should it see fit. I also expressed concern that the interests of the respondent trustee and the respondent insurer were sufficiently in conflict that they should not be represented by the same counsel.

2 The application was reconvened on 30th August 1984 with counsel for the intervenor law society present. At the close of argument on that day I delivered judgment orally, granting the applicants the relief requested. The attached are my reasons as requested by counsel.

***Wood J.* (orally):**

3 The applicants Sarjit Singh Pannu and Gurdev Kaur Pannu are the plaintiffs in an action commenced in this court on 12th March 1982 by which they claim damages for breach of a fiduciary duty said to have been owed to them by the bankrupt when he acted as their solicitor in a real estate transaction in 1976. They seek an order, pursuant to s. 49 of the Bankruptcy Act, R.S.C. 1970, c. B-3, permitting them to continue the action against the bankrupt who made an assignment for the general benefit of creditors on 20th July 1984. That application is not opposed.

4 They also seek a declaration that they, and not the estate of the bankrupt, should enjoy the benefit of a policy of professional liability insurance issued to the Law Society of British Columbia (the "named insured") by a consortium of underwriters managed by the Gestas Corporation Ltd. (the "insurer"), in the event that they either reach a compromise settlement of their action or obtain judgment against the bankrupt at trial.

5 A trustee in bankruptcy opposes the second application on two grounds. As a preliminary objection, it is argued that the application for declaratory relief should be dismissed as being premature. Alternatively, on the substantive issue, the trustee argues that the estate of the bankrupt is entitled to whatever proceeds may become payable by virtue of the terms of the policy of insurance in question.

6 I shall deal first with the argument that the application for declaratory relief is premature. The trial of the plaintiffs' action is set to commence on 3rd October 1984. The trustee says that until the plaintiffs have judgment in that action, the insurer is under no obligation to pay in accordance with the terms of the policy. Any dispute over who should have the benefit of the policy is thus contingent upon the outcome of the litigation, and it is argued that declaratory relief should not be granted when the dispute which it seeks to set at rest has not yet arisen and may not, in fact, arise.

7 There are no funds in the bankrupt's estate available for distribution to the unsecured creditors, whose claims presently exceed $131,000. The trial of the action against the bankrupt is expected to last three to four days and will involve considerable expense for the plaintiffs, who are people of limited means. They cannot afford to pursue their right of action against the bankrupt if the only result will be to benefit the unsecured creditors of his estate.

8 In *Solosky v. R.*, [1980] 1 S.C.R. 821, 16 C.R. (3d) 294, 50 C.C.C. (2d) 495, 105 D.L.R. (3d) 745, 30 N.R. 380, the appellant, who was an inmate of a federal penitentiary, sought a declaration that future correspondence between himself and his solicitor be delivered without being opened or read by prison staff engaged in the censorship of inmate correspondence pursuant to regulations [Penitentiary Service Regulations, C.R.C. 1978 c. 1251] promulgated under the Penitentiary Act, R.S.C. 1970, c. P-6. The Federal Court of Appeal [[1978] 2 F.C. 632, 41 C.C.C. (2d) 49, 86 D.L.R. (3d) 316, 22 N.R. 34] held, inter alia, that to make such an order with respect to correspondence not yet written would be to grant declaratory relief with respect to an issue the future existence of which was purely

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hypothetical.

9 An appeal was taken to the Supreme Court of Canada. In speaking to this issue for the court, Dickson J., as he then was, said, at pp. 830-31:

> Declatory relief is a remedy neither constrained by form nor bounded by substantive content, which avails persons sharing a legal relationship, in respect of which a "real issue" concerning the relative interests of each has been raised and falls to be determined.
>
> The principles which guide the court in exercising jurisdiction to grant declarations have been stated time and again. In the early case of *Russian Commercial and Industrial Bank v. British Bank for Foreign Trade Ltd.*, [1921] 2 A.C. 438, in which parties to a contract sought assistance in construing it, the Court affirmed that declarations can be granted where real, rather than fictitious or academic, issues are raised. Lord Dunedin set out this test (at p. 448):
>
> > The question must be a real and not a theoretical question, the person raising it must have a real interest to raise it, he must be able to secure a proper contradictor, that is to say, someone presently existing who has a true interest to oppose the declaration sought.
>
> In *Pyx Granite Co. Ltd. v. Ministry of Housing and Local Government*, [1958] 1 Q.B. 554, (rev'd [1960] A.C. 260, on other grounds), Lord Denning described the declaration in these general terms (p. 571):
>
> > ... if a substantial question exists which one person has a real interest to raise, and the other to oppose, then the court has a discretion to resolve it by a declaration, which it will exercise if there is good reason for so doing.
>
> The jurisdiction of the court to grant declaratory relief was again stated, in the broadest language, in *Pharmaceutical Society of Great Britain v. Dickson*, [1970] A.C. 403 (H.L.), a case in which the applicant sought a declaration that a proposed motion of the pharmaceutical society, if passed, would be *ultra vires* its objects and in unreasonable restraint of trade. In the course of his judgment, Lord Upjohn stated, at p. 433:
>
> > A person whose freedom of action is challenged can always come to the court to have his rights and position clarified, subject always, of course, to the right of the court in exercise of its judicial discretion to refuse relief in the circumstances of the case.

10 In my view, these very broad descriptions of the court's discretionary jurisdiction to grant declaratory relief, adopted and applied by the Supreme Court of Canada in the above passages, are determinative of the preliminary issue raised by the trustee in this application. A substantial question exists to be determined. The applicants have a real interest in the outcome, as does the trustee. Indeed, the issue is one of public importance.

11 There is good reason to resolve the question now. The Pannus are entitled to know now whether the judgment which they seek against the bankrupt, if obtained, will result in anything more than symbolic relief. Serious settlement discussions are unlikely to take place unless and until the substantive issue raised in this application is resolved. The early determination of that issue is therefore of great practical importance.

12 I am satisfied that the declaratory relief sought is not premature, and that I have the discretion to grant such relief if the applicants are otherwise entitled to it.

13 The trustee's position is that if the applicants obtain judgment against the bankrupt they simply become unse-

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cured creditors of his estate and that the proceeds of the insurance would then form part of that estate. Reliance is placed upon the decision in *Re Harrington Motor Co.; Ex parte Chaplin*, [1928] Ch. 105 (C.A.). There the applicant had recovered judgment against the company as a result of injuries he sustained when struck by one of its vehicles. The company was insured under a policy which provided for indemnification of all sums which it became legally liable to pay in such circumstances. Before paying the applicant's judgment, however, the company went bankrupt and the insurers then paid the policy proceeds to the liquidator. The Court of Appeal upheld the trial judge, who had dismissed Chaplin's application for declaratory relief and for an order that the liquidator pay the proceeds of the policy to him. The reasons for dismissing the appeal are illustrated, in a nutshell, by the following passage from the judgment of Lord Hanworth M.R. found at pp. 113-14:

> The money which is being received and which will be distributed by the liquidator is a sum which the debtors, the company, have secured should be paid to them in certain events, but which has been secured by their own contract made with the insurance company, and not by any intervention of the creditor, Mr. Chaplin, although it was in consequence of an accident which he suffered that the loss arose, in respect of which the insurance company has made the payment.

14 Commenting on this decision 40 years later, Lord Denning M.R. in *Post Office v. Norwich Union Fire Ins. Soc.*, [1967] 2 Q.B. 363, [1967] 2 W.L.R. 709, [1967] 1 All E.R. 577 (C.A.), said at p. 373:

> In the days before the Act of 1930, when an injured person got judgment against a wrongdoer who was insured, and the wrongdoer then went bankrupt, the injured person had no direct claim against the insurance moneys. He could only prove in the bankruptcy. The insurance moneys went into the pool for the benefit of the general body of creditors: see *In Re Harrington Motor Co. Ltd. ex parte Chaplin*, [1928] 1 Ch. 105, 44 T.L.R. 58, C.A., applied in *Hood's Trustees v. Southern Union General Insurance Co. of Australasia*, [1928] 1 Ch. 793, C.A. That was so obviously unjust that Parliament intervened. In the Act of 1930 the injured person was given a right against the insurance company. Section 1 says that: "Where under any contract of insurance a person ... is insured against liabilities to third parties which he may incur," then in the event of the insured becoming bankrupt if he is an individual, or, in the case of the insured being a company, in the event of a winding-up.
>
> > if, either before or after that event, any such liability as aforesaid is incurred by the insured, his rights against the insurer under the contract in respect of the liability shall, notwithstanding anything in any Act or rule of law to the contrary, be transferred to and vest in the third party to whom the liability was so incurred.

15 The trustee argues that no similar legislation has been effected in Canada and that therefore the Court of Appeal result in the *Harrington Motor* case is determinative of the issue raised in the application before me.

16 The insuring agreement in effect in this case reads, in part, as follows:

> The *Insurers* agree with the *Named Insured*, named in the Declarations made a part thereof, and in consideration of the payment of the premium and in reliance upon the statement in the Declarations and subject to the limits of liability, exclusions, conditions and other terms of this policy:
>
> **Insuring Agreements**
>
> I. — To pay on behalf of the *Insured* all sums which the *Insured* shall become legally obligated to pay as damages because of any act or omission of the *Insured*,or of any other person for whose acts or omissions the *Insured* is legally responsible, and arising out of the performance of professional services for others in the *Insured's* capacity as a lawyer but only in his capacity as a member of the Law Society of British Columbia.

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17 The "*Insured*" to whom reference is made in this agreement includes each solicitor who is a member of the Law Society of British Columbia and who holds a valid certificate of insurance issued under the policy. It is common ground that the bankrupt was an insured under this policy at the time he acted for the applicants in 1976.

18 This agreement obligates the insurer to pay, on the insured's behalf, any claim which he may become legally liable to pay. It thus secures a benefit for third persons, such as the applicants in this case, for whom the insured performs professional services in his capacity as both a lawyer and a member of the Law Society of British Columbia.

19 A similar contract of insurance was in effect in *Employer's Liability Assur. Corp. v. Lefaivre*, [1930] S.C.R. 1, 11 C.B.R. 290, [1930] 1 D.L.R. 689. In that case the Supreme Court of Canada addressed the question of who was entitled to the proceeds of a policy of insurance taken out by an employer for the benefit of employees who were injured on the job, when that employer had made an assignment in bankruptcy after an employee was injured. The employee obtained judgment against the trustee who, in turn, brought action against the insurer, who had refused to pay anyone for reasons that do not concern the issues in this case.

20 The insuring agreement there obligated the insurer [pp. 694-95]:

> ... (a) to pay "to every person entitled to claim under the Workmen's Compensation Act promptly and in the manner therein specified, the total amount payable or such instalments as may be declared due..."
>
> ... (b) "to compensate the owner for losses suffered by him as a result of the responsibility imposed on him by law for damages resulting from injuries suffered by his employees whilst legally employed, wherever such injuries took place, provided it be within the territorial limits of the Dominion of Canada or of the United States of America."

21 The trustee's action against the insurer succeeded at trial and was upheld on appeal. In the Supreme Court of Canada, where he also succeeded, the trustee argued that the proceeds of the policy should be paid to the benefit of the bankrupt's estate. The court disagreed. Speaking for the majority, Rinfret J., as he then was, said at pp. 700-701 (translation):

> The injured Levesque was not paid. As the policy in question is one of guaranty, we believe that the intention of the contract is that the amount of the insurance should be for the benefit of the victim of the accident. We do not share the fear of the company that it may be forced to pay a second time. We believe that the right to sue, given to the employee in the case we have discussed, creates only an alternative obligation and that the company is freed from it by doing one of the two things which were the object to that contract (Civil Code, art. 1093). But the interests of justice and the spirit of the agreement in question demand that the amount of the insurance due be paid to the victim of the accident. The two parties have recognized this...
>
> Levesque was not a party to the case and so we foresee difficulties in the execution of the judgment if we order payment direct to him. But as the plaintiff is an officer of the Court, we maintain the action, declaring however that the trustee shall receive the amount for the benefit of the creditor Levesque and with instructions to hold this amount apart from the other assets of the bankrupt estate, and to hand it to Levesque.

22 To permit the estate of the bankrupt to receive the proceeds of the policy of insurance in this case would result in an injustice to the applicants, for whose benefit one would have expected that the policy was intended. The other creditors of the estate would gain a windfall from the misfortune of the applicants as a result of a policy of insurance from which no one ever intended them to benefit.

23 Fortunately, such an undesirable result is avoided by the express wording of the insuring agreement in this case. I conclude that, as in the *Employer's Liability* case, supra, this policy is worded in such a way as to evidence its

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intention that the proceeds of the insurance should be for the benefit of those who suffer a loss or damage as a result of the culpable acts or omissions of the insured. That being the case, I am bound to get effect to the conclusion of the court in the *Employer's Liability* case. To paraphrase Rinfret J., the interests of justice and the spirit of the agreement in question demand that the applicants have the declaration which they seek.

24 I am reinforced in this conclusion by those cases which hold that a third person who is not a party to a contract of indemnity or guaranty, but who has a beneficial interest thereunder as a cestui que trust, can sue in a court of equity to enforce such contract to his benefit. The rule in this regard was stated by Cotton L.J. in *Gandy v. Gandy* (1885), 30 Ch. D. 57 at 66-67 (C.A.):

> Now, of course, as a general rule, a contract cannot be enforced except by a party to the contract; and either of two persons contracting together can sue the other, if the other is guilty of a breach of or does not perform the obligation of that contract. But a third person — a person who is not a party to the contract — cannot do so. That rule, however, is subject to this exception: if the contract, although in form it is with *A.*, is intended to secure a benefit to *B.*, so that *B.* is entitled to say he has a beneficial right as *cestui que trust* under that contract; then *B.* would, in a Court of Equity, be allowed to insist upon and enforce the contract. That, in my opinion, is the way in which the law may be stated.

This statement of the law was approved by the Supreme Court of Canada in *Prov. Treas. for Man. v. Min. of Fin. for Can.; A.G. Man. v. Min. of Fin. for Can.*, [1943] S.C.R. 370, 24 C.B.R. 320, [1943] 3 D.L.R. 673, per Hudson J. at p. 378.

25 It follows that the beneficial interest of a third party under a policy of insurance, which can be enforced against an insurer in a court of equity, cannot be affected by the assignment into bankruptcy of the insured who has no proprietary interest in the proceeds of that insurance.

26 The applicants will have a declaration that they are entitled to the benefit of any moneys which may become payable, as a consequence of the pursuit of their action. No. C821214 against the bankrupt Gerald Alan Major, pursuant to a certain contract of insurance, being policy No. 077-020-477, between the Gestas Corporation as managers for the insurers named therein and the Law Society of British Columbia, as the named insured.

27 After hearing the submissions of counsel and reviewing the authorities cited by them on the matter of costs, I have decided that the applicants are entitled to solicitor/client costs against the trustee, as taxed or agreed upon, pursuant to Sched. C of the British Columbia Supreme Court Rules. This application raised a matter of considerable public importance and, although of necessity, it was brought under the bankruptcy proceedings, the issues raised are so inextricably bound up with as to be inseparable from the issues raised in the action brought against the bankrupt by the applicants. In the event that the estate of the bankrupt no longer has sufficient funds to meet these costs, I direct that they be paid by the trustee personally.

28 The Law Society of British Columbia, who supported the applicants, seeks no costs. I make no order as to the costs of the respondent insurer, who was represented throughout by counsel for the trustee.

Application allowed.

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TAB 8

2007 CarswellNS 251, 2007 NSCA 68, [2007] I.L.R. I-4601, 32 C.B.R. (5th) 1, 50 C.C.L.I. (4th) 17, 814 A.P.R. 286, 255 N.S.R. (2d) 286, 284 D.L.R. (4th) 113

Buchanan, Re

Thomas W. Buchanan and The Dominion of Canada General Insurance Company, a body corporate, and Rexel North America Inc., a body corporate under the laws of the Dominion of Canada (Appellants) v. Superline Fuels Inc. (Respondent)

Nova Scotia Court of Appeal

Cromwell, Saunders, Oland JJ.A.

Heard: October 17, 2006
Judgment: June 6, 2007
Docket: C.A. 266625, 26629, 266631, 26635

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Proceedings: affirming *Buchanan, Re* (2006), 19 C.B.R. (5th) 67, (sub nom. *Buchanan v. Superline Fuels Inc)* 240 N.S.R. (2d) 390, (sub nom. *Buchanan v. Superline Fuels Inc)* 763 A.P.R. 390, 2006 NSSC 51, 2006 CarswellNS 72 (N.S. S.C.)

Counsel: David Coles, Q.C., Brian Casey, Shelly Martin (Articled Clerk) for Appellant, Rexel North America Inc.

W. Augustus Richardson, Lisa Richards for Appellants, Buchanan, Dominion of Canada

Wendy Johnston, Q.C., Stephen Kingston for Respondent, Superline Fuels

Michael Brooker, Q.C. for Marsha Watkins (not participating)

Subject: Civil Practice and Procedure; Insolvency; Insurance; Contracts

Bankruptcy and insolvency --- Effect of bankruptcy on other proceedings — Proceedings against bankrupt — After discharge of bankrupt

Plaintiff company contracted with owner to install oil tank — Plaintiff entered into subcontract with defendant to install tank — Leak was discovered in installed tank, which plaintiff paid substantial amount of money to remedy — Plaintiff brought action against defendant and insurer — Defendant made assignment in bankruptcy — Plaintiff was granted order to continue action against defendant — Defendant was discharged — Plaintiff's application to continue action was granted — Trial judge found discharge did not affect plaintiff's right to proceed against defendant in effort to obtain judgment, which could then be enforced against insurer — Trial judge found that order entitled

plaintiff to recover proceeds of defendant's third party liability insurance only, and that plaintiff would have to file separate claim as unsecured creditor after obtaining judgment if wished to participate in distribution of proceeds of bankruptcy — Trial judge found injured party had proprietary interest in insurance proceeds, not insured — Trial judge found disallowing action would allow insurer to escape its responsibilities under policy — Defendants appealed — Appeal dismissed — Discharge did not prevent plaintiff from continuing with action — Trial judge misinterpreted leave order, which did not affect substantive rights between parties — Sections 145 and 133 of Bankruptcy and Insolvency Act, which allows for certain claims covered by insurance to continue in spite of bankruptcy, are not applicable to policies of general commercial liability — Amounts paid under s. 145 of Act are made to third parties on behalf of insured, while amounts paid to insured — Debt did not have to be satisfied by defendant, but underlying legal obligations were not extinguished — Obligation to pay proceeds of insurance claim still existed for purposes of insurance policy — Allowing action to continue was in accordance with principles of Act — Allowing claim did not affect distribution of bankrupt's property or impede financial rehabilitation — Result would not tempt claimants to delay proceedings until after discharge — Fact that judgment had not been entered or settlement reached did not change fact that insurer was legally obligated to pay legitimate claims on insured's policy — Supplier of part, who had been added as third party, was not prejudiced.

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — To Court of Appeal — Availability — Leave by judge

Claims against insurer of bankrupt.

Insurance --- Contracts of insurance — General principles

Plaintiff company contracted with owner to install oil tank — Plaintiff entered into subcontract with defendant to install tank — Leak was discovered in installed tank, which plaintiff paid substantial amount of money to remedy — Plaintiff brought action against defendant and insurer — Defendant made assignment in bankruptcy — Plaintiff was granted order to continue action against defendant — Defendant was discharged — Plaintiff's application to continue action was granted — Trial judge found discharge did not affect plaintiff's right to proceed against defendant in effort to obtain judgment, which could then be enforced against insurer — Trial judge found that order entitled plaintiff to recover proceeds of defendant's third party liability insurance only, and that plaintiff would have to file separate claim as unsecured creditor after obtaining judgment if wished to participate in distribution of proceeds of bankruptcy — Trial judge found injured party had proprietary interest in insurance proceeds, not insured — Trial judge found disallowing action would allow insurer to escape its responsibilities under policy — Defendants appealed — Appeal dismissed — Discharge did not prevent plaintiff from continuing with action — Provision in policy that bankruptcy did not relieve insurer of obligations did not constitute waiver of right to rely on discharge as defence — Waiver clause could not uphold decision of trial judge in itself — Clause which stated that bankruptcy of insured did not relieve insurer's obligations was not waiver of right to rely on discharge as defence — Waiver was intended for benefit of insured, not third parties — Discharge was complete bar against bankrupt, but not insurer — Fact that judgment had not been entered or settlement reached did not change fact that insurer was legally obligated to pay legitimate claims on insured's policy.

Cases considered by *Oland J.A.*:

Bell ExpressVu Ltd. Partnership v. Rex (2002), 212 D.L.R. (4th) 1, 287 N.R. 248, [2002] 5 W.W.R. 1, 166 B.C.A.C. 1, 271 W.A.C. 1, 18 C.P.R. (4th) 289, 100 B.C.L.R. (3d) 1, 2002 SCC 42, 2002 CarswellBC 851, 2002 CarswellBC 852, 93 C.R.R. (2d) 189, [2002] 2 S.C.R. 559 (S.C.C.) — referred to

Bristol-Myers Squibb Co. v. Canada (Attorney General) (2005), 2005 SCC 26, 2005 CarswellNat 1261, 2005 CarswellNat 1262, 253 D.L.R. (4th) 1, [2005] 1 S.C.R. 533, 39 C.P.R. (4th) 449, 334 N.R. 55 (S.C.C.) — considered

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Builders Contract Management Ltd. v. Simcoe & Erie General Insurance Co. (1993), 16 C.C.L.I. (2d) 84, 110 Sask. R. 175, [1993] I.L.R. 1-2994, 1993 CarswellSask 95 (Sask. Q.B.) — referred to

Chaplin v. Harrington Motor Co. (1927), [1928] Ch. 105 (Eng. C.A.) — considered

Co-Operative Avicole de St-Isidore Ltd. v. Co-operators General Insurance Co. (1997), 44 C.C.L.I. (2d) 1, 1997 CarswellOnt 2277, (sub nom. *Co-opérative Avicole de St-Isidore Ltd. v. Co-operators General Insurance Co.)* 32 O.T.C. 81 (Ont. Gen. Div.) — considered

Dutchak Estate v. Seidle (1998), 1998 CarswellSask 722, (sub nom. *Kowtzen v. Seidle)* 176 Sask. R. 99 (Sask. Q.B.) — referred to

Eurasia Auto Ltd. v. M & M Welding & Supply (1985) Inc. (1991), 1991 CarswellAlta 306, 5 C.B.R. (3d) 227, 1 C.C.L.I. (2d) 203, 119 A.R. 348 (Alta. Master) — referred to

Geary v. C & K Mufflers (June 6, 2006), Doc. 267105 (U.S. Mich. Ct. App.) — considered

Handelman, Re (1997), 1997 CarswellOnt 2891, 48 C.B.R. (3d) 29 (Ont. Bktcy.) — considered

Housen v. Nikolaisen (2002), 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, 286 N.R. 1, [2002] 7 W.W.R. 1, 2002 CarswellSask 178, 2002 CarswellSask 179, 2002 SCC 33, 30 M.P.L.R. (3d) 1, 219 Sask. R. 1, 272 W.A.C. 1, [2002] 2 S.C.R. 235 (S.C.C.) — referred to

Husky Oil Operations Ltd. v. Minister of National Revenue (1995), 1995 CarswellSask 739, 1995 CarswellSask 740, 188 N.R. 1, 24 C.L.R. (2d) 131, 35 C.B.R. (3d) 1, 128 D.L.R. (4th) 1, 137 Sask. R. 81, 107 W.A.C. 81, [1995] 3 S.C.R. 453, [1995] 10 W.W.R. 161 (S.C.C.) — considered

J & P Holdings Ltd. v. Saskatchewan Mutual Insurance Co. (1990), 1990 CarswellSask 120, [1990] I.L.R. 1-2651, 84 Sask. R. 52, 44 C.C.L.I. 205 (Sask. Q.B.) — considered

Kryspin, Re (1983), 40 O.R. (2d) 424, 44 C.B.R. (N.S.) 232, 142 D.L.R. (3d) 638, 1983 CarswellOnt 158 (Ont. Bktcy.) — considered

Letovsky v. Mutual Motor Freight Ltd. (1958), 37 C.B.R. 83, 66 Man. R. 311, 26 W.W.R. 433, 16 D.L.R. (2d) 355, 1958 CarswellMan 2 (Man. Q.B.) — considered

Major, Re (1984), 56 B.C.L.R. 342, 54 C.B.R. (N.S.) 28, 1984 CarswellBC 588, [1984] 6 W.W.R. 435 (B.C. S.C.) — followed

Maritime Drywall Ltd., Re (1979), 1979 CarswellNS 298, 37 N.S.R. (2d) 488, 67 A.P.R. 488 (N.S. T.D.) — considered

McMurachy v. Red River Valley Mutual Insurance Co. (1994), [1994] 6 W.W.R. 99, 92 Man. R. (2d) 225, 61 W.A.C. 225, 115 D.L.R. (4th) 220, 22 C.C.L.I. (2d) 1, [1994] I.L.R. 1-3093, 1994 CarswellMan 126 (Man. C.A.) — considered

McMurachy v. Red River Valley Mutual Insurance Co. (1994), 24 C.C.L.I. (2d) 198n, [1994] 9 W.W.R. lxxiii (S.C.C.) — referred to

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2007 CarswellNS 251, 2007 NSCA 68, [2007] I.L.R. I-4601, 32 C.B.R. (5th) 1, 50 C.C.L.I. (4th) 17, 814 A.P.R. 286, 255 N.S.R. (2d) 286, 284 D.L.R. (4th) 113

Miller, Re (2001), 2001 CarswellOnt 2834, 27 C.B.R. (4th) 107 (Ont. S.C.J.) — followed

Musser v. Musser (2003), 2003 Ohio 1440 (U.S. Ohio Ct. App.) — referred to

Northern Assurance Co. v. Brown (1956), [1956] S.C.R. 658, 3 D.L.R. (2d) 705, [1956] I.L.R. 1-229, 1956 CarswellOnt 76 (S.C.C.) — referred to

Qualiglass Holdings Inc. v. Zurich Indemnity Co. of Canada (2004), 16 C.C.L.I. (4th) 95, 8 C.B.R. (5th) 111, 47 Alta. L.R. (4th) 325, 368 A.R. 171, [2004] I.L.R. I-4329, [2006] 3 W.W.R. 505, 2004 CarswellAlta 1013, 2004 ABQB 577 (Alta. Q.B.) — considered

Rizzo & Rizzo Shoes Ltd., Re (1998), 1998 CarswellOnt 1, 1998 CarswellOnt 2, 50 C.B.R. (3d) 163, [1998] 1 S.C.R. 27, 33 C.C.E.L. (2d) 173, 154 D.L.R. (4th) 193, 36 O.R. (3d) 418 (headnote only), (sub nom. *Rizzo & Rizzo Shoes Ltd. (Bankrupt), Re)* 221 N.R. 241, (sub nom. *Rizzo & Rizzo Shoes Ltd. (Bankrupt), Re)* 106 O.A.C. 1, (sub nom. *Adrien v. Ontario Ministry of Labour)* 98 C.L.L.C. 210-006 (S.C.C.) — referred to

Simonelli v. Mackin (2003), 39 C.B.R. (4th) 297, (sub nom. *Simonelli (Bankrupt), Re)* 320 A.R. 330, (sub nom. *Simonelli (Bankrupt), Re)* 288 W.A.C. 330, 2003 CarswellAlta 176, 2003 ABCA 47 (Alta. C.A. [In Chambers]) — referred to

Skenandoa Rayon Corp. v. Halifax Fire Ins. Co. (1935), 245 A.D. 279, 281 N.Y.S. 193 (U.S. N.Y.A.D. 4th Dept.) — referred to

Somersall v. Friedman (2002), [2002] I.L.R. I-4114, 292 N.R. 1, 2002 SCC 59, 25 M.V.R. (4th) 1, 2002 CarswellOnt 2550, 2002 CarswellOnt 2551, [2002] 3 S.C.R. 109, 39 C.C.L.I. (3d) 1, (sub nom. *Scottish & York Insurance Co. v. Somersall)* 215 D.L.R. (4th) 577, 163 O.A.C. 201, [2002] R.R.A. 679 (S.C.C.) — considered

Vandepitte v. Preferred Accident Insurance Co. of New York (1931), [1932] S.C.R. 22, [1932] 1 D.L.R. 107, 1931 CarswellBC 117 (S.C.C.) — considered

Woodworth v. J.S. McMillan Fisheries Ltd. (2000), 21 C.B.R. (4th) 314, 28 C.C.L.I. (3d) 187, 2000 CarswellBC 2550, 82 B.C.L.R. (3d) 381, 2000 BCSC 1783 (B.C. S.C.) — considered

Statutes considered:

Automobile Insurance Act, S.N.S. 1932, c. 5

s. 24 — considered

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

Generally — referred to

s. 2 "claim provable in bankruptcy", "provable claim" or "claim provable" — considered

s. 2 "property" — referred to

s. 30 — referred to

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s. 69.3 [en. 1992, c. 27, s. 36(1)] — considered

s. 69.3(1) [en. 1992, c. 27, s. 36(1)] — considered

s. 69.4 [en. 1992, c. 27, s. 36(1)] — considered

s. 121(1) — considered

s. 121(2) — considered

s. 135(1) — considered

s. 135(1.1) [en. 1997, c. 12, s. 89(1)] — considered

s. 145 — considered

s. 158(d) — considered

s. 178(1) — referred to

s. 178(2) — considered

s. 183(1) — considered

s. 193 — considered

s. 193(a) — considered

s. 193(b) — considered

s. 193(c) — considered

s. 193(d) — considered

s. 193(e) — considered

Insurance Act, S.B.C. 1925, c. 20

s. 24 — considered

Insurance Act, R.S.N.S. 1989, c. 231

s. 28 — considered

s. 28(1) — considered

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s. 133 — considered

s. 133(1) — considered

s. 133(3) — considered

APPEAL by defendant from judgment reported at *Buchanan, Re* (2006), 19 C.B.R. (5th) 67, (sub nom. *Buchanan v. Superline Fuels Inc)* 240 N.S.R. (2d) 390, (sub nom. *Buchanan v. Superline Fuels Inc)* 763 A.P.R. 390, 2006 NSSC 51, 2006 CarswellNS 72 (N.S. S.C.), granting plaintiff's application to continue action arising out of installation of oil tank despite discharge from bankruptcy.

***Oland J.A.*:**

Introduction

1 An absolute order of discharge releases a bankrupt from all claims provable in bankruptcy. But how does that order affect a claimant which, before the bankrupt made an assignment in bankruptcy, brought an action against him but had not obtained judgment before the absolute discharge order, and where, at all material times, the bankrupt had insurance against the type of loss claimed? Does the order act as a complete defence to the claim? Or can a claim against the insurer survive that order? These are the main issues to be determined on this appeal.

Background

2 The facts giving rise to this litigation are not in dispute. They were set out in *Buchanan, Re*, 2006 NSSC 51 (N.S. S.C.), the decision in the Supreme Court of Nova Scotia in Bankruptcy and Insolvency (the "Bankruptcy Court") under appeal. Following are extracts from the summary by Justice Donald M. Hall:

> ¶ 3 . . . In November, 1999, Superline, through one of its divisions, registered as Discount Fuels (Discount), contracted with a home owner, Marsha Watkins (Watkins) for the supply and installation of an oil tank at Watkins' residence for domestic heating purposes. Superline, through Discount, then entered into a subcontract with Buchanan, who was carrying on business under the firm name "Sable Heating and Ventilation" (Sable), to supply and install the oil tank.
>
> ¶ 4 Approximately nine months later a leak was discovered in the oil filter on the line leading from the tank to the interior of the house. The leak caused significant contamination of the soil in the vicinity of the oil tank for which Superline accepted responsibility and paid a substantial sum of money to remedy the problem.
>
> ¶ 5 Superline, however, determined that the leak had been caused by a pinched gasket in the oil filter installed by Discount [sic.] Superline contended that Discount [sic] was negligent in the manner in which it completed the installation of the oil tank and was responsible for the damage and demanded full compensation from Discount [sic] for its remediation costs.
>
> ¶ 6 Buchanan denied responsibility for the oil leak. At the time he had a policy of insurance in place with [The Dominion of Canada General Insurance Company] which covered him for such claims. Once Buchanan became aware of Superline's claim he informed Dominion of the claim. . . .
>
> ¶ 7 As a result of Buchanan's and Dominion's denial of liability, Superline commenced an action on December 6, 2001, against Buchanan claiming damages including reimbursement of its expenses in remedying the loss caused by the oil spill.

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¶ 8 Buchanan filed a defence to the action on January 31, 2002, denying any responsibility for Buchanan's [sic] loss. At the same time Buchanan initiated a third party proceeding against Rexel North America Inc., (Rexel) and Roby Metals Ltee (Roby), the supplier and manufacturer respectively, of the alleged defective filter. Rexel filed a defence to the third party action. Roby, which subsequently made an assignment in bankruptcy, did not.

. . . . .

¶ 11 In the meantime, on January 25, 2002, Buchanan had made an assignment in bankruptcy. The claims of Superline were listed as a "contingent" claim.

¶ 12 Under date of April 4, 2002, Superline obtained an order *ex parte* before Nathanson, J., of this Court, which provided, in part, as follows:

> IT IS ORDERED THAT Superline Fuels Inc. be and is hereby granted leave to continue an action in the Supreme Court of Nova Scotia against Thomas W.J. Buchanan.
>
> AND IT IS ORDERED THAT the right of Superline Fuels Inc. to proceed with this action pursuant to this Order shall be for the purpose only of the limits of the insurance policy of the bankrupt, Thomas W.J. Buchanan, and subject to any coverage limits thereto.
>
> AND IT IS FURTHER ORDERED that the time for filing any claim which Superline Fuels Inc. may have as an unsecured creditor after the judgment pursuant to the action against the bankrupt, Thomas W.J. Buchanan, pursuant to subsection 124(1) of the *Bankruptcy and Insolvency Act* be and same is hereby extended until it shall have been ascertained what amount Superline Fuels Inc. shall receive under its judgment.

¶ 13 Apparently Buchanan made an application in April or May, 2003, for an absolute discharge from bankruptcy. The application came before Kennedy, C.J. of this Court, who granted an order under date of May 6, 2003, which contained the following provision:

> AND IT IS FURTHER ORDERED that upon the Court being satisfied that the Bankrupt has completed the above stated terms that an Absolute Order of Discharge shall issue; provided that, pending, the issuance of the Absolute Order of Discharge, either Superline Fuels Inc., or the Bankrupt or his insurer, the Dominion of Canada General Insurance Company, may apply to this Honourable Court for a declaration as to the effect, if any, of the conditional or absolute discharge of the Bankrupt on any and all claims of Superline Fuels Inc. against the Bankrupt, but for greater certainty, any such application shall not restrict or affect the administration by the Trustee of the Bankrupt's Estate including the distribution of any dividends to unsecured creditors.

¶ 14 An absolute order discharging Buchanan was granted by the Registrar in Bankruptcy on November 26, 2004. The order repeated the above clause in the following terms:

> AND IT IS FURTHER ORDERED that an Absolute Order of discharge shall issue, provided that, pending the issuance of the Absolute Order of discharge, either Superline Fuels Inc., or the Bankrupt or his insurer, the Dominion of Canada General Insurance Company, may apply to this Honourable Court for a declaration as to the effect, if any, of the Absolute discharge of the Bankrupt on any and all claims of Superline Fuels Inc. against the Bankrupt, but for greater certainty any such application shall not restrict or affect the administration by the Trustee of the Bankrupt's Estate including the distribution of any dividends to unsecured creditors.

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3 As noted in this extract, when Buchanan made an assignment into bankruptcy in January 2002, his statement of affairs showed the disputed claim by Superline as "contingent." Most actions against a bankrupt are automatically stayed by the bankruptcy proceedings (s. 69.3 of the *Bankruptcy and Insolvency Act*, R.S. 1985, c. B-3, s. 1; 1992, c. 27, s. 2 (the "*BIA*")), but a creditor may apply to the court for leave to continue its claim (s. 69.4). Superline applied *ex parte* for a declaration that the statutory stay be lifted with respect to its claim. The April 2002 order issued by Nathanson, J. (the "Leave Order") granted Superline leave to continue its action against Buchanan.

4 Superline consented to the May 6, 2003 conditional discharge order granted by Kennedy, C.J. which provided *inter alia* that, pending the issuance of the absolute order for discharge, Superline, Buchanan or Dominion could apply for a declaration as to the effect, if any, of the discharge of Buchanan on Superline's claims against him. No such application was made prior to the November 26, 2004 absolute order of discharge (the "Discharge Order"). Only after the issuance of that Discharge Order did Superline apply for such a declaration pursuant to s. 183(1) of the *BIA*.

The Decision of the Bankruptcy Judge

5 The bankruptcy judge heard three applications — one by each of Superline, Buchanan, and Dominion. First, Superline had applied for a declaration pursuant to s. 183(1) of the *BI*A as to the effect, if any, of Buchanan's bankruptcy on its claims against him. Justice Hall granted its application. His order dated May 19, 2006 provided that Buchanan's absolute bankruptcy discharge shall not operate to limit, restrict or relieve Dominion of any liability or obligation it may have to pay, on behalf of Buchanan, any third party in respect of the proceedings pertaining to the fuel leak and soil contamination, where the liability arises pursuant to the commercial general liability policy issued by Dominion to Buchanan (the "Policy").

6 Second, Buchanan had applied to amend his defence to provide that he had been released from further liability as a consequence of his discharge from bankruptcy, and for an order striking out Superline's statement of claim and for summary judgment. Third, Dominion had applied for a declaration that Superline has no rights or cause of action against it pursuant to the Policy. The judge dismissed each of these applications by Buchanan and Dominion.

7 Rexel was represented at the hearing of the applications, and made submissions supporting Buchanan's position. Buchanan, Dominion and Rexel (the "appellants") apply for leave to appeal the decision and order relating to Superline's application; and, if granted, appeal that decision and order. Buchanan appeals from the dismissal of his applications. He and Dominion appeal from the decision and order dismissing Dominion's application.

Issues

8 With respect to the decision and order relating to Superline's application, the notices of appeal filed by the appellants set out multiple grounds of appeal. These can be combined and reworded as follows:

(1) Is leave required to appeal the order which granted Superline's application for a declaration and, if so, should leave be granted?

(2) Did the bankruptcy judge err in holding that the Leave Order affected the substantive rights of Buchanan and Dominion?

(3) Does the Discharge Order operate as a discharge of the claims of Superline against Buchanan as it relates to indemnity insurance which may be available to respond to the claims against him?

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(4) Does a provision in the Policy providing that bankruptcy of the insured does not relieve the insurer of its obligation mean that Dominion has waived its right to rely upon Buchanan's Discharge Order as a defence?

(5) Prior to any judgment being entered against Dominion, does Superline have rights directly against Dominion under the Policy it issued which names Buchanan as an insured?

(6) If Superline is entitled to proceed with its action, does this constitute prejudice to Rexel?

These issues incorporate the issues raised by Dominion in appealing the dismissal of its application.

9 The issues pertaining to Buchanan's appeal of the dismissal of his applications are:

(1) Whether leave should be granted with respect to his applications to amend his defence to provide that he had been released from further liability as a consequence of the company Discharge Order, and to strike out Superline's statements of claims and to provide for summary judgment, and

(2) If so, whether Buchanan is entitled to summary judgment against Superline, giving effect to that defence.

Standard of Review

10 Determining the test for appellate review requires consideration of the nature of the decision. This appeal does not challenge any of the bankruptcy judge's findings of fact or inferences of fact, nor does it involve questions of mixed fact and law. Rather, the critical issues are all questions of law. For such questions, the standard of review is correctness. See *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, [2002] S.C.J. No. 31 (S.C.C.).

Analysis

11 I begin with the issues which pertain to the decision and order granting Superline's application for a declaration. The first relates to leave to appeal.

(1) Is leave required to appeal the Order granting Superline's application for a declaration?

12 Section 193 of the *BIA* sets out when this court can hear an appeal from an order or decision of the bankruptcy court. It reads:

193. Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:

(a) if the point at issue involves future rights;

(b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;

(c) if the property involved in the appeal exceeds in value ten thousand dollars;

(d) from the grant or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and

(e) in any other case by leave of a judge of the Court of Appeal.

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(Emphasis added)

13 According to Buchanan and Dominion, no leave is necessary and the case at bar could come within s. 193(a) or (c). However, they candidly acknowledge that there are difficulties with their submissions.

14 In my view, it is not necessary to decide if those provisions apply in these circumstances. Assuming, without deciding, that none of s. 193(a), (b), (c) or (d) is applicable, I would grant leave to appeal the order granting Superline a declaration, pursuant to s. 193(e). The issues which are the subject of this appeal are important to all of the parties to this litigation and to the action itself, and the appeal is clearly not frivolous. See *Simonelli v. Mackin* (2003), 39 C.B.R. (4th) 297 (Alta. C.A. [In Chambers]).

(2) Did the bankruptcy judge err in holding that the Leave Order granting leave to Superline to continue its action affected the substantive rights of Buchanan and Dominion?

15 In my respectful view, in relying as he did on the Leave Order in deciding to grant Superline's application for a declaration, the bankruptcy judge erred.

16 In his decision, the judge made it clear that the Leave Order was one of the reasons for his granting Superline's application. After noting that the Trustee in Bankruptcy consented to the Leave Order, he continued:

> ¶ 31 This order has not been appealed nor varied in any way although there was a reference to it in the subsequent order for Buchanan's absolute discharge from bankruptcy. Thus the order continues in full force and effect and was not overridden by the subsequent absolute order of discharge.
>
> ¶ 32 Indeed, in referring to Superline's claim as it did in the order of discharge, in my view the court acknowledged that Superline's claim was still outstanding. It is not clear to me why the order provided that any of the interested parties may apply for a declaration as to the effect of the absolute discharge on Superline's claim in view of the previous order permitting Superline to continue its action. That order clearly provided that Superline would be entitled to recover the proceeds of Buchanan's third party liability insurance only and would have to file a separate claim as an unsecured creditor after obtaining judgment, it [sic] it wished to participate in the distribution of the proceeds of the bankruptcy. Superline did not and does not claim any relief under this latter provision. It was also suggested that it is now too late to make the application since the order stated that it may be made "pending" the issuance of the absolute order of discharge. I do not accept this argument. First, because such an application was immaterial since the order granted by Nathanson, J., clearly authorized Superline to proceed with its action, and second, the court could not have intended the result suggested by Mr. Darling since the order of absolute discharge was issued the very same day it was granted.
>
> ¶ 33 Accordingly, for these reasons and the principles enunciated in **Major** and **Miller**, it is my opinion that the absolute discharge does not affect Superline's right to proceed against Buchanan in an effort to obtain judgment against him which it may then enforce against Dominion, subject to the limits in the policy.
>
> (Emphasis added)

17 None of the parties had directed the bankruptcy judge to the Leave Order in either oral or written submissions on the issues before him, much less suggested that it might have the effect of authorizing Superline to proceed with its action, as stated in his decision. Nor had the judge himself raised this with the parties during the hearing.

18 The Leave Order is procedural, rather than substantive, in nature. Such an order is contemplated in s. 69.4 of

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the *BIA*, and Superline applied for it pursuant to that provision. The relevant sections read:

> 69.3 (1) Subject to subsections (2) and (3) and sections 69.4 and 69.5, on the bankruptcy of any debtor, no creditor has any remedy against the debtor or the debtor's property, or may commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged. . . .
>
> 69.4 A creditor who is affected by the operation of sections 69 to 69.3 or any other person affected by the operation of section 69.3 may apply to the court for a declaration that those sections no longer operate in respect of that creditor or person, and the court may make such a declaration, subject to any qualifications that the court considers proper, if it is satisfied
>
> (a) that the creditor or person is likely to be materially prejudiced by the continued operation of those sections; or
>
> (b) that it is equitable on other grounds to make such a declaration.

19 What a s. 69.4 declaration accomplishes is a lifting of the automatic stay imposed by s. 69.3. Thus, all the Leave Order did was to grant leave to Superline to continue its action against Buchanan, and thereby to claim whatever rights it might have against the insurance policy Dominion had issued to Buchanan. Contrary to the assertion by the bankruptcy judge, it did not clearly authorize Superline to proceed with its action. The Leave Order did not purport to, nor in law could it, determine the rights of Superline against Buchanan and Dominion.

20 Moreover, it appears from the judge's wording that he considered that the Leave Order continued to be effective after the Discharge Order and even beyond. This is not correct in law. The Discharge Order of November 26, 2004 discharged Buchanan. Afterwards, the trustee in bankruptcy completed his work, and was discharged. According to s. 69.3, the stay of proceedings against the bankrupt debtor ceased to apply on the discharge of the trustee. Thus, in stating that the Leave Order was not "overridden" by the Discharge Order and by implying that it continued in full force and effect, the bankruptcy judge erred.

21 Neither the wording nor the purpose of the Leave Order supports the judge's conclusion that the Leave Order determined that Superline was entitled to proceed pursuant to the Policy. However, as will be seen in the analysis of the next issue, the Leave Order was not the only basis for the judge's determination that the Discharge Order did not terminate Superline's claim.

(3) Does the Discharge Order operate as a discharge of the claims of Superline against Buchanan as it relates to indemnity insurance which may be available to respond to the claims against him?

22 In considering this issue, I will summarize the parties' arguments before the bankruptcy judge and his analysis, and then proceed to consider the relevant legislation, the case law, and the wording of the Policy itself.

23 Before the bankruptcy judge, Superline argued that its action against Buchanan was not affected by the Discharge Order. It submitted that although Buchanan is released, Superline's claim against Dominion, his insurer, survives. Buchanan and Dominion argued that that order discharged Buchanan from any further responsibilities for any debts or financial obligations incurred prior to his bankruptcy. In their view, Superline could no longer obtain judgment against Buchanan, and it followed that it could have no claim against Dominion under Buchanan's policy. In short, Buchanan and Dominion argued that they have a complete defence to Superline's claims arising from the oil spill.

24 The bankruptcy judge determined that the Discharge Order did not affect Superline's right to proceed against

Buchanan, in an effort to obtain a judgment against him which might be enforced against his insurer, Dominion. He stated that denial of such an opportunity because of Buchanan's bankruptcy would be unfair and unjust, and that it is the injured party, not the insured, who has the proprietary interest in the insurance proceeds. In deciding this issue, the judge mainly relied on:

(1) the Leave Order. Earlier in this decision, I determined that he erred in relying on the Leave Order;

(2) a line of cases, in particular *Major, Re* (1984), 54 C.B.R. (N.S.) 28 (B.C. S.C.) (Wood, J.) and *Miller, Re* (2001), 27 C.B.R. (4th) 107 (Ont. S.C.J.) (Deputy Registrar Sproat); and

(3) the wording of the Policy itself.

25 The parties' positions on appeal could hardly be more opposite. The appellants submit that the bankruptcy judge erred by failing to give effect to the clear wording of s. 178(2) on the effect of a discharge from bankruptcy. They contend that the *BIA* does not create any exemption for claims which are insured and, as a consequence, after the Discharge Order, Superline cannot pursue a judgment against Buchanan, which it could enforce against Dominion. Moreover, according to the appellants, the fact that claims covered by certain other insurance policies are expressly unaffected by absolute discharge orders leads to an inference that claims covered by commercial general liability policies are affected by such orders. They say that *Major, Re*, supra is of little relevance; *Miller, Re*, supra is wrongly decided; and that, unless Superline proved its claim before Buchanan's discharge, its claim was released by it.

26 For its part, Superline argues that the effect of the appellants' submissions is to extinguish the liability of a bankrupt for all claims against him or her, even where that liability may be satisfied by third parties or property in which the bankrupt has no legal or beneficial interest. It says that s. 178(2) is not applicable in the circumstances of this case. This is because, urges Superline, the coverage provided by the Policy in relation to its property damage claim does not constitute "property" as defined in s. 2 of the *BIA*. Section 178(2) is not engaged at all, and consequently it could not act to discharge Superline's claim against Buchanan.

27 These arguments as to the effect of the Discharge Order and, in particular, whether it acts as a release of the claims of Superline against Buchanan, require an analysis and interpretation of the statutory provisions, and a consideration of case law. I begin my analysis by considering the relevant provisions of the *BIA* and principles of statutory interpretation.

(a) Bankruptcy and Insolvency Legislation

28 Central to the arguments on appeal is s. 178(2) of the *BIA* which sets out the effect of an order of absolute discharge. It provides:

178 (2) Claims released — Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.

Nothing in s. 178(1) applies to this appeal.

29 The definition section of the *BIA*, s. 2, states that:

"claim provable in bankruptcy," "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;

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It is uncontested that Superline's claim is one "provable" in bankruptcy.

30 Also relevant is s. 121 which reads in part:

> 121.(1) Claims provable — 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.
>
> (2) Contingent and unliquidated claims — The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135. . . .

According to s. 135(1)(1.1), the trustee in bankruptcy determines whether any contingent claim is a provable claim and, if so, values it.

31 The "modern approach" to statutory interpretation is well established. In *Bristol-Myers Squibb Co. v. Canada (Attorney General)*, [2005] S.C.J. No. 26 (S.C.C.), Binnie, J. described it as follows:

> ¶ 95 In his book *Construction of Statutes* (2nd ed. 1983), at p. 87, E.A. Driedger sets out this often-cited principle:
>
> > Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.
> >
> > It is now well settled in law that this modern approach is the preferred method of statutory interpretation ... However, this framework need not be applied in a formulaic manner. The factors need not be canvassed separately in every case, given that they are very closely related and interdependent...[Emphasis added]

See also *Rizzo & Rizzo Shoes Ltd., Re* (1998), 154 D.L.R. (4th) 193 (S.C.C.) at ¶ 21; *Bell ExpressVu Ltd. Partnership v. Rex* (2002), 212 D.L.R. (4th) 1 (S.C.C.) at ¶ 26-28.

32 As indicated, the object of the legislation and the intention of Parliament in its enactment are factors to be considered in undertaking the interpretation of a statute. In *Husky Oil Operations Ltd. v. Minister of National Revenue* (1995), 128 D.L.R. (4th) 1 (S.C.C.), Iacobbuci, J. set out the objects of the *BIA* generally as follows at ¶ 7:

> **A. The purposes of federal bankruptcy legislation**
>
> At the outset, it is useful to remember that our bankruptcy system serves two distinct goals. The first is to ensure the equitable distribution of a bankrupt debtor's assets among the estate's creditors *inter se*. As one commentator has noted (Aleck Dadson, "Comment" (1986), 64 Can. Bar Rev. 755, at p. 755):
>
> > Bankruptcy serves this goal by replacing a regime of individual action with a regime of collective action. While the pre-bankruptcy regime of individual action allows creditors to pursue their separate and competing claims to the debtor's assets, bankruptcy's regime of collective action sorts out those diverse claims and deals with the debtor's assets in a way which brings benefits to creditors as a group (reduced costs, increased recovery). . . . The collectivization of insolvency proceedings can only be achieved by denying to creditors the use of pre-bankruptcy remedies.

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> See also Peter W. Hogg, *Constitutional Law of Canada* (3rd ed. (supplemented) (Scarborough), Ont.: Toronto, 1992), vol. 1, at p. 25-3 (looseleaf). The second goal of the bankruptcy system is the financial rehabilitation of insolvent individuals (Dadson, *supra*, at p. 755). This goal is furthered through the opportunity for an insolvent individual's discharge from outstanding debts.
>
> (Emphasis added)

See also *Houlden and Morawetz, The 2007 Annotated Bankruptcy and Insolvency Act*, (Toronto: Carswell, 2006) at pp. 2-3.

33 Those purposes of bankruptcy and insolvency legislation both relate to the property of the bankrupt. One seeks to effect a fair distribution of his or her assets among the bankrupt's creditors. The second relates to his or her financial rehabilitation, in order to allow him or her to start anew and protect any future property the bankrupt might acquire from existing creditors.

34 With the objects of the *BIA* in mind, I return to the express wording of s. 178(2) which is repeated for convenience:

> 178 (2) Claims released — Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.

It makes no mention of any exemption for a claim against a bankrupt which may be covered by a commercial general liability policy such as that issued by Dominion to Buchanan or, indeed, by any other insurance coverage.

35 The appellants argue that the existence of other provisions, namely s. 145 of the *BIA* and s. 133 of the *Insurance Act*, R.S.N.S. 1989, c. 231, as amended (the "*Insurance Act*"), buttress their argument that the Discharge Order acts as a complete defence to Superline's claim. They say that these other provisions lead to the inference that claims covered by commercial general liability insurance are caught by s. 178(2). With respect, for the reasons which follow, I am unable to agree.

(b) Section 145 of the BIA

36 The *BIA* contains an express exception to the application of s. 178(2) for claims against a bankrupt that may be covered by *automobile liability insurance*. Section 145 reads:

> 145. Proceeds of liability insurance policy on motor vehicles — Nothing in this Act affects the right afforded by provincial statute of any person who has a claim against the bankrupt for damages on account of injury to or death of any person, or injury to property, occasioned by a motor vehicle, or on account of injury to property being carried in or on a motor vehicle, to have the proceeds of any liability insurance policy applied in or toward the satisfaction of the claim.

However, the inference that the appellants submit should be drawn from its existence, namely, that the proceeds of commercial general liability insurance policies which are not specifically exempted in the *BIA*, must consequently be affected by an absolute order of discharge, does not withstand examination when the origins of s. 145 are considered.

37 Its legislative history clearly shows that s. 145 was intended to remedy an injustice flowing from the strict application of the common law. In *Letovsky v. Mutual Motor Freight Ltd.*, [1958] M.J. No. 4 (Man. Q.B.), the Manitoba Court of Queen's Bench observed at ¶ 55:

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> This section [now s. 145] was first passed in 1931 when it became sec. 125A (1931, ch. 17, sec. 1). It was passed to remedy what was long recognized as an injustice. Formerly any money recovered under a claim against the insurer such as this would go to the trustee and enure for the benefit of all the creditors: See, for example, note in (1927) 71 Sol J 461.

38 Prior to the enactment of what is now s. 145, insurance proceeds payable directly to an insured under an automobile liability policy were pooled with the general assets of a bankrupt's estate and divided among his creditors, rather than delivered to the injured party. See, for example, *Chaplin v. Harrington Motor Co.* (1927), [1928] Ch. 105 (Eng. C.A.), where the applicant was injured in a motor vehicle accident involving Harrington Motor Company, Limited, which subsequently went into liquidation. Its insurance policy provided that, in the event of damage or loss, "the assured should be paid by the insurance company all sums which the assured would be legally liable to pay by way of compensation." The applicant applied for a determination as to whether he or the liquidator was entitled to the insurance proceeds. The court held that the insurance funds fell into the bankrupt's estate and was distributable among the creditors of the company *pari passu*. After commenting that the situation seemed to disclose a hardship, Atkin, L.J. continued at p. 118:

> But the position in law seems to me clearly to be that a third party in a case like the present has no claim in law or in equity of any sort against the insurance company, or against the money paid by the insurance company, nor has he any claim against the person who injures him, the assured, to direct the assured to pay over the sum of money received under the insurance policy to him. The amount that the assured in fact received is part of his general assets. As a general rule the expediency of that, I think, cannot be disputed. It obviously would disturb the whole practice of insurance if the claimant against the assured who caused the risk had a direct right of recourse against the insurance company, and we know that in actual practice the assured receives the money — the parties being solvent — and does not pay over necessarily that sum of money to the third party who is injured, but, of course, pays his claim out of his own assets and uses the insurance money, so far as it goes, because it does not always completely meet his liability. ...

39 Section 145 was the legislative response to *Chaplin v. Harrington Motor Co.*, supra. It removed the injustice flowing from a strict application of the common law which deprived innocent third party victims of motor vehicle accidents of insurance proceeds.

40 In addition to its particular legislative history, the argument for an inference based on the existence of s. 145 does not take into account a significant difference between automobile liability insurance and commercial general liability insurance. Unlike the former, generally policies pertaining to the latter do not provide for any payment of insurance proceeds directly *to an insured.* Instead, commercial general liability policies provide for payment *on behalf of an insured* to the injured third party.

41 This distinction was discussed by Cowan, C.J.T.D. in *Maritime Drywall Ltd., Re*, [1979] N.S.J. No. 718 (N.S. T.D.). There, funds were payable as a result of liability attributed to Maritime Drywall for damages suffered by a third party in a fire. The liability policy did not provide that the insurer was to pay any sums directly to the company. The trustee under a proposal filed by the company applied for an order requiring its insurer to pay moneys due under the liability policy directly to the trustee, claiming that the rights of the company vested in the trustee under the proposal.

42 Cowan, C.J.T.D. distinguished the principles set out in *Chaplin v. Harrington Motor Co.*, supra. Beginning at ¶ 17 he stated:

> Even if the Trustee were to be considered to be in the same position as if the company had made an assignment in bankruptcy as at the date of the proposal, and even if s. 50(5) of the *Bankruptcy Act* applied [now s. 71], with

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the result that all property of the debtor, Maritime Drywall, passed to and is vested in the Trustee, I am of the opinion that all that passed to and vested in the Trustee, with respect to the matter before me, was the right to step into the shoes of the Insured, Maritime Drywall, and to require the Insurer to carry out its obligations under the comprehensive liability rider, and to pay on behalf of the Insured the sums which the Insured has become obligated to pay, by reason of the liability imposed by law upon the Insured with respect to the claims of the claimants ...

In my opinion, therefore, in the circumstances of this case, and having regard to the wording of the insuring agreements in the comprehensive liability rider of the policy in question, the Insurer may pay to the claimants the respective amounts agreed upon among them, with respect to their claims against Maritime Drywall, free and clear of any claim by the Trustee under the proposal in bankruptcy made by Maritime Drywall. [Emphasis added]

43 Accordingly, where a liability policy provides that payment shall be made *on behalf of an insured*, rather than *to an insured*, insurance proceeds do not vest in the trustee for distribution or payment. Rather, the trustee receives only the right to compel the insurer to pay the claimant on behalf of the bankrupt insurer.

44 Where s. 145 of the *BIA* was a legislative response to the common law pertaining to automobile liability insurance, and where the provisions pertaining to payment of insurance proceeds in such policies are different from those in commercial general liability policies, in my view, it is not appropriate to interpret s. 178(2) in light of s. 145.

(c) Section 133 of The Insurance Act

45 Similarly, the interpretation given to s. 178(2) should not be affected by the existence of s. 133 of our provincial *Insurance Act*. That provision was intended to remedy an inequity that arose in the context of claims arising out of motor vehicle accidents. The relevant portions of s. 133 read:

133 (1) Any person who has a claim against an insured, for which indemnity is provided by a contract evidenced by a motor vehicle liability policy, notwithstanding that that person is not a party to the contract, may, upon recovering a judgment therefor in any province of Canada against the insured, have the insurance money payable under the contract applied in or towards satisfaction of his judgment and of any other judgments or claims against the insured covered by the contract and may, on behalf of himself and all persons having such judgments or claims, maintain an action against the insurer to have the insurance money so applied.

. . . . .

(3) A creditor of the insured is not entitled to share in the insurance money payable under any contract unless his claim is one for which indemnity is provided by that contract. . . .

46 First proclaimed as part of *The Automobile Insurance Act* in 1932 (S.N.S. 1932, c.5) as s. 24, s. 133 was a legislative response to *Vandepitte v. Preferred Accident Insurance Co. of New York* (1931), [1932] S.C.R. 22 (S.C.C.). In that case, the Supreme Court of Canada considered the application of what was then s. 24 of the *British Columbia Insurance Act*, (1925, c.20) in the context of injuries arising out of a motor vehicle accident, which reads as follows:

24. Where a person incurs liability for injury or damage to the person or property of another and is insured against such liability and fails to satisfy a judgment awarding damages against him in respect of such liability, and an execution against him in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject

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to the same equities as the insurer would have if the judgment had been satisfied.

That provision is virtually identical to s. 28 of the current *Insurance Act*.

47 In *Vandepitte*, supra the respondent was injured when the vehicle in which she was a passenger collided with one owned by Berry and operated, with his consent, by his daughter. After having obtained judgment against the daughter, the respondent's action against the owner's insurer to recover the amount of the judgment was unsuccessful. The court reasoned that there was no privity of contract between the daughter and the insurer. It ultimately concluded that s. 24 of the British Columbia legislation did not oblige the insurer to satisfy the judgment against the daughter, who was an unnamed insured.

48 As a result of *Vandepitte*, several provinces, including Nova Scotia, amended their insurance legislation. Locke, J. of the Supreme Court of Canada recounted the history of these changes in *Northern Assurance Co. v. Brown*, [1956] S.C.R. 658, [1956] S.C.J. No. 42 (S.C.C.), at pp. 665-667. The amendments enabled persons recovering judgments for damages for negligence against insured persons, named or unnamed, to access the insurance monies to the extent provided. In view of that specific and narrow objective, and the fact that s. 133 relates to motor vehicle liability insurance, it is not appropriate to draw any inference in regard to s. 178(2) of the *BIA* from the existence of that provision of the *Insurance Act.*

49 In summary, the existence of neither s. 145 of the *BIA* nor s. 133 of the *Insurance Act* leads to the inference that claims to the proceeds of a commercial general liability insurance policy are precluded by s. 178(2) of the *BIA*.

(d) Major, Re and Miller, Re

50 In granting Superline the declaration it sought, as well as relying on the Leave Order and the wording of the Policy, the judge relied on case law. It is helpful to set out relevant provisions of the Policy at this point, in order to provide context for my analysis of the jurisprudence. The insuring agreement contained in the Policy imposes two obligations on the insurer, Dominion. These are set out in Section I, Coverage A as follows:

> **1. Insuring Agreement.**
>
> a. We will pay those sums that the insured becomes legally obligated to pay as compensatory damages because of "bodily injury" or "property damage" to which this insurance applies. No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under SUPPLEMENTARY PAYMENTS — COVERAGES A, B AND D. This insurance applies only to "bodily injury" and "property damage" which occurs during the policy period. The "bodily injury" or "property damage" must be caused by an "occurrence". The "occurrence" must take place in the "coverage territory". We will have the right and duty to defend any "action" seeking those compensatory damages . . . (Emphasis added)

I will call the first, the "duty to indemnify;" and the second, the "duty to defend."

51 It is noteworthy that the Policy does not specify whether any payments by the insurer are made on behalf of the insured, directly to the claimant, or otherwise. The parties to the appeal agree that any payments payable pursuant to the duty to indemnify would be made by the insurer to the claimant on behalf of the insured. For the purposes of this decision, I have accepted that position.

52 I turn then to the case law. Neither the bankruptcy judge nor this court was provided with any appellate decisions on the effect of an absolute order of discharge on claims against a bankrupt who had insurance coverage. In each of the two principal decisions the bankruptcy judge relied upon, *Major, Re*, supra and *Miller, Re*, supra the insuring agreement called on the insurer to pay "on behalf of" the insured.

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53 In *Major, Re*, supra a solicitor who had been sued for breach of fiduciary duty made an assignment in bankruptcy. The plaintiffs sought leave to continue their action, and a declaration that any insurance proceeds belonged to them, rather than the trustee of the estate in bankruptcy. The British Columbia Supreme Court granted their application, holding that once the liability of the bankrupt insured was established, the insurance policy called for a payment by the insurer directly to the creditor. At ¶ 24, it commented:

> To permit the estate of the bankrupt to receive the proceeds of the policy of insurance in this case would result in an injustice to the applicants, for whose benefit one would have expected that the policy was intended. The other creditors of the estate would gain a windfall from the misfortune of the applicants as a result of a policy of insurance from which no one ever intended them to benefit.

The factual matrix of *Major, Re* was such that it was not necessary to address the effect of a discharge from bankruptcy on the liability of the insured.

54 The facts in *Miller, Re*, supra are closer to those which underlie this appeal. There the plaintiff, Walton, applied for leave to continue an action in negligence against Miller, a bankrupt lawyer who, at all material times, was insured under a liability insurance policy. Almost a year after Walton commenced her action, Miller made an assignment in bankruptcy. However, he did not give her notice of either the assignment or, months later, his automatic discharge. When she learned of his bankruptcy, Walton applied for leave to continue. Miller argued that, he having been discharged from bankruptcy, her claim against him had been released by s. 178(2) of the *BIA*.

55 Deputy Registrar Sproat of the Ontario Superior Court of Justice (In Bankruptcy and Insolvency) allowed the motion to continue the application and granted a declaration that, if successful in recovering damages from the lawyer's insurers, Walton, rather than the bankrupt's estate, was entitled to those proceeds. He stated:

> ¶ 29 Lastly, the effect of s. 178(2) of the BIA must be examined. That provision provides for a release of claims provable in bankruptcy. Counsel for Miller submits that the release has the effect of eliminating Miller's legal obligation to pay Walton. I am of the view that this is not the correct interpretation and effect of the provision.
>
> ¶ 30 The effect of Miller's bankruptcy and of s. 178(2) of the BIA is such that Miller will not and cannot be called upon to actually pay on the judgment. ...
>
> ¶ 31 The decision of Farley J. in *Re Handelman* [1997] O.J. No. 3599 (Ont. Bktcy.) is of assistance. In this case, Farley J. upheld Master Ferron's grant of leave to the creditor to proceed with an action against a discharged bankrupt. In doing so, Farley J. considered the decision of Catzman J. in *Re Kryspin* (1983), 40 O.R. (2d) 424 (Ont. Bktcy.) as to the effect of the predecessor to the present s. 178(2). Catzman J. held that the provision did not extinguish the debt but only operated to release the bankrupt from claims provable in bankruptcy. Farley J. noted further that the stay provision contained in the BIA only stayed "any remedy against the bankrupt's property ..." and the commencement or continuation of any action "for the recovery of a claim provable in bankruptcy" (see s. 69.3(1) of the BIA). On the basis of these authorities, I conclude that s. 178(2) does not have the effect of releasing Miller's legal obligation to pay but, rather, speaks to the fact that Walton does not have any ability to pursue remedies against Miller's property.
>
> (Emphasis added)

56 The Deputy Registrar also observed at ¶ 47 of *Miller, Re*, supra:

> I am of the view that the declaration sought by Walton [the third party] as to entitlement to the insurance proceeds should issue. I do so on the basis that the very purpose of the insurance policy is to benefit third parties

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who are affected by the errors and omissions of their solicitors. The other creditors of Miller should not benefit from the wrong, if proven, occasioned to Walton.

57 In his decision at ¶ 24, the bankruptcy judge also referred to *Eurasia Auto Ltd. v. M & M Welding & Supply (1985) Inc.*, [1991] A.J. No. 400 (Alta. Master). There the issue was whether any insurance money would go to the claimant or to the estate of the bankrupt. The general liability insurance coverage provided that the insurer would pay "on behalf of the insured all sums" which the insured shall become legally obligated to pay. As observed earlier, the insuring agreements in *Major, Re*, supra and *Miller, Re*, supra contained the same phraseology. Master Funduk stated:

> I see no difference between that and the insurance policies found in *Major, Re*, 54 C.B.R. (n.s.) 28 (B.C.S.C.) and the cases that decision relies on.
>
> If the bankrupt had not gone bankrupt it could not have demanded that the insurer pay it. The policy calls for something else.
>
> The bankruptcy does not (and cannot) change the terms of the policy. All that the Trustee can demand of the insurer is that it pay to the injured third party.
>
> If the insurance proceeds fell into the estate it would mean that creditors of the bankrupt would get money from an insurance policy for claims not covered by the policy.
>
> If the policy provided that the insurer would pay to the insured that might well result in a different conclusion, but that is not the case here. The bankrupt and (the Trustee) can only call on the insurer to perform its obligations as the parties agreed to. What they agreed to is that the insurer pay to the injured party.
>
> .....
>
> I find that this is a Re Major situation. The Plaintiff does not have to share with other creditors if it gets a judgment which is covered by the policy. The insurer can pay directly to the Plaintiff in that case.

See also *Dutchak Estate v. Seidle*, [1998] S.J. No. 756 (Sask. Q.B.).

58 I am not persuaded that the bankruptcy judge erred by relying on the reasoning in *Miller, Re*, supra and the cases referred to therein and thereafter that, although s. 178(2) releases the bankrupt from claims provable in bankruptcy, it does not extinguish the debts that form the basis for such claims. In the appeal before us, this means that s. 178(2) releases Buchanan, from having to satisfy the debt, but it does not extinguish the underlying legal obligation. As I will explain, that underlying obligation survives for the purpose of the insurance policy and s. 28 of the *Insurance Act*, whether the extent of the obligation is crystalized by settlement or judicial determination before or after the order for discharge issues.

59 In reaching this conclusion, I have rejected the appellants' arguments that *Miller, Re*, supra was wrongly decided, and that Deputy Registrar Sproat erred in relying on *Kryspin, Re*, 44 C.B.R. (N.S.) 232, [1983] O.J. No. 2927 (Ont. Bktcy.) and *Handelman, Re* (1997), 48 C.B.R. (3d) 29 (Ont. Bktcy.)).

60 In *Handelman, Re*, supra at ¶ 6, Farley, J. stated that Catzman, J. correctly described the effect of s. 178(2) of the *BIA* (then s. 148(2)) in *Kryspin, Re*, supra. There a medical doctor who had executed general security agreements in favour of two banks made an assignment into bankruptcy. A dispute arose over whether payments by OHIP for services rendered by him should be payable to the doctor or to the banks. Before it resolved, the doctor obtained an

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absolute order of discharge. In deciding that the assignments in the security agreements to the bank operate with respect to the OHIP payments for insured services performed by the doctor until his discharge from bankruptcy and thereafter were ineffective, Catzman, J. stated at ¶ 50:

> ¶ 50 In the interest of precision, it should be observed that s. 148(2) does not in terms purport to extinguish the debts owed by the bankrupt at the time of bankruptcy, but rather to release the bankrupt from all claims provable in bankruptcy other than those specified in s. 148(1). . . .

61 In both Miller, Re, supra and Handelman, Re, supra the bankrupt did not disclose the plaintiff's possible or contingent claim to the trustee and did not give notice of his bankruptcy to the plaintiff. Certainly equitable concerns were a factor in those cases; for example, Justice Farley in Handelman, Re, supra pointed out at ¶ 4 that s. 158(d) of the *BIA* creates a duty upon the bankrupt to advise the trustee of all assets and liabilities and that creditors must be alerted in some manner so they may prove their claims. However, it is my view that the fact that those discharges were obtained with a degree of stealth was not determinative of this issue. The reasoning in respect to s. 178(2) in those decisions can stand alone.

62 Furthermore, I do not accept that the bankruptcy judge erred by failing to follow *Woodworth v. J.S. McMillan Fisheries Ltd.* (2000), 21 C.B.R. (4th) 314 (B.C. S.C.). There, the plaintiff fell on property leased to a fishery company, which had a comprehensive general liability policy. The company subsequently filed a proposal which was approved by sufficient creditors, and then by the British Columbia Supreme Court. Only afterwards did the plaintiff commence her action in negligence, and apply for leave to pursue her claim so that she might access the insurance funds. While the British Columbia Supreme Court granted leave, it held that the fisheries company had a complete defence to the plaintiff's claim, despite the fact that it might be covered by insurance. It determined that the proposal was binding on all unsecured claims, even though the plaintiff had not participated in the proposal process.

63 In the course of his decision, the judge in *Woodworth*, supra wondered whether there really was a distinction between proposal and bankruptcy situations, and suggested that the same reasoning should apply to the bankruptcy of a company as to an individual. He asked himself:

> ¶ 24 . . . are not bankrupts effectively released from all pre-bankruptcy claims? Subsection 178(2) of the *Act* states that, with the exception of certain specified claims, an order of discharge from bankruptcy releases the bankrupt from all claims provable in bankruptcy. . .
>
> ¶ 25 . . . The rationale was that, as the claim against the bankrupt became a claim against the estate and could be asserted against the trustee and the estate, the discharge from bankruptcy did not affect the ability of the plaintiff to continue the action for the purpose of establishing liability. I have reservations about this rationale because, although the claim continues to exist within the bankruptcy estate despite the bankrupt's discharge, the assertion of the claim in an action is being done outside the bankruptcy estate. I also query whether the insurer would be required to pay after the bankrupt's discharge because, in the phraseology of Commonwealth's policy, the insured bankrupt would not be legally obligated to pay because the discharge from bankruptcy operated to release the bankrupt from the claim.

Later in my decision, I will address the meaning of "legally obligated to pay." For the present purposes of my examination of Miller, Re, supra and the reasoning in that and other cases, it is sufficient to note that these comments are clearly *obiter dicta.* Moreover, the appeal before us pertains, not to a proposal as in *Woodworth*, supra, but to a bankruptcy and the effect of a discharge from bankruptcy.

64 I conclude that the bankruptcy judge did not err in relying upon Major, Re, supra and Miller, Re, supra in granting Superline its application. Despite the issuance of the Discharge Order, Superline is not preluded from continuing its claim against Buchanan in an attempt to access the insurance proceeds. Such a conclusion accords with

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the purposes of the *BIA* described earlier. It does not affect the orderly distribution of the bankrupt's property among his creditors nor, since the claim does not affect Buchanan or his assets, does it impede his financial rehabilitation.

65 Moreover, as the bankruptcy judge pointed out, policy reasons also support this conclusion. Were Superline not able to continue, Dominion would garner a windfall. The liability insurer would be permitted to obtain a financial benefit from the absolute discharge of its own insured. Finally, I do not accept the argument that if the bankruptcy judge's decision is upheld, both insured and uninsured claimants will delay proceeding until after a bankrupt's discharge, in order to increase the payment that might be received. Uninsured claims will not include features such as the payable on behalf of the insured characteristic, which was significant here. The same might be said of many insured claims and, of course, generally parties have an interest in concluding disputes and claims expeditiously and efficiently.

(4) Does a provision in the Policy providing that bankruptcy of the insured does not relieve the insurer of its obligation mean that Dominion has waived its right to rely upon Buchanan's Discharge Order as a defence?

66 In his decision, the bankruptcy judge referred to wording in the Policy in deciding that, despite the Discharge Order, Superline could still advance its claim. Section IV, Condition 1 of the insuring agreement (the "waiver clause") deals specifically with the effect of the bankruptcy of the insurer on the insurer's obligations:

> Bankruptcy or insolvency of the insured or of the insured's estate will not relieve us of our obligations under this rider.

As is apparent from these proceedings, notwithstanding his insolvency and bankruptcy, Dominion continues to provide a defence to Buchanan. Superline argues that the inclusion of the waiver clause in the Policy means that Dominion has waived its right to rely upon Buchanan's discharge from bankruptcy as a defence.

67 The bankruptcy judge quoted an extract from *Miller, Re*, supra on the interpretation of the waiver clause. In that decision, Deputy Registrar Sproat commented as follows at ¶ 28:

> Secondly, the LPIC insurance policy expressly provides that its obligations are unaffected by the bankruptcy of the insured. Counsel for Walton points to the following provision of the LPIC policy:
>
> > M. ... Bankruptcy or insolvency of the insured or of the insured's estate shall not relieve the insurer of any of its obligations hereunder.
>
> Thus, even if counsel for Miller is correct that s. 178(2) of the BIA operates as a release of the bankrupt's legal obligation to pay, it appears that LPIC has waived its right to rely upon the statutory release. ...

68 In *Insurance Law: A Guide to Fundamental Principles, Legal Doctrines and Commercial Practices* (St. Paul: West Publishing Co. 1988), Professor R. Keeton discussed the origins of such provisions regarding the effect of bankruptcy at pp. 377-8:

> In its original form, liability insurance was an agreement by an insurer to indemnify an insured against loss arising as a consequence of an insured's tort liability to a third person. As the relationship of the liability insurer to the insureds and the injured persons was originally structured, even after obtaining a tort judgment against an insured an injured victim was not entitled to proceed against the insurer when the insured either could not pay or did not pay. If the injured person sought payments directly from the insurer, the insurer could defend successfully because its obligation was only to the insured. ... The obvious inequity of such situations led to legislation in some states requiring that liability insurance contracts include a provision to the effect that the insolvency or bankruptcy of an insured shall not release an insurer from liability. In time, similar legislation almost certainly

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> would have been adopted in every state had not insurers revised the standard policy forms used for liability insurance to provide coverage without regard to an insured's solvency.

69 In the text, *Commercial General Liability Insurance* (Markham: Butterworths, 2000*)*, H. Sanderson et al. explained at p. 6 that the concept of comprehensive general liability insurance developed in the United States, grew during World War II, and became popular throughout that country and Canada thereafter. The authors noted:

> In Canada the effort to produce standard form CGL coverage for the Canadian insurance industry was undertaken by the Insurance Bureau of Canada (IBC). They have from time to time issued standard form wording of Comprehensive GL coverage which in large part has adopted the American forms, adapted to the Canadian legal environment. For this reason, American decisions interpreting CGL wording are commonly accepted by Canadian courts when they are called upon to interpret various provisions of a CGL policy.

70 In support of its argument that Dominion waived its right to rely on s. 178(2) and the Discharge Order, Superline relies upon *Geary v. C & K Mufflers* [, Doc. 267105 (U.S. Mich. Ct. App. 2006)], 2006 Mich. App. LEXIS 1800, where the Court of Appeals for Michigan considered the effect of a waiver clause. After the injured plaintiff obtained judgment against him, the defendant filed a voluntary petition for bankruptcy. The plaintiff sought relief from the automatic stay, and the bankruptcy court granted an order authorizing the plaintiff to "recover against any insurance policy issued [with the bankrupt] as the insured ..." After the defendant's discharge from bankruptcy, the plaintiff obtained a writ of garnishment against the defendant's insurer. The court rejected the insurer's argument that its obligations ended following the insured's discharge from bankruptcy. It stated at p. 6:

> We also conclude that the trial court properly rejected Secura's argument that Finney's bankruptcy discharge terminated its obligation to satisfy a judgment against its insured for bodily injury. The provision of the parties' contract that directly addresses this issue could not be clearer and governs. Section E(1) of Secura's business owners liability coverage form, captioned "Bankruptcy," plainly states, "Bankruptcy or insolvency of the insured or of the insured's estate will not relieve us of our obligations under this policy."

71 *Geary*, supra is consistent with the approach of other American courts interpreting bankruptcy provisions. See, for example, *Skenandoa Rayon Corp. v. Halifax Fire Ins. Co.*, 245 A.D. 279, 281 N.Y.S. 193 (U.S. N.Y.A.D. 4th Dept. 1935), N.Y. App. Div. LEXIS 10281, and *Musser v. Musser*, 2003 Ohio 1440 (U.S. Ohio Ct. App. 2003), 2003 Ohio App. LEXIS 1384.

72 There is, however, a factual distinction between the American cases cited and the situation which is the basis of the decision under appeal. In the American cases, the plaintiff had obtained judgment prior to the insured's bankruptcy. That same scenario appears to be what was contemplated in the passage quoted from Professor Keeton. For that reason, where judgment against the bankrupt has not been obtained, as is the situation in this appeal, it would not be appropriate to rely on the American cases in determining whether the waiver clause was intended to allow third parties who suffer loss at the hands of a bankrupt to recover directly from the bankrupt's liability insurer.

73 In my view, the waiver clause was not intended for the benefit of third parties. Rather, it was inserted for the benefit of the insured. It relates to the insurer's duty to indemnify (i.e., to pay all sums he becomes "legally obligated to pay" as compensatory damages), and the duty to defend (i.e., to defend an action seeking such damages) described earlier. The purpose of the waiver clause is to require the insurer to defend the insured despite his bankruptcy and, pursuant to the duty to indemnify, to pay any successful claims against the insured despite his bankruptcy.

74 Accordingly, I reject the argument that the waiver clause serves as an alternate ground for upholding the decision of the bankruptcy judge.

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(5) Prior to any judgment being entered against Dominion, does Superline have rights directly against Dominion under the Policy it issued which names Buchanan as an insured?

75 Pursuant to the duty to indemnify in the Policy, Dominion is not required to indemnify unless it is "legally obligated to pay." The only named insured in the Policy is Buchanan, operating as Sable Heating and Ventilation. Dominion did not guarantee Buchanan's obligations, or agree to indemnify any creditor, or to indemnify Superline with respect to any loss it may have suffered arising from his alleged negligence and breach of contract. According to the appellants, as Superline is a stranger to the insurance contract, it has no rights thereunder until judgment has been entered against Buchanan, or an agreement reached with the insured and insurer.

76 The issue then is this: what does "legally obligated to pay" in the duty to indemnify mean? In particular, is there any obligation to indemnify enforceable by Superline, prior to the liability of Buchanan being reduced to either a judgment or a settlement agreement to which Dominion is a party? While Superline has neither obtained judgment against Buchanan, nor settled its claim, Buchanan and Dominion certainly knew well before his Discharge Order of Superline's claim.

77 I begin my analysis with s. 28 of the *Insurance Act* which sets out when a claimant acquires a right to sue an insurer directly. It reads:

> **Action against insurer**
>
> 28 (1) Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against him in respect of his liability, and an execution against him in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.
>
> (2) This Section does not apply to motor vehicle liability policies.

78 Section 28(1) makes it clear that if, *before* the Discharge Order issued, it had obtained judgment against Buchanan which he did not satisfy, Superline would have been entitled to claim against Dominion to the limits of the Policy. The judgment against Buchanan would have been released by the Discharge Order, but Superline could continue directly against the insurer.

79 I turn then to an examination of the academic writing, the terms of the Policy, and the case law relevant to the interpretation of the phrase "legally obligated to pay" in the duty to indemnify.

80 The text *Snowden and Lichty: Annotated Commercial General Liability Policy*, looseleaf (Aurora: Canada Law Book Inc.), discusses the phrase "legally obligated to pay" at ¶ 7:20.1 as follows:

> **7:20.1 Meaning of "Legally Obligated to Pay"**
>
> At first glance and notwithstanding the absence of definition, one would not expect the courts to have difficulty attributing meaning to "legally obligated to pay". One Court has stated that a lay person would quite naturally and properly consider that a Court judgment to pay damages is a legal obligation. Where a Court judgment fixes the obligation of the insured to pay damages to a third party, there is a legal obligation.

That a prior judicial determination would create a legal obligation to pay is not surprising. It remains to be seen whether anything other than, or earlier than, a judgment is captured by that phrase.

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81 Jurisprudence on the insurer's duty to indemnify as set out in the statement "We will pay all sums which you become legally obligated to pay . . . " is limited. The parties did not direct this court to any appellate decisions. *Builders Contract Management Ltd. v. Simcoe & Erie General Insurance Co.*, [1993] S.J. No. 176 (Sask. Q.B.) is not helpful since its principal issue was when an insurance claim is made. However, a few lower court cases relating to the effect of limitation periods set out in the insurance policies themselves, such as those found in Section IV, Condition 6 of the Policy, and relating to releases, provide some guidance. I will review these briefly.

82 In *J & P Holdings Ltd. v. Saskatchewan Mutual Insurance Co.* (1990), 84 Sask. R. 52 (Sask. Q.B.) and *Co-Operative Avicole de St-Isidore Ltd. v. Co-operators General Insurance Co.*, 44 C.C.L.I. (2d) 1, [1997] O.J. No. 2550 (Ont. Gen. Div.), the insurance policies specified, *as a condition precedent*, that no action lies against the insurer until the amount of the insured's obligation to pay has been determined by judgment after trial or by written agreement of the insured, the claimant and the insurer. In *J & P Holdings*, supra when the sheriff was unable to execute on the applicant's judgment against the estate of a bankrupt contractor, the applicant brought an action against the contractor's insurer. It argued that J & P was out of time under the policy. The Saskatchewan Court of Queen's Bench decided that the applicant was not subject to the policy's limitation period, as provincial legislation governed the situation.

83 In *Co-Operative Avicole*, supra the plaintiff claimed indemnification against its own insurer, for its loss following a court judgment finding it liable for damages for breach of contract. That decision had been allowed in part on appeal. At ¶ 67, the judge stated:

> ¶ 67 Similarly, with respect to the one (1) year limitation period in the policy to take action against Cooperators, not only were they advised well before the trial judgment that they would look to Cooperators to indemnify them but action was taken before that judgment was finally dealt with by the Court of Appeal. No cases on point were cited at this hearing but it seems logical to me that the time when it can be said that St. Isidore "became legally obligated to pay" was when the appeal was decided and any further possible appeal period was exhausted. Had there been no appeal, St. Isidore's cause of action against it's [sic] insurer would have arisen only after the trial judgment was rendered and the appeal period had passed. It is significant, in my view, that the condition dealing with this limitation period utilizes the words "finally determined" when stipulating when an action is to lie against the insurer. (Emphasis added)

84 Section IV, Condition 6 of the Policy issued by Dominion to Buchanan provides:

> **6. Legal Action Against Us.**
>
> ***No person or organization has a right under this rider***
>
> a. To join us as a party or otherwise bring us into an "action" asking for compensatory damages from an insured; or
>
> b. To sue us on this rider unless all of its terms have been fully complied with.
>
> A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured obtained after an actual trial; but we will not be liable for compensatory damages that are not payable under the terms of this rider or that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative. Every "action" or proceeding against us shall be commenced within one year next after the date of such judgment or agreed settlement and not afterwards. If this Policy is governed by the law of Quebec every "action" or proceeding against us shall be commenced within three years from the time the right of action arises.

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(Emphasis added)

85 Unlike that in *J & P Holdings*, supra and *Co-Operative Avicole*, supra the wording in Section IV, Condition 6 of the Policy does not require an agreed settlement or a final judgment after trial as firm conditions precedent to the right to sue. While its wording is not as rigorous, that Condition does stipulate that no organization has the right to sue the insurer *unless* it has complied with all the terms of the Policy, and that an organization may sue to recover on an agreed settlement or on "final judgment" after trial. In my view, that wording is sufficiently similar for the observations on "legally obligated to pay" in those decisions to be considered here.

86 In *Qualiglass Holdings Inc. v. Zurich Indemnity Co. of Canada*, 2004 ABQB 577 (Alta. Q.B.), after their lawyer advised their accountant of the plaintiffs' intention to seek compensation for alleged accounting errors, the accountant did not contact his errors and omissions insurer. The insurance lapsed. He later made an assignment into bankruptcy. The plaintiffs commenced their action; the insurers denied coverage. After obtaining judgment against the accountant, the plaintiffs brought an action against the insurer to recover the benefit of the insurance coverage related to its claim. In response to the insurer's argument that the claim was reported outside the time limit, the trial judge held:

> ¶ 58 In any event, Zurich's position is without merit. In the policy upon which the action is founded, Zurich first agreed to indemnify Chinnery in respect of ". . . all sums which the Insured shall be legally obliged to pay as damages because of any act or omission of the Insured . . .". Zurich also agreed, as an additional obligation under the policy, to defend any suit brought against Chinnery alleging liability for which Zurich agreed to indemnify Chinnery. When Zurich advised Chinnery on April 30, 1997 that coverage would be denied, there had been no determination that Chinnery was legally obliged to pay damages to Qualiglass. Chinnery may at that point have had a cause of action under the policy in respect of Zurich's failure to provide him with a defence of Qualiglass' claim, but he had, at that point, no claim for indemnity. His claim for indemnity did not arise until he was "legally obligated to pay" damages to Qualiglass. That occurred on March 28, 2001 when Qualiglass obtained judgment against Chinnery.
>
> ¶ 59 The cause of action pursued by Qualiglass in this action, Chinnery's cause of action for indemnity under the policy, arose on March 28, 2001. The limitation period in respect of that cause of action had not expired when this action was commenced on November 14, 2001. (Emphasis added)

87 In *McMurachy v. Red River Valley Mutual Insurance Co.* (1994), 115 D.L.R. (4th) 220 (Man. C.A.), leave to appeal dismissed [1994] S.C.C.A. No. 267 (S.C.C.), the facts underlying the timing issue included a settlement that did not include the insurer, and a release. A worker was seriously injured when constructing a home for the insured. After the insurer denied coverage, the worker settled his action against the insured, who assigned her cause of action against the insurer to the worker. The assignment was accompanied by a release. Before trial, the insurer conceded that it had wrongfully denied coverage to the insured. The trial judge dismissed the worker's action on the basis that the release meant that the insured had suffered no loss. In allowing the appeal, Scott, C.J.M. for the court stated at p. 227:

> It is my conclusion that the trial judge was in error when he dismissed the plaintiff's action on the overly simplistic basis that the insured "had suffered no loss". The insurer wrongfully repudiated its contractual liability to defend and indemnify its insured McMurachy. In order to protect herself from the exposure of significant personal liability, the insured entered into a settlement with the claimant which she was clearly entitled to do. At that moment, at the latest, the insurer's responsibility was fixed and the arrangement made thereafter for the assignment of the claim and the fixture [sic] protection of the insured, all arising from the breach of contract of the insurer, does not negate the insurer's obligation to indemnify under the terms of the policy. (Emphasis added)

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88 In all these cases, judgment had already been obtained or a settlement reached. In the context of when limitation periods started to run, several courts have considered that an insurer became "legally obligated to pay" when liability had been determined by legal process. While, on a factual basis, *McMurachy* supra, is less relevant to this appeal than the other decisions reviewed, it does not suggest that the obligation to pay could arise any earlier than the settlement necessitated by the wrongful denial of coverage. Here, neither judgment nor settlement has been achieved. I also observe that none of these cases had to consider the effect of an order of absolute discharge on the duty to indemnify.

89 While no appellate decision considering the meaning of "legally obligated to pay" was brought to our attention, the court asked the parties for submissions in regard to *Somersall v. Friedman*, [2002] S.C.J. No. 60, 2002 SCC 59 (S.C.C.) in which the Supreme Court of Canada examined the meaning of the phrase "legally entitled to recover" in an insurance context. The Somersalls were injured in a car accident by Friedman, an underinsured driver. They brought an action against him, and later entered into a limits agreement with him. Among other things, it provided that Friedman would admit liability at trial, and that the Somersalls would not claim against him or his insurer in excess of Friedman's policy limit of $200,000. The Somersalls then sought to recover the remainder of their damages from their own insurer, pursuant to their underinsured driver coverage known as the SEF 44 endorsement. It obliges the insurer to:

> . . . indemnify each eligible claimant for the amount that such eligible claimant is legally entitled to recover from an inadequately insured motorist as compensatory damages in respect of bodily injury or death sustained by an insured person by accident arising out of the use or operation of an automobile. (Emphasis added)

90 The insurer argued that the limits agreement bound the Somersalls, and applied for a determination before trial of its liability on a question of law. The motions judge ruled that the Somersalls were no longer "legally entitled to recover" damages beyond those already recovered pursuant to that agreement. That ruling was overturned by the Ontario Court of Appeal.

91 In considering the scope and meaning of the phrase "legally entitled to recover," the Supreme Court of Canada examined the relevant time of the inquiry. Iacobucci, J. for the majority, stated:

> ¶ 29 Thus, it must be decided at which point in the past the inquiry must be conducted on the best reading of the contract. *The language of clause 2, in my view, clearly makes the time at which the insurer becomes subject to making the indemnity payment contemporaneous with the time at which the insured must be legally entitled to recover.* Whenever the insurer, under the contract, "shall indemnify", i.e., whenever the insurer's obligation comes into being, whatever legal entitlement there "is" at that time is the amount that the insurer must pay by way of indemnification.
>
> ¶ 30 *The question, therefore, is when the obligation to indemnify comes into being. In my view, the answer must be that the insurer becomes obliged to make the payment the moment the claim of the insured against the tortfeasor comes into being, that is, at the time of the accident.* At that moment, all of the conditions set out in the SEF 44 will be satisfied; death or bodily injury has occurred, negligently caused by an inadequately insured motorist. In other words, all of the conditions necessary to make out a claim in tort against the inadequately insured driver come into being at the moment of the accident. *The SEF 44 means to compensate the insured for the existence of such a claim against an inadequately insured driver. The obligation of the insurer, therefore, comes into being at the same time as the obligation of the tortfeasor to pay damages.* (Underlining in original; italics added)

92 The factual underpinnings of *Somersall*, supra prevent it from being determinative of the meaning of the phrase in the duty to indemnify which is under consideration. The phrase "legally entitled to recover" in the underinsured driver coverage endorsement considered in *Somersall*, supra is similar to the phrase "legally obligated to pay"

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in the Policy, but the two are not identical. More significantly, the contexts are different. In *Somersall*, supra the court examined the meaning of a contract between an insurer and its insured, who had insured against their own injury. Here, the claimant, Superline, was not a party to the Policy between Buchanan and his insurer, Dominion. Furthermore, in *Somersall*, supra the question to be answered, namely when the liability of the person who caused the loss arises, is different from the question here, namely when the duty to indemnify arises. Finally, bankruptcy and absolute orders for discharge were not considerations in that decision.

93 In my opinion, based upon the interaction of s. 28 of the *Insurance Act*, s. 178(2) of the *BIA*, and the wording of the Policy, the fact that any judgment Superline may obtain against Buchanan must follow his Discharge Order does not prevent Superline from continuing its action against him, in an effort to access the insurance under the Policy. Allow me to elaborate.

94 Earlier in this decision, I determined that by following *Miller, Re*, supra and that line of cases, the bankruptcy judge did not err. In the result, s. 178(2) of the *BIA* released Buchanan from claims provable in bankruptcy, such as that asserted by Superline. Put another way, the Discharge Order prevents Superline from enforcing any judgment against Buchanan and his property. This, of course, reflects the objectives of our bankruptcy legislation as described in *Husky Oil Operations Ltd.*, supra quoted in ¶ 32 above. However, s. 178(2) does not extinguish Buchanan's underlying legal obligation, if any, to Superline. At all material times, Buchanan had insurance coverage, which would be paid to a successful claimant and not be available to his creditors, against the very types of claims Superline is advancing against him. The Leave Order granted Superline leave to continue its action for the very purpose of determining Buchanan's liability. Superline's action may continue in order to determine what, if anything, Buchanan was obligated to pay prior to the issuance of his Discharge Order.

95 As previously discussed, had Superline obtained judgment against Buchanan *before* his Discharge Order issued, it could have proceeded directly against Buchanan's insurer, Dominion, pursuant to s. 28(1) of the *Insurance Act*. Here, the Discharge Order preceded any judgment against Buchanan. An examination of that provision shows that the determinations made earlier in respect of s. 178(2) satisfy several of its conditions. It is reproduced again for convenience:

> **Action against insurer**
>
> 28 (1) Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against him in respect of his liability, and an execution against him in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.

96 Assuming that the continuation of its action against Buchanan allows Superline to satisfy the conditions in s. 28(1) for a direct action, the insurer could not rely on its own insured's bankruptcy to escape payment. According to s. 28(1), the claim is subject to the same equities the insurer would have "as if the judgment had been satisfied." If judgment had been obtained and satisfied, the waiver clause in the Policy would not assist to avoid liability. As discussed earlier, the waiver clause requires an insurer to defend its insured and to fulfill its duty to indemnify, despite the insured's bankruptcy.

97 Accordingly, whether Buchanan's liability was determined before, or will be determined after, his discharge from bankruptcy does not affect his insurer's obligation to indemnify. As in the analysis in *Somersall*, supra the question is when that duty arises. Given the wording in the duty to indemnify in the Policy, namely: "We will pay those sums that the insured becomes legally obligated to pay as compensatory damages . . ." and s. 28 reviewed above, the answer is at that point in time where "a person incurs a liability for injury or damage;" i.e. before discharge.

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98 In conclusion, in my view, the fact that Superline has not entered judgment against Buchanan or reached a settlement with him and his insurer does not prevent it from proceeding against Buchanan. While his Discharge Order is a complete bar to enforcement of any judgment Superline may obtain against him, it does not preclude Superline from taking out judgment against him in order to continue against his insurer.

(6) If Superline is entitled to proceed with its action, does this constitute prejudice to Rexel?

99 As indicated in the background facts, after Superline commenced its action against Buchanan, Buchanan added Rexel and Roby Metals Ltée. as third parties. Roby Metals Ltée. subsequently declared bankruptcy; it is no longer involved in these proceedings.

100 Rexel points out that by third partying it, Buchanan had a contingent claim against it. It argues that as this constituted "property" as defined in s. 2 of the *BIA*, the Trustee could have settled that claim with Rexel or could have proceeded with the third party claim in litigation (s. 30 of the *BIA*). Since Superline did not proceed with its claim, neither Rexel nor the Trustee took any steps to deal with Buchanan's third party claim against Rexel. This, asserts Rexel, resulted in such prejudice to its position that Buchanan's bankruptcy and Discharge Order should prevent any future claim against it.

101 With respect, I cannot agree with Rexel's position. Buchanan's liability, if any, has not yet been determined. If found to be none, the third party claim will fail. If Buchanan is liable, then the extent of Rexel's liability, if any, will also be determined. At this point, where no findings of fact, much less any determination of liability, have been made, it is impossible to assess whether, as Rexel urges, there was a "real likelihood" that the third party claim could have been compromised for its nuisance value only.

102 It was not necessary to decide, and I make no comment whatsoever, as to whether Rexel's liability as third party, if any, survives the Discharge Order, nor as to any rights Dominion may have against Rexel.

Buchanan's Appeal Against Dismissal of its Applications

103 As set out earlier, Buchanan's appeal raises two issues:

(1) Whether leave should be granted with respect to his applications to amend his defence to provide that he had been released from further liability as a consequence of the company Discharge Order, and to strike out Superline's statements of claims and to provide for summary judgment, and

(2) If so, whether Buchanan is entitled to summary judgment against Superline, giving effect to that defence.

104 Having decided that the Discharge Order releases Buchanan and his property from any liability to Superline, I need not deal with these issues.

Disposition

105 I would grant the appellants leave to appeal the decision and order of the bankruptcy judge which provided that the Discharge Order shall not operate to limit, restrict or relieve Dominion of any liability or obligation it may have to pay, on behalf of Buchanan, any third party where the liability arises pursuant to the Policy, but would dismiss the appeal.

106 As is apparent from my review of the jurisprudence, the issues raised on this appeal were novel. In the cir-

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cumstances, there will be no order of costs.

Appeal dismissed.

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TAB 9

2007 CarswellNfld 383, 2007 NLCA 77, [2008] I.L.R. I-4665, 56 C.C.L.I. (4th) 161, 38 C.B.R. (5th) 224, 830 A.P.R. 199, 272 Nfld. & P.E.I.R. 199

Genge v. Parrill

Steward Genge and Rick Genge (Appellants) and Lionel Barrett Parrill and Wilson Parrill (Respondents)

Newfoundland and Labrador Court of Appeal

M. Rowe, K.J. Mercer, L.D. Barry JJ.A.

Heard: December 5, 2007
Judgment: December 14, 2007
Docket: 06/102

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Counsel: John R. Sinnott, Q.C. for Appellants

Colin Feltham for Respondents

Subject: Civil Practice and Procedure; Insolvency; Torts

Bankruptcy and insolvency --- Effect of bankruptcy on other proceedings — Proceedings against bankrupt — After discharge of bankrupt

P was rendered paraplegic after he was struck while driving automobile by snowmobile operated by S and owned by R — At time of collision, there was no insurance on snowmobile — At trial as to liability only, S and R were held 75 percent responsible for collision — Decision was appealed unsuccessfully to this court and leave to Supreme Court of Canada was denied — Following receipt of P's claim in respect of quantum of damages, S and R made assignment in bankruptcy — Upon S and R's discharge from bankruptcy, P sought to continue his action to obtain judgment as to quantum of damages — P sought to continue action not to enforce judgment against S and R, but rather to recover what he could from judgment recovery pursuant to Judgment Recovery (Nfld.) Ltd. Act ("JRA") — P's application to trial division to have judgment recovery joined in action as to P's damages was dismissed — S and R applied under R. 17A of Rules of the Supreme Court, 1986 to dismiss P's action on basis that they were discharged bankrupts and therefore, released from P's claims — S and R's submissions focused on whether P could proceed against judgment recovery by operation of s. 145 Bankruptcy and Insolvency Act ("BIA") — Judge dismissed S and R's application for summary judgment on basis that scheme established under JRA was covered by phrase "liability insurance policy" — S and R appealed — Appeal dismissed — S and R failed to show how applications judge erred — Discharge did not prevent P from continuing action — Although BIA releases bankrupt from claims provable in bankruptcy, it does not extinguish debts that form basis for such claims — S and R were released from having to satisfy debt, but it did not extinguish underlying legal obligation that survived for purpose of insurance policy.

Cases considered by *M. Rowe J.A.*:

Buchanan, Re (2007), (sub nom. *Buchanan v. Superline Fuels Inc.*) [2007] I.L.R. I-4601, 2007 CarswellNS 251, 2007 NSCA 68, 32 C.B.R. (5th) 1, 50 C.C.L.I. (4th) 17, (sub nom. *Buchanan v. Superline Fuels Inc.*) 255 N.S.R. (2d) 286, (sub nom. *Superline Fuels Inc. v. Buchanan*) 284 D.L.R. (4th) 113, (sub nom. *Buchanan v. Superline Fuels Inc.*) 814 A.P.R. 286 (N.S. C.A.) — followed

Buchanan, Re (2007), 2007 CarswellNS 574, 2007 CarswellNS 575 (S.C.C.) — referred to

Duvall, Re (1992), 63 B.C.L.R. (2d) 97, 11 C.B.R. (3d) 264, 1992 CarswellBC 485 (B.C. S.C.) — referred to

Eurasia Auto Ltd. v. M & M Welding & Supply (1985) Inc. (1991), 1991 CarswellAlta 306, 5 C.B.R. (3d) 227, 1 C.C.L.I. (2d) 203, 119 A.R. 348 (Alta. Master) — referred to

Major, Re (1984), 56 B.C.L.R. 342, 54 C.B.R. (N.S.) 28, 1984 CarswellBC 588, [1984] 6 W.W.R. 435 (B.C. S.C.) — referred to

Yu v. Befus (2003), 2003 ABQB 451, 2003 CarswellAlta 1374, 38 Alta. L.R. (4th) 93, 344 A.R. 197, [2005] 3 W.W.R. 543 (Alta. Q.B.) — referred to

Statutes considered:

Automobile Insurance Act, R.S.N. 1970, c. 17

s. 24A [en. 1971, No. 74, s. 5] — referred to

Automobile Insurance Act, R.S.N. 1990, c. A-22

Generally — referred to

s. 26 — referred to

Automobile Insurance (Amendment) Act, S.N.L. 1994, c. 4

s. 5 — considered

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

Generally — referred to

s. 69 — referred to

ss. 69-69.31 — referred to

ss. 69-69.4 — referred to

s. 69.3 [en. 1992, c. 27, s. 36(1)] — referred to

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s. 69.4 [en. 1992, c. 27, s. 36(1)] — referred to

s. 121(1) — referred to

s. 145 — considered

s. 168.1(1)(f) [en. 1992, c. 27, s. 61(1)] — referred to

s. 168.1(4) [en. 1992, c. 27, s. 61(1)] — referred to

s. 178(1) — referred to

s. 178(2) — referred to

Interpretation Act, R.S.C. 1985, c. I-21

s. 12 — referred to

Judgment Recovery (Nfld.) Ltd. Act, R.S.N. 1990, c. J-3

Generally — referred to

s. 26 — referred to

s. 26(1) — referred to

s. 26(2) — referred to

s. 26(11) — referred to

Judicature Act, R.S.N. 1990, c. J-4

s. 97 — referred to

Rules considered:

Rules of the Supreme Court, 1986, S.N. 1986, c. 42, Sched. D

R. 17A [en. Nfld. Reg. 165/94] — considered

R. 17A.01(1) [en. Nfld. Reg. 165/94] — considered

R. 17A.03(1) [en. Nfld. Reg. 165/94] — considered

R. 17A.05(2) [en. Nfld. Reg. 165/94] — referred to

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2007 CarswellNfld 383, 2007 NLCA 77, [2008] I.L.R. I-4665, 56 C.C.L.I. (4th) 161, 38 C.B.R. (5th) 224, 830 A.P.R. 199, 272 Nfld. & P.E.I.R. 199

APPEAL by driver and owner of snowmobile from decision of applications judge dismissing their application for summary judgment.

***M. Rowe J.A.*:**

Introduction

1 This decision deals with whether the province's (former) scheme for compensating victims of uninsured motorists under the *Judgment Recovery (Nfld.) Ltd. Act*, R.S.N.L. 1990, c. 9-3 comes within the meaning of "liability insurance policy" in s. 145 of the *Bankruptcy and Insolvency Act*, R.S.C., c. B-3.

Facts

2 In March 1990, Lionel Parrill (one of the Respondents, the other being his father Wilson Parrill) was driving an automobile that was struck by a snowmobile operated by Rick Genge (one of the Appellants) and owned by Steward Genge (the other Appellant). As a result of the collision, Lionel Parrill was rendered a paraplegic.

3 At the time of the collision, there was no insurance on the snowmobile operated by Rick Genge.

4 At a trial as to liability only, the Genges were held 75% responsible for the collision and, thus, Lionel Parrill's resulting injuries. That decision was appealed unsuccessfully to this Court. Leave to appeal to the Supreme Court of Canada was denied.

5 Following receipt of Mr. Parrill's claim in respect of the quantum of damages, the Genges made an assignment in bankruptcy in December 2001. In September 2002, the Genges were discharged from bankruptcy.

6 Lionel Parrill is seeking to continue his action against the Genges to obtain a judgment as to the quantum of damages. Mr. Parrill is doing so not so as to enforce the judgment against the Genges, but rather to recover what he can from Judgment Recovery pursuant to the *Judgment Recovery (Nfld.) Ltd. Act*, rep. by *Automobile Insurance (Amendment) Act*, S.N.L. 1994, c. 4, s.5.[FN1] (The maximum that Mr. Parrill could obtain from Judgment Recovery is $200,000.)

7 Mr. Parrill applied in the Trial Division to have Judgment Recovery joined in the action as to Mr. Parrill's damages; that application was denied.

8 In April 2006, the Genges applied under Rule 17A of the *Rules of the Supreme Court, 1986* to dismiss Mr. Parrill's action on the basis that the Genges are discharged bankrupts and, therefore, released from Mr. Parrill's claims. (Unless Mr. Parrill can obtain final judgment against the Genges, counsel state that Judgment Recovery will resist making payment to him.)

9 Rule 17A reads, in part:

> 17A.01(1) A ... defendant may ... apply to the Court ... seeking ... dismissal of ... the claim in the statement of claim ... .
>
> 17A.03(1) Where the Court is satisfied that there is no genuine issue for trial with respect to a claim or defence, the Court shall grant summary judgment accordingly.

10 On the Genges' application for summary judgment, submissions focused on whether Mr. Parrill could pro-

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ceed against Judgment Recovery by operation of s. 145 of the *Bankruptcy and Insolvency Act*. That provision reads:

> 145. *Proceeds of liability insurance policy on motor vehicles* — Nothing in this Act affects the right afforded by provincial statute of any person who has a claim against the bankrupt for damages on account of injury to or death of any person, or injury to property, occasioned by a motor vehicle, or on account of injury to property being carried in or on a motor vehicle, to have the **proceeds of any liability insurance policy** applied in or toward the satisfaction of the claim.
>
> [Emphasis added.]

11 In an unreported decision, annexed hereto as appendix A, Green C.J.T.D. dismissed the Genges' application. He determined that upon proper application of the principles of statutory interpretation and consideration of the analysis in *Yu v. Befus*, 2003 ABQB 451, 344 A.R. 197 (Alta. Q.B.) the scheme established under the *Judgment Recovery (Nfld.) Ltd. Act* was covered by the phrase "liability insurance policy".

12 The Genges appealed that decision to this Court. However, the Appellants have failed to show how the Applications Judge erred. To the contrary, I would affirm his reasons for decision.

13 I would add only that the Nova Scotia Court of Appeal's decision in *Buchanan, Re*, 2007 NSCA 68, 255 N.S.R. (2d) 286 (N.S. C.A.), leave to appeal to S.C.C. refused, (S.C.C.) is further authority for the Applications Judge's interpretation of s. 145 of the *Bankruptcy and Insolvency Act*. There the defendant Buchanan (who had installed a leaky oil tank) had made an assignment in bankruptcy and been discharged after the plaintiff had brought action against Buchanan and his third party liability insurer. The Nova Scotia Court of Appeal held the discharge did not prevent the plaintiff from continuing the action. Oland J.A., for the Court, stated at para. 58:

> ... although s. 178(2) [of the **Bankruptcy and Insolvency Act**] releases the bankrupt from claims provable in bankruptcy, it does not extinguish the debts that form the basis for such claims. In the appeal before us, this means that s. 178(2) releases Buchanan from having to satisfy the debt, but it does not extinguish the underlying legal obligation. ...[T]hat underlying obligation survives for the purpose of the insurance policy ..., whether the extent of the obligation is crystallized by settlement or judicial determination before or after the order for discharge issues.

I agree with this reasoning.

14 The appeal is dismissed. The Respondents will have their costs in this Court on a party and party basis.

> In this application by the defendants for judgment on summary trial under Rule 17A, the defendants argue that the plaintiffs' right to claim damages for personal injury resulting from a collision between the plaintiffs' car and the defendants' uninsured snowmobile has been discharged by the defendants' bankruptcy and subsequent absolute discharge. It follows, counsel says, that the Court has no jurisdiction to set the assessment of damages down for hearing or to otherwise proceed to deal with the plaintiffs' claim. The plaintiffs reply that [sic] the argument that their right to pursue judgment against the defendants to enable them to claim against the province's unsatisfied judgment fund is preserved by Section 145 of the *Bankruptcy and Insolvency Act* [R.S.C. 1985, c. B-3]. Neither party took the position that it was inappropriate to decide the matters under Rule 17A, so I will therefore do so.
>
> The plaintiffs obtained an apportioned judgment against the defendants on issues of liability in 1994. Subsequently, in an effort to settle quantum, the plaintiffs submitted a quantification of the claimed damages. The defendants concluded that it would be impossible to pay an amount anywhere near the amount claimed and made an assignment in bankruptcy. The plaintiffs' claim was treated as a provable claim in bankruptcy, and the defen-

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dants, as I noted, ultimately received their discharge.

Prior to receipt of the discharge, the plaintiffs made an application and received an order purportedly under Section 69 of the *Bankruptcy and Insolvency Act*, which relates to stays of proceedings on filing of a notice of intention to make a proposal. The application and order was for leave to continue the proceeding against the defendants on the ground that no creditors would be unduly prejudiced by the continuation of the action, that the continuation would not interfere with the administration of the bankrupts' estate, and that it would not give the plaintiffs an unfair advantage.

Counsel for the defendants has taken the position that the order, to be effective, would have had to have been made under Section 69.4 in relation to a 69.3 stay. Since it was not, he says, the statutory stay has never been lifted.

Having reviewed the transcript of the hearing when the application was made and taking into consideration the statutory structure of Sections 69 through to 69.4, it is obvious to me, and I believe it would also be obvious to the applications judge at the time, that the plaintiffs were intending to apply for the lifting of the statutory stay that would otherwise have applied under Section 69.3 upon the defendants' bankruptcies. Section 69, which I said relates to notices of intention to make a proposal, manifestly had no connection with the facts of this case. I am also satisfied that in making the order, the judge intended that the order be made under Section 69.4. That is the section that applies to all of the statutory stays that arise in various circumstances under Section 69 through to Section 69.31. Section 69.4 is the only section under which a lifting of the stay could be made. The language used by the plaintiffs in support of the application at the hearing was clearly intended to address the conditions that have to be met for the lifting of the stay under Section 69.4. Accordingly, if it were necessary for this decision, I would have concluded that the plaintiffs would be entitled to an order rectifying the order they obtained to clearly indicate that it was being made under Section 69.4; or, alternatively, I would have been prepared to grant an order for leave to continue the proceeding nunc pro tunc.

The real issue before the Court, however, is whether Section 145 of the *Bankruptcy and Insolvency Act* allows the plaintiffs' action to proceed notwithstanding the defendants' discharge. Clearly, the combined effect of Sections 121(1), 168.1(1)(f), 168.1(4), and Section 178(2) is to discharge a bankrupt from all claims provable in bankruptcy with only certain limited exceptions in Section 178(1), which do not apply here. Now, Section 145 reads:

> Nothing in this **Act** affects the right afforded by provincial statute of any person who has a claim against the bankrupt for damages on account of injury to or death of any person, or injury to property, occasioned by a motor vehicle, or on account of injury to property being carried in or on a motor vehicle, to have the proceeds of any liability insurance policy applied in or toward the satisfaction of the claim.

The plaintiffs say that they want to be able to pursue the claim against the defendants for the sole purpose of obtaining a judgment which would then entitle them to access the provisions of the *Judgment Recovery (Nfld.) Ltd. Act* [R.S.N.L. 1990, c. J-3] to obtain payment up to the statutory maximum on the basis that the defendants were uninsured at the time of the accident. They say that the Judgment Recovery scheme is, in effect, a form of uninsured driver liability insurance. Because the money recoverable would not form part of the defendants' bankrupt estates but would be paid directly to the plaintiffs, there is no prejudice to any creditors of the estates, and the purpose of the bankruptcy legislation would not be subverted.

Relying on *Yu v. Befus* [2003 ABQB 451, 344 A.R. 197 (Alta. Q.B.)], a decision of the Alberta Queen's Bench, they argue that the *Bankruptcy and Insolvency Act* should be given a purposive liberal interpretation in accordance with Section 12 of the *Interpretation Act* [R.S.C. 1985, c. I-21] so that the statutory scheme under the *Judgment Recovery (Nfld.) Ltd. Act* should be included within the phrase "liability insurance policy".

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The defendants say, in contrast, that on a plain reading of the section, a statutory scheme that does not involve a policy or a contract of indemnity cannot be said on any realistic reading to be a liability insurance policy. Section 145 only exempts one narrow circumstance from the operation of the *Act*. It exempts only liability insurance proceeds regarding motor vehicle accidents, not liability insurance for professional malpractice or other types of liability insurance dealing with other circumstances. There is no reason, therefore, to suppose that Parliament intended to include statutory uninsured motorist schemes without expressly adverting to them.

As I indicated at the outset, I acknowledge that this is a difficult issue. On the one hand, there does not seem to be any good reason in principle why the plaintiffs should be deprived of the opportunity to avail of the statutory scheme if its operation would not adversely impact on the defendants, any more than a private insurance scheme would and if the policy of the *Bankruptcy and Insolvency Act* would not be subverted. On the other hand, it does seem a bit of a stretch to massage the language, read literally, to include the *Judgment Recovery* system. As I indicated, this is one of those cases where it would probably be desirable for the matter to be resolved by the Court of Appeal; but from my point of view, I believe a broad, liberal, purposive interpretation should be applied. The Judgment Recovery scheme is designed to take the place of insurance where none otherwise exists. It is intended to fill a gap in the private insurance regime to ensure that all persons injured on the highway by the fault of another have access to some compensation. It furthers the policy of requiring compulsory motor vehicle third party liability insurance for the protection of the public. In other words, it is intended to be insurance by another name. Indeed, compensation payable through the Judgment Recovery system is funded by insurance companies.

Allowing a plaintiff to access uninsured motorist coverage just as in the case of private insurance proceeds does not offend the principle that all creditors of the bankrupt should be treated equally, because in neither case will the proceeds form part of the bankrupt's estate. Furthermore, allowing a claim in these circumstances would be consistent with other cases such as *Major, Re* [(1984), 56 B.C.L.R. 342 (B.C. S.C.)], and *Eurasia Auto Ltd. v. M & M Welding & Supply (1985) Inc.* [(1991), 5 C.B.R. (3d) 227 (Alta. Master)], which deal with lifting of stays where a plaintiff is entitled to payment of proceeds of insurance on the basis that the proceeds are for the benefit of the person suffering the loss or damage as a result of the culpable acts or omissions of the insured. Such entitlement, these cases reasoned, could not be affected by the bankruptcy of the insured who had no proprietary interest in the insurance proceeds. The key in these cases [to] lifting a stay is whether the plaintiff had a direct cause of action against the insurer so that there was no possibility of the proceeds forming part of the bankrupt's estate to be used for other creditors. The same rationale applies to the claim to the proceeds of a liability insurance policy, and, for the reasons I will give in a moment, the statutory scheme under the *Judgment Recovery (Nfld.) Ltd. Act*. In each case the claimant has a direct claim to the proceeds, and they do not pass through the bankrupt's estate. Allowing the plaintiffs access to such proceeds is therefore completely consistent with the policy of the *Bankruptcy and Insolvency Act*. It is also consistent with the principles developed in such cases as *Duvall, Re* [(1992), 63 B.C.L.R. (2d) 97 (B.C. S.C.)], which was cited in argument, that allow a claimant to proceed against an insurer outside of Section 145 of the *Bankruptcy and Insolvency Act* in certain circumstances.

Now, if that were all to this case, the story would end there. I would be prepared to apply *Yu v. Befus* and allow the plaintiffs' claim to proceed; but there is a further dimension, however, which I must consider. Counsel for the defendants points out that there are important, significant differences between the private insurance scheme in Newfoundland and Labrador and the Judgment Recovery scheme. In the former, Section 24A (now Section 26) of the *Automobile Insurance Act* [R.S.N.L. 1990, c. A-22], provides that the insurer who pays out on behalf of its insured effectively causes a release of the plaintiffs' claim to the extent of the payment and is prevented from seeking to recover the amount of the payment from the insured. Under the Judgment Recovery scheme, however, Judgment Recovery is, upon paying the plaintiffs' judgment, deemed by Section 26(11) of the *Judgment Recovery (Nfld.) Ltd. Act*, to be the judgment creditor in the place of the plaintiff, and may seek to recover the amount from the uninsured driver. In addition, the company has the ability to arrange for the suspension of

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the defendants' driver's licence if payment is not forthcoming. Counsel for the defendant argues: first, that this difference demonstrates that the Judgment Recovery scheme is not really insurance and therefore cannot fall within the words "liability insurance" in Section 145; and, secondly, he argues that this difference means that the defendants will be still exposed to potential liability in respect of a claim that should have been wiped out by his discharge, with the result that the policy of the *Bankruptcy and Insolvency Act* to permit rehabilitation of a bankrupt unfettered by past debts would be subverted. (I might just say parenthetically that there were other differences between the two schemes which were asserted by counsel for the defendants, as well, the main one being that Section 26 of the *Automobile Insurance Act* gives the claimant the right to sue the defendants' insurer directly, and he says that Section 26 of the *Judgment Recovery (Nfld.) Ltd. Act* does not do the same. I do not agree with this distinction. While Section 26(1) of the *Judgment Recovery (Nfld.) Ltd. Act* allows a claimant to apply to Judgment Recovery for payment, Subsection 26(2) requires the company to pay out within seven days after application. If Judgment Recovery failed to abide by its statutory obligations, I have no doubt the claimant could sue Judgment Recovery directly to enforce his claims. It is for this reason that I have referred above to the right of a claimant to sue Judgment Recovery directly.)

Now, returning to the two arguments made by counsel for the defendants on the basis of the difference between the two schemes relating to the right of Judgment Recovery to sue the uninsured driver but the lack of such an equivalent right under the private insurance scheme, I will deal with those two arguments. As to the first argument, I reject that argument. I do not consider it a fundamental aspect of an insurance scheme that the insurer, having paid an indemnity, must be precluded from suing his insured for recovery. Certainly, that is the current regime in Newfoundland and Labrador and perhaps in other provinces, but there is nothing to preclude the Newfoundland legislature from amending its *Automobile Insurance Act* tomorrow to allow such recovery. If it did, the regime would still fall under Section 145. Accordingly, the fact that this difference exists, does not make the Judgment Recovery scheme for that reason not an insurance scheme.

For the second argument, which has given me more difficulty, after careful consideration I have decided to reject it also. Judgment Recovery may only proceed to recover its payout from the defendants because it is statutorily subrogated to the plaintiffs' position. While it is true that the quantum of the plaintiffs' entitlement is not yet determined in this case and can only be embodied in a judgment after a damages hearing, the liability to pay that amount, whatever it may ultimately be, was established long before the bankruptcy. The damage judgment is fully derivative from that liability judgment. The ability of the plaintiffs to recover from the defendants, and hence the subrogated right of the company to recover from the defendants, may well be affected by the defendants' ultimate discharge. I reject the argument of the defendants which is based on the presupposition that Judgment Recovery will necessarily have a right to recover its payout from the defendants if the plaintiffs are paid out first. Section 26(1) of the *Judgment Recovery (Nfld.) Ltd. Act* refers to a final judgment, not necessarily an enforceable judgment. The enforceability of a plaintiff's judgment may be affected by all sorts of equities existing between the plaintiff and the defendant. There is nothing in the *Judgment Recovery (Nfld.) Ltd. Act* that says that in such circumstances the plaintiff would not be entitled to have his claim paid by Judgment Recovery, even though there may be some road blocks in the way of the plaintiff enforcing it directly against the defendant. The status of the judgment as between the plaintiffs and the defendants is therefore not the determining factor regarding the ability of the plaintiffs to claim against the company, so long as the judgment can be said to be a final judgment. The potential of the company proceeding against the defendants is therefore not a consideration at this point. That is a matter that should be dealt with if and when the company were to seek recovery from the defendants. As noted, such a claim would no doubt be resisted on the basis that the liability as against the defendants was wiped out by the defendants' discharge and that the company could have no greater right to recover than the plaintiff.

In any event, while it may not be strictly necessary, I believe it would be appropriate to order, pursuant to Section 97 of the *Judicature Act* and the inherent power of the Court to control its own process to prevent an abuse of process, that the plaintiffs may not proceed to execute on any judgment as to quantum that may be obtained as against the defendants but will be limited to making a claim under the *Judgment Recovery (Nfld.) Ltd. Act.*

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While it would always be possible for Judgment Recovery (Nfld.) Ltd. to apply to lift such a stay if there were grounds to do so, until such an application were to be made and granted, the company would be statutorily subrogated to a judgment that would be subject to a stay of enforcement. That would be consistent with the intent of allowing the plaintiff to access the statutory compensation while at the same time not exposing the defendants to a liability in violation of the underlying policy of the *Bankruptcy and Insolvency Act*. While it is true that Judgment Recovery may, in these circumstances, be deprived of a right to statutory recovery, that comes about by virtue of the *Bankruptcy and Insolvency Act*. There may be many circumstances where Judgment Recovery is not able to recoup its payouts. If this issue had arisen before the defendants' discharge, the plaintiffs would have had a strong case to lift any statutory stay and proceed against the defendants with a view to accessing the Judgment Recovery fund on the basis of cases like *Re Major*, *Eurasia Auto Limited*, and *Re Duvall*. In such circumstances there would be no question that Judgment Recovery would nevertheless not be able to recoup its losses. Likewise, if the plaintiff had obtained judgment, made a claim to Judgment Recovery, and received payment before the defendants' assignment into bankruptcy, and the defendants thereafter made an assignment, Judgment Recovery's right to recovery would also have been frustrated. It should not be placed in a better position simply because the issue had arisen at a different time.

In the circumstances, therefore, I will dismiss the defendants' application under Rule 17A and make an order, to be in effect until otherwise ordered, that in proceeding against the defendants, the plaintiffs may not enforce any judgment against the defendants personally but may only make a claim with respect to payment of the judgment from Judgment Recovery.

As to costs, this is one of those rare cases where the Court should exercise its discretion under [Rule 17A.05(2)] and order that each party bear its own costs. The unusual nature of the issues in this case and the uncertainty of the law and the interpretation to be given to the relevant legislation justified the bringing of this application. In the words of the rule, it was "nevertheless reasonable" for the defendants to have made the application even though they were unsuccessful.

Appeal dismissed.

Appendix A

5.(1) The *Judgment Recovery (Nfld.) Ltd. Act* is repealed.

(2) Notwithstanding subsection (1), where an action is commenced under the *Judgment Recovery (Nfld.) Act* before the commencement of this Act, or where an accident involving an automobile occurs before the commencement of this Act, that action shall be governed by the *Judgment Recovery (Nfld.) Ltd. Act* and that Act shall be considered to be in force for the purpose of those actions until all those actions have been settled or dealt with in accordance with the *Judgment Recovery (Nfld.) Ltd. Act*.

FN1 S. 5 of the *Automobile Insurance Amendment Act* reads:

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TAB 10

2005 CarswellOnt 6818, 15 C.B.R. (5th) 307, 11 B.L.R. (4th) 185, 204 O.A.C. 205, 261 D.L.R. (4th) 368, 78 O.R. (3d) 241

Stelco Inc., Re

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO STELCO INC., AND OTHER APPLICANTS LISTED IN SCHEDULE "A"

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

Ontario Court of Appeal

Goudge, Sharpe, Blair JJ.A.

Heard: November 14, 2005
Judgment: November 17, 2005
Docket: CA C44436, M33171

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Proceedings: additional reasons at *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 6510, 15 C.B.R. (5th) 305 ((Ont. C.A.)); affirmed *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 6483, 15 C.B.R. (5th) 297 ((Ont. S.C.J. [Commercial List]))

Counsel: Paul Macdonald, Andrew Kent, Brett Harrison for Informal Independent Converts' Committee

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

Robert Staley, Alan Gardner for Senior Debenture Holders

Fred Myers for Her Majesty the Queen in Right of Ontario, Superintendent of Financial Services

Ken Rosenberg for United Steelworkers of America

A Kauffman for Tricap Management Ltd.

Kyla Mahar for Monitor

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Murray Gold for Salaried Retirees

Heath Whitley for CIBC

Steven Bosnick for U.S.W.A. Loc. 5328, 8782

Subject: Insolvency; Civil Practice and Procedure

Bankruptcy and insolvency --- Proposal — Practice and procedure

Leave to appeal order made in Companies' Creditors Arrangement Act proceeding — S Inc. presented Proposed Plan of Compromise or Arrangement (Plan) to its unsecured creditors for approval — Plan included subordinated debenture holders, senior debt holders, and trade creditors in same group for purposes of voting on Plan — Prior to vote on Plan, subordinated debenture holders brought motion seeking order classifying themselves as separate class for voting purposes on basis that they had different interests from rest of group — Supervising judge dismissed motion — Subordinated debenture holders sought leave to appeal dismissal of motion — Leave to appeal granted — Leave is only sparingly granted with regard to orders made in Companies' Creditors Arrangement Act (CCAA) proceedings because of their "real time" dynamic and because of generally discretionary character underlying many of orders made by supervising judges in such proceedings — Here, leave to appeal was granted because proposed appeal raised issue of significance to practice, namely nature of common interest test to be applied by courts for purposes of classification of creditors in CCAA proceedings — Where there is urgency that leave application be expedited in public interest, court will do so in this area of law as it does in other area; however, where what is involved is essentially attempt to review discretionary order made on facts of case, in tightly supervised process with which judge is intimately familiar, collapsed process that was made available in this particular situation will not generally be afforded — Issues raised on this appeal, and timing factor involved, warranted expedited procedure that was ordered.

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

S Inc. presented Proposed Plan of Compromise or Arrangement (Plan) to its unsecured creditors for approval — Plan included subordinated debenture holders, senior debt holders, and trade creditors in same group for purposes of voting on Plan — Prior to vote, subordinated debenture holders brought motion seeking order classifying themselves as separate class for voting purposes on basis that they had different interests from rest of group — Supervising judge dismissed motion — Subordinated debenture holders appealed from dismissal of motion — Appeal dismissed — No error could be found in supervising judge's factual findings or in his exercise of discretion in determining that subordinated debenture holders should remain in same class as other creditors — There was no material distinction between legal rights of subordinated debenture holders and those of senior debt holders vis-à-vis S Inc. — Supervising judge was correct in law in applying principles dealing with commonality of interest test as summarized in recent case, which principles were cited with approval by Court of Appeal in another recent decision — Principles applied by supervising judge were not inconsistent with earlier decision of present court in other case dealing with common interest test, because differing interests in question were not different legal interest as between two creditors; they were different legal interests as between each of creditors and debtor company — Case cited by subordinated debenture holders did not deal with issue of whether creditors with divergent interests as amongst themselves, as opposed to divergent legal interests vis-à-vis debtor company, could be forced to vote as members of common class — Creditors should be classified in accordance with their contract rights, i.e., according to their respective interests in debtor company — To hold classification and voting process hostage to vagaries of potentially infinite variety of disputes, as between already disgruntled creditors who had been caught in maelstrom of Companies' Creditors Arrangement Act (CCAA) restructuring, would run risk of hobbling that process unduly and could lead to very type of fragmentation and multiplicity of discrete classes or sub-classes of classes that judges have warned

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2005 CarswellOnt 6818, 15 C.B.R. (5th) 307, 11 B.L.R. (4th) 185, 204 O.A.C. 205, 261 D.L.R. (4th) 368, 78 O.R. (3d) 241

might well defeat purpose of CCAA.

Cases considered by *Blair J.A.*:

Campeau Corp., Re (1991), 10 C.B.R. (3d) 100, 86 D.L.R. (4th) 570, 1991 CarswellOnt 155 (Ont. Gen. Div.) — referred to

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

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

Country Style Food Services Inc., Re (2002), 2002 CarswellOnt 1038, 158 O.A.C. 30 (Ont. C.A. [In Chambers]) — referred to

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

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

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

Northland Properties Ltd., Re (1989), (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 34 B.C.L.R. (2d) 122, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) [1989] 3 W.W.R. 363, 1989 CarswellBC 334 (B.C. C.A.) — referred to

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey*) 1 O.R. (3d) 289, (sub nom. *Elan Corp. v. Comiskey*) 41 O.A.C. 282, 1990 CarswellOnt 139 (Ont. C.A.) — considered

NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295, 1990 CarswellNS 33 (N.S. T.D.) — referred to

Pacific Coastal Airlines Ltd. v. Air Canada (2001), 2001 BCSC 1721, 2001 CarswellBC 2943, 19 B.L.R. (3d) 286 (B.C. S.C.) — considered

Savage v. Amoco Acquisition Co. (1988), 59 Alta. L.R. (2d) 260, 68 C.B.R. (N.S.) 154, 40 B.L.R. 188, (sub nom. *Amoco Acquisition Co. v. Savage*) 87 A.R. 321, 1988 CarswellAlta 291 (Alta. C.A.) — referred to

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

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

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2005 CarswellOnt 6818, 15 C.B.R. (5th) 307, 11 B.L.R. (4th) 185, 204 O.A.C. 205, 261 D.L.R. (4th) 368, 78 O.R. (3d) 241

Stelco Inc., Re (2005), 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2005 CarswellOnt 1188, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 196 O.A.C. 142 (Ont. C.A.) — referred to

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

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

Statutes considered:

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

Generally — referred to

Joint Stock Companies Arrangements Act, 1870 (33 & 34 Vict.), c. 104

Generally — referred to

ADDITIONAL REASONS to judgment reported at *Stelco Inc., Re* (2005), 2005 CarswellOnt 6510, 15 C.B.R. (5th) 305 (Ont. C.A.).

***Blair J.A.*:**

Background

1 This appeal arises out of the reorganization of Stelco Inc., and related companies, pursuant to the *Companies' Creditors Arrangement Act* ("CCAA").[FN1] Stelco has been in the midst of this fractious process for approximately twenty-one months. Justice Farley has been the supervising judge throughout.

2 Stelco has presented a Proposed Plan of Compromise or Arrangement to its creditors for their approval. The vote was scheduled for Tuesday, November 15, 2005. On Thursday, November 10, a group of creditors known as the Informal Independent Converts' Committee ("the Converts' Committee) sought an order from the supervising judge, amongst other things, classifying the Subordinated Debenture Holders whom they represent as a separate class for voting purposes. Justice Farley dismissed the motion. In the face of the pending vote, the Converts' Committee sought leave to appeal on Thursday afternoon (The courts were closed on Friday, November 11, for Remembrance Day). Rosenberg J.A. dealt with the matter and directed that the application for leave, and if leave be granted, the appeal, be heard by a panel of this court on Monday, November 14, 2005.

3 This panel heard the application for leave and the appeal on Monday. We concluded that leave should be granted, but that the appeal must be dismissed, and at the conclusion of argument — and in order to clarify matters so that the vote could proceed the following day — we issued a brief endorsement with our decision, but indicating that more detailed reasons would follow.

4 The endorsement read as follows:

> In our view, the appellants have not demonstrated a different legal interest from the other unsecured creditors vis à vis the debtor, nor any basis for setting aside the finding of Farley J. that there are no different practical interests such that the appellants deserve a separate class. We see no legal error or error in principle in his exer-

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cise of discretion.

Leave to appeal is granted, but the appeal must therefore be dismissed. Because of the importance of the issue for Ontario practice in this area, we propose to expand somewhat on these reasons in due course.

5 These are those expanded reasons.

Facts

6 Stelco's Proposed Plan is made to unsecured creditors only. It is not intended to affect the claims of secured creditors.

7 The Converts' Committee represents unsecured creditors who hold $90 million of convertible unsecured subordinated debentures issued by Stelco pursuant to a Supplemental Trust Indenture dated January 21, 2002, and due in 2007. With interest, the claims of the Subordinated Debenture Holders now amount to approximately $110 million. Those claims are subordinated to approximately $328 million in favour of Senior Debt Holders. In addition, Stelco has unsecured trade debts totalling approximately, $228 million. In the Proposed Plan, these three groups of unsecured creditors — the Subordinated Debenture Holders (represented by the Converts' Committee), the Senior Debt Holders, and the Trade Creditors — have all been included in the same class for the purposes of voting on the Proposed Plan or any amended version of it.

8 The Converts' Committee takes issue with this, and seeks to have the Subordinated Debenture Holders classified as a separate class of creditors for voting purposes. They argue that their interests are different than those of the Bondholders and that creditors who do not have common interests should not be classified in the same group for voting purposes. They submit, therefore, that the supervising judge erred in law in not granting them a separate classification. In that regard, they rely upon this court's decision in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (Ont. C.A.). They also argue that the supervising judge was wrong, on the facts contained in the record, in finding that the Subordinated Debenture Holders and the Bondholders did not have conflicting interests.

9 In making their argument about a different interest, the appellants rely upon their status as subordinated debt holders as shaped particularly by Articles 6.2 and 6.3 of the Supplemental Trust Indenture. In essence those provisions reinforce the subordinated nature of their debt. They stipulate (a) that if the Subordinated Debenture Holders receive any payment from Stelco, or any distribution from the assets of Stelco, before the Senior Debt is fully paid, they are obliged to remit any such payment or distribution to the Senior Debt Holders until the latter have been paid in full (Art. 6.2(3)), but (b) that no such payment or distribution by Stelco shall be deemed to constitute a payment on the Subordinated Debenture Holders' debt (Art. 6.3). The parties refer to these provisions as the "Turnover Payment" provisions.

10 In short, although Stelco is obliged to pay both groups of creditors in full, as between the Subordinated Debenture Holders and the Senior Debt Holders, the latter are entitled to be paid in full before the former receive anything. The Supplemental Trust Indenture makes it clear that the provisions of Article 6 "are intended solely for the purpose of defining the relative rights of [the Subordinated Debenture Holders] and the holders of the Senior Debt" (Art. 6.3).

11 The appellants contend that the Turnover Payment provisions distinguish their interests from those of the Subordinated Debenture Holders when it comes to voting on Stelco's Proposed Plan. They say that the Subordinated Debenture Holders' interest in maximizing the amounts to be made available to unsecured creditors ends once they have received full recovery, in part as a result of the Turnover Payments that the Subordinated Debenture Holders will be required to make from their portion of the funds. On the other hand, the Subordinated Debenture Holders

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will have an interest in seeking more because their recovery, for practical purposes, will have only begun once that point is reached.

12 The respondents submit, for their part, that the appellants are seeking a separate classification for a collateral purpose, i.e., so that they will be able to veto the Proposed Plan, or at least threaten to veto it, unless they are granted a benefit to which they are not entitled — the elimination of their subordinated position by virtue of the Turnover Payment provisions.

13 Farley J. rejected the appellants' arguments. The thrust of his decision in this regard is found in paragraphs 13 and 14 of his reasons:

> [13] I would note as well that the primary and most significant attribute of the ConCom debt and that of the BondCom debt/Senior Debt[FN2] plus the trade debt vis-à-vis Stelco is that it is all unsecured debt. Thus absent valid reason to have separate classes it would be reasonable, logical, rational and practical to have all this unsecured debt in the same class. Certainly that would avoid any unnecessary fragmentation — and in this respect multiplicity of classes does not mean that that fragmentation starts only when there are many classes. Unless more than one class is necessary, fragmentation would start at two classes. Fragmentation if necessary, but not necessarily fragmentation.
>
> [14] Is it necessary to have more than one class? Firstly, it would not appear to me that as between Stelco and the unsecured creditors overall there is any material distinction. Secondly, there would not appear to me to be any confiscation of any rights (or the other side of the coin any new imposition of obligations) upon the holders of the ConCom debt. The subrogation issue was something which these holders assumed on the issue of that debt. Thirdly, I do not see that there is a realistic conflict of interest. Each group of unsecured creditors including the ConCom debt holders and the BondCom debt holders has the same general interest vis-à-vis Stelco, namely to extract from Stelco through the Plan the maximum value in the sense of consideration possible. . . . That situation is not impacted for our purposes here in this motion by the possibility that in a subsequent dispute between the ConCom holders and the BondCom holders there may be a difference of opinion as to the variation of the consideration obtained.

14 We agree with his conclusion and see no basis to interfere with his findings in that regard.

The Leave Application

15 The principles to be applied by this court in determining whether leave to appeal should be granted to someone dissatisfied with an order made in a CCAA proceeding are not in dispute. Leave is only sparingly granted in such matters because of their "real time" dynamic and because of the generally discretionary character underlying many of the orders made by supervising judges in such proceedings. There must be serious and arguable grounds that are of real and significant interest to the parties. The court has assessed this criterion on the basis of a four-part test, namely,

a) whether the point on appeal is of significance to the practice;

b) whether the point is of significance to the action;

c) whether the appeal is *prima facie* meritorious or frivolous; and

d) whether the appeal will unduly hinder the progress of the action.

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See *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.) at para. 24; *Country Style Food Services Inc., Re*, [2002] O.J. No. 1377, 158 O.A.C. 30 (Ont. C.A. [In Chambers]) at para. 15; *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]) at para. 7.

16 Here, we granted leave to appeal because the proposed appeal raised an issue of significance to the practice, namely the nature of the "common interest" test to be applied by the courts for purposes of the classification of creditors in CCAA proceedings. Although the law seems to have progressed in the lower courts along the lines developed in Alberta, beginning with the decision of Paperny J. in *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), this court has not dealt with the issue since its decision in *Nova Metal Products Inc. v. Comiskey (Trustee of)*, *supra*, and the Converts' Committee argues that the Alberta line of authorities is contrary to *Nova Metal Products Inc.*

17 A brief further comment respecting the leave process may be in order.

18 The court recognizes the importance of its ability to react in a responsible and timely fashion to the appellate needs arising in the "real time" dynamics of CCAA restructurings. Often, as in the case of this restructuring, they involve a significant public dimension. For good policy reasons, however, appellate courts in Canada — including this one — have developed relatively stringent parameters for the granting of leave to appeal in CCAA cases. As noted, leave is only sparingly granted. The parameters as set out in the authorities cited above remain good law.

19 Merely because a corporate restructuring is a big one and money is no object to the participants in the process, does not mean that the court will necessarily depart from the normal leave to appeal process that applies to other cases. In granting leave to appeal in these circumstances, we do not wish to be taken as supporting a notion that the fusion of leave applications with the hearing of the appeal in CCAA restructurings — particularly in major ones such as this one involving Stelco — has become the practice. Where there is an urgency that a leave application be expedited in the public interest, the court will do so in this area of the law as it does in other areas. However, where what is involved is essentially an attempt to review a discretionary order made on the facts of the case, in a tightly supervised process with which the judge is intimately familiar, the collapsed process that was made available in this particular situation will not generally be afforded.

20 As these reasons demonstrate, however, the issues raised on this particular appeal, and the timing factor involved, warranted the expedited procedure that was ordered by Justice Rosenberg.

The Appeal

No Error in Law or Principle

21 Everyone agrees that the classification of creditors for CCAA voting purposes is to be determined generally on the basis of a "commonality of interest" (or a "common interest") between creditors of the same class. Most analyses of this approach start with a reference to *Sovereign Life Assurance Co. v. Dodd* (1892), [1891-94] All E.R. Rep. 246 (Eng. C.A.), which dealt with the classification of creditors for voting purposes in a winding-up proceeding. Two passages from the judgments in that decision are frequently cited:

At pp. 249-250 Lord Esher said:

> The Act provides that the persons to be summoned to the meeting, all of whom, it is to be observed, are creditors, are persons who can be divided into different classes, classes which the Act[FN3] recognizes, though it does not define. The creditors, therefore, must be divided into different classes. What is the reason for prescribing such a course? It is because the creditors composing the different classes have different interests, and, therefore, if a different state of facts exists with respect to different creditors, which may affect their minds and

judgments differently, they must be separated into different classes.

At p. 251, Bowen L.J. stated:

> The word "class" used in the statute is vague, and to find out what it means we must look at the general scope of the section, which enables the court to order a meeting of a "class of creditors" to be summoned. It seems to me that we must give such a meaning to the term 'class' as will prevent the section being so worked as to produce confiscation and injustice, and that we must confine its meaning to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

22 These views have been applied in the CCAA context. But what comprises those "not so dissimilar" rights and what are the components of that "common interest" have been the subject of debate and evolution over time. It is clear that classification is a fact-driven exercise, dependent upon the circumstances of each particular case. Moreover, given the nature of the CCAA process and the underlying flexibility of that process — a flexibility which is its genius — there can be no fixed rules that must apply in all cases.

23 In *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), Paperny J. nonetheless extracted a number of principles to be considered by the courts in dealing with the commonality of interest test. At para. 31 she said:

> In summary, the cases establish the following principles applicable to assessing commonality of interest:
>
> 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
>
> 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.
>
> 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.C.A., namely to facilitate reorganizations if possible.
>
> 4. In placing a broad and purposive interpretation on the C.C.C.A., the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
>
> 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
>
> 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.

24 In developing this summary of principles, Paperny J. considered a number of authorities from across Canada, including the following: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.); *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.); *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 71 (N.S. T.D.); *Woodward's Ltd., Re* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.); *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.); *Northland Properties Ltd., Re* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *NsC Diesel Power Inc., Re* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.); *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.), (*sub nom. Amoco Acquisition Co. v. Savage*); *Wellington Building Corp., Re* (1934), 16 C.B.R. 48 (Ont. S.C.). Her summarized principles were cited by the Alberta Court of Appeal, apparently with approval, in a subsequent Canadian Airlines Corp., Re decision: *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]) at para. 27.

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25 In the passage from his reasons cited above (paragraphs 13 and 14) the supervising judge in this case applied those principles. In our view he was correct in law in doing so.

26 We do not read the foregoing principles as being inconsistent with the earlier decision of this court in *Nova Metal Products Inc. v. Comiskey (Trustee of)*. There the court applied a common interest test in determining that the two creditors in question ought not to be grouped in the same class of creditors for voting purposes. But the differing interests in question were not different legal interests as between the two creditors; they were different legal interests as between each of the creditors and the debtor company. One creditor (the Bank) held first security over the debtor company's receivables and the other creditor (RoyNat) held second security on those assets; RoyNat, however, held first security over the debtor's building and realty, whereas the Bank was second in priority in relation to those assets. The two creditors had differing commercial interests in how the assets should be dealt with (it was in the interests of the bank, with a smaller claim, to collect and retain the more realizable receivable assets, but in the interests of RoyNat to preserve the cash flow and have the business sold as a going concern). Those differing commercial interests were rooted in differing legal interests as between the individual creditors and the debtor company, arising from the different security held. Because of the size of its claim, RoyNat would dominate any group that it was in, and Finlayson J.A. was of the view that RoyNat, as the holder of second security, should not be able to override the Bank's legal interest as the first secured creditor with respect to the receivables by virtue of its voting rights. On the basis that there was "no true community of interest" between the secured creditors (p. 259), given their different legal interests, he ordered that the Bank be placed in a separate class for voting purposes.

27 *Nova Metal Products Inc. v. Comiskey (Trustee of)* did not deal with the issue of whether creditors with divergent interests as amongst themselves — as opposed to divergent legal interests vis-à-vis the debtor company — could be forced to vote as members of a common class. Nor did it apply an "identity of interest" test — a test that has been rejected as too narrow and too likely to lead to excessive fragmentation: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*, *supra*,); *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, *supra*; *Fairview Industries Ltd., Re*, *supra*; *Woodward's Ltd., Re*, *supra*. In our view, there is nothing in the decision in *Nova Metal Products Inc.* that is inconsistent with the evolutionary set of principles developed in the Alberta jurisprudence and applied by the supervising judge here.

28 In addition to commonality of interest concerns, a court dealing with a classification of creditors issue needs to be alert to concerns about the confiscation of legal rights and about avoiding what the parties have referred to as "a tyranny of the minority". Examples of the former include *Nova Metal Products Inc. v. Comiskey (Trustee of)* [FN4] and *Wellington Building Corp., Re*, *supra*[FN5]. Examples of the latter include *Sklar-Peppler*, *supra*[FN6] and *Campeau Corp., Re* (1991), 10 C.B.R. (3d) 100 (Ont. Gen. Div.)[FN7].

29 Here, as noted earlier in these reasons, the respondents argue that the appellants are seeking a separate classification in order to extract a benefit to which they are not entitled, namely a concession that the Turnover Payment requirements of their subordinated position be extinguished by the Proposed Plan, thus avoiding their obligation to transfer payments to the Senior Debt Holders until they have been paid in full, and freeing up all of the distribution the appellants will receive from Stelco for payment on account of their own claims. On the other hand, the appellants point to this conflict between the Subordinated Debenture Holders and the Senior Debt Holders as evidence that they do not have a commonality of interest or the ability to consult together with a view to whatever commonality of interest they may have vis-à-vis Stelco.

30 We agree with the line of authorities summarized in *Canadian Airlines Corp., Re* and applied by the supervising judge in this case which stipulate that the classification of creditors is determined by their legal rights in relation to the debtor company, as opposed to their rights as creditors in relation to each other. To the extent that other authorities at the trial level in other jurisdictions may suggest to the contrary — see, for example *NsC Diesel Power Inc., Re*, *supra* — we prefer the Alberta approach.

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31 There are good reasons for such an approach.

32 First, as the supervising judge noted, the CCAA itself is more compendiously styled "An act to facilitate compromises and arrangements between companies and their creditors". There is no mention of dealing with issues that would change the nature of the relationships as between the creditors themselves. As Tysoe J. noted in *Pacific Coastal Airlines Ltd. v. Air Canada*, [2001] B.C.J. No. 2580 (B.C. S.C.) at para. 24 (after referring to the full style of the legislation):

> [The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

33 In this particular case, the supervising judge was very careful to say that nothing in his reasons should be taken to determine or affect the relationship between the Subordinate Debenture Holders and the Senior Debt Holders.

34 Secondly, it has long been recognized that creditors should be classified in accordance with their contract rights, that is, according to their respective interests in the debtor company: see Stanley E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar. Rev. 587, at p. 602.

35 Finally, to hold the classification and voting process hostage to the vagaries of a potentially infinite variety of disputes as between already disgruntled creditors who have been caught in the maelstrom of a CCAA restructuring, runs the risk of hobbling that process unduly. It could lead to the very type of fragmentation and multiplicity of discrete classes or sub-classes of classes that judges and legal writers have warned might well defeat the purpose of the Act: see Stanley Edwards, "Reorganizations under the Companies' Creditors Arrangement Act", *supra*; Ronald N. Robertson Q.C., "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association — Ontario Continuing Legal Education, 5th April 1983 at 19-21; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, *supra*, at para. 27; *Northland Properties Ltd., Re*, *supra*; *Sklar-Peppler*, *supra*; *Woodward's Ltd., Re*, *supra*.

36 In the end, it is important to remember that classification of creditors, like most other things pertaining to the CCAA, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny J. noted in *Canadian Airlines Corp., Re*, "the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans."

Discretion and Fact Finding

37 Having concluded that the supervising judge made no error in law or principle in his approach to the classification issue, we can find no error in his factual findings or in his exercise of discretion in determining that the Subordinate Debenture Holders should remain in the same class as the Senior Debt Holders and Trade Creditors in the circumstances of this case.

38 We agree that there is no material distinction between the legal rights of the Subordinated Debenture Holders and those of the Senior Debt Holders vis-à-vis Stelco. Each is entitled to be paid the monies owing under their respective debt contracts. The only difference is that the former creditors are subordinated in interest to the latter and have agreed to pay over to the latter any portion of their recovery received until the Senior Debt has been paid in

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full. As between the two groups of creditors, this merely reflects the very deal the Subordinated Debenture Holders bought into when they purchased their subordinated debentures. For that reason, the supervising judge was also entitled to determine that this was not a case involving any confiscation of legal rights.

39 Finally, the supervising judge's finding that there is no "realistic conflict of interest" between the creditors is supported on the record. Each has the same general interest in relation to Stelco, namely to be paid under their contracts, and to maximize the amount recoverable from the debtor company through the Plan negotiation process. We do not accept the argument that the Senior Debt Holder's efforts will be moderated in some respect because they will be content to make their recovery on the backs of the Subordinated Debenture Holders through the Turnover Payment process. In order to carry the class, the Senior Debt Holders will require the support of the Trade Creditors, whose interest is not affected by the subordination agreement. Thus the Senior Debt Holders will be required to support the maximization approach.

40 We need not deal with whether a realistic and genuine conflict of interest, produced by different legal positions of creditors vis-à-vis each other, could ever warrant separate classes, as we are satisfied that even if it could, this is not such a case.

Disposition

41 Accordingly, we would not interfere with the supervising judge's decision that the appellants had not made out a case for a separate class. The appeal is therefore dismissed.

***Goudge J.A.*:**

I agree.

***Sharpe J.A.*:**

I agree.

Application granted; appeal dismissed.

FN1 R.S.C. 1985, c. C-36, as amended.

FN2 Farley J. uses the term "ConCom debt" to refer to the debt represented by the Converts' Committee (i.e., that of the Subordinated Debenture Holders), and the term "BondCom debt" to refer to that of the Senior Debt Holders.

FN3 The *Joint Stock Companies Arrangement Act*, 1870.

FN4 A second secured creditor with superior voting power was separated from a first secured creditor for voting purposes, in order prevent the former from utilising its superior voting strength to adversely affect the latter's prior security position.

FN5 The court refused to allow subsequent mortgagees to vote in the same class as a first mortgagee because in the circumstances the subsequent mortgagees would be able to use their voting power to destroy the priority rights and security of the first mortgagee.

FN6 Borins J., as he then was, warned against the dangers of "excessive fragmentation" and of creating "a special class simply for the benefit of the opposing creditor, which would give that creditor the potential to exercise an un-

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warranted degree of power".

FN7 Montgomery J. declined to grant a separate classification to a minority group of creditors who would use that classification to extract benefits to which it was not otherwise entitled.

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TAB 11

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2009 CarswellAlta 1269, 2009 ABQB 490, [2009] A.W.L.D. 3785, 57 C.B.R. (5th) 205, 479 A.R. 318

SemCanada Crude Co., Re

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

And In the Matter of a Plan of Compromise or Arrangement of SemCanada Crude Company, SemCAMS ULC, SemCanada Energy Company, A.E. Sharp Ltd., CEG Energy Options, Inc., 319278 Nova Scotia Company and 1380331 Alberta ULC

Alberta Court of Queen's Bench

B.E. Romaine J.

Heard: August 5, 2009
Judgment: August 24, 2009
Docket: Calgary 0801-08510

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Sean Fitzgerald for Tri-Ocean Engineering Ltd.

Dean Hutchison for Crescent Point Energy Trust, Enbridge Pipelines Inc.

Caireen Hanert for Bellamount Exploration Ltd., Enersul Limited Partnership

Bryce McLean for DPH Focus Corporation

Aubrey Kauffman for BNP Paribas

Subject: Insolvency

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous

S brought application for various relief related to holding of meetings of creditors to consider three plans to restructure and distribute assets of Companies' Creditors Arrangement Act ("CCAA") applicants, including applications for orders authorizing establishment of single class of creditors for each plan for purpose of considering and voting on plan — Applications granted — There was no good reason to exclude secured lenders and noteholders from single classification of voters in proposed plans, nor to create separate class for their votes — There were no material distinctions between claims of these two creditors and claims of remaining unsecured creditors that were not more properly subject of sanction hearing, apart from deferred issue of whether secured lenders were entitled to vote their entire guarantee claim — No rights of remaining unsecured creditors were being confiscated by proposed classification, and no injustice arose, particularly given separate tabulation of votes which enabled voice of remaining unsecured creditors to be heard and measured at sanction hearing — There were no conflicts of interest so over-riding as to make consultation impossible — While there were differences of interest and treatment among affected creditors in class, these were issues that would be addressed at sanction hearing — Approval of proposed classification in context of integrated plans was in accordance with spirit and purpose of CCAA.

Cases considered by *B.E. Romaine J.*:

Campeau Corp., Re (1991), 10 C.B.R. (3d) 100, 86 D.L.R. (4th) 570, 1991 CarswellOnt 155 (Ont. Gen. Div.) — considered

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

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

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

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

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

San Francisco Gifts Ltd., Re (2004), 5 C.B.R. (5th) 92, 42 Alta. L.R. (4th) 352, 2004 ABQB 705, 2004 CarswellAlta 1241, 359 A.R. 71 (Alta. Q.B.) — referred to

San Francisco Gifts Ltd., Re (2004), 2004 ABCA 386, 2004 CarswellAlta 1607, 5 C.B.R. (5th) 300, 42 Alta. L.R. (4th) 371, 361 A.R. 220, 339 W.A.C. 220 (Alta. C.A.) — considered

SemCanada Crude Co., Re (2009), 2009 CarswellAlta 167, 2009 ABQB 90, 52 C.B.R. (5th) 131 (Alta. Q.B.) — referred to

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 1991 CarswellOnt 220, 8 C.B.R. (3d) 312, 86

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D.L.R. (4th) 621 (Ont. Gen. Div.) — considered

Stelco Inc., Re (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — considered

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

Statutes considered:

Bankruptcy Code, 11 U.S.C.

s. 503(b)(9) — referred to

Chapter 7 — referred to

Chapter 11 — referred to

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

Generally — referred to

s. 6 — referred to

s. 11(1) — referred to

s. 22(2) [rep. & sub. 2007, c. 36, s. 71] — referred to

APPLICATION for orders authorizing establishment of single class of creditors for three plans to restructure and distribute assets for purpose of considering and voting on plans.

***B.E. Romaine J.*:**

Introduction

1 The SemCanada Group applied for various relief related to the holding of meetings of creditors to consider three plans to restructure and distribute assets of the CCAA applicants, including applications for orders authorizing the establishment of a single class of creditors for each plan for the purpose of considering and voting on the plans. I granted the applications, and these are my reasons.

Relevant Facts

2 On July 22, 2008, SemCanada Crude Company ("SemCanada Crude") and SemCAMS ULC ("SemCAMS") were granted initial Orders pursuant to s. 11(1) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c.C-36, as amended (the "CCAA").

3 On July 30, 2008, the CCAA proceedings of SemCAMS and SemCanada Crude and the bankruptcy proceedings of SemCanada Energy Company ("SemCanada Energy") A.E. Sharp Ltd. ("AES") and CEG Energy Options, Inc. ("CEG") which had been commenced on July 24, 2008 were procedurally consolidated for the purpose of administrative convenience.

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4 In addition, CCAA protection was granted to two affiliated companies, 3191278 Nova Scotia Company (A319") and 1380331 Alberta ULC ("138"). SemCanada Energy, AES, CEG, 319 and 138 are collectively referred to as the "SemCanada Energy Companies". The CCAA applicants are collectively referred to as the "SemCanada Group".

5 On July 22, 2008, SemGroup L.P. and its direct and indirect subsidiaries in the United States (the "U.S. Debtors") filed voluntary petitions to restructure under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

6 According to the second report of the Monitor, the financial problems of the SemGroup arose from a failed trading strategy and the volatility of petroleum products prices, leading to material margin calls related to large futures and options positions on the NYMEX and OTC markets, resulting in a severe liquidity crisis. SemGroup's credit facilities were insufficient to accommodate its capital needs, and the corporate group sought protection under Chapter 11 and the CCAA.

7 The SemCanada Group are indirect, wholly-owned subsidiaries of SemGroup LP. The SemCanada Group is comprised of three separate businesses:

(a) SemCanada Crude, a crude oil marketing and blending operation;

(b) the SemCanada Energy Companies, whose business was gas marketing, including the purchase and sale of gas to certain of its four subsidiaries as well as to SemCAMS; and

(c) SemCAMS, whose business consists of ownership interests in large gas processing facilities located in Alberta, as well as agreements to operate these facilities.

8 SemCrude, L.P. as U.S. borrower and a predecessor company of SemCAMS as Canadian borrower, certain U.S. SemGroup corporations and Bank of America as administrative agent for a syndicate of lenders (the "Secured Lenders") entered into a credit agreement in 2005 (the "Credit Agreement"). The Credit Agreement provides four different credit facilities. There are no advances outstanding with respect to the Canadian term loan facility, but in excess of U.S. $2.9 billion is owing under the U.S. term loan facility, the working capital loan facility and the revolver loan.

9 Five of the SemCanada Group, including SemCanada Crude, SemCanada Energy and SemCAMS, have provided a guarantee of all obligations under the Credit Agreement to the Secured Lenders, who rank as senior secured lenders, and under a US $600 million bond indenture issued by SemGroup. The guarantee is secured by a security and pledge agreement (the "Security Agreement") signed by the five members of the SemCanada Group.

10 The SemCanada Energy Companies were liquidated or have ceased operations and no longer have significant ongoing operations. As a result of liquidation proceedings and the collection of outstanding accounts receivable, the SemCanada Energy Companies hold approximately $113 million in cash. An application to distribute that cash to the Secured Lenders was adjourned *sine die* on January 19, 2009: *SemCanada Crude Co., Re*, 2009 ABQB 90 (Alta. Q.B.).

11 Originally, SemCAMS and SemCanada Crude proposed to restructure their businesses as stand-alone operations without further affiliation with the U.S. Debtors and accordingly sought bids in a solicitation process

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undertaken in early 2009. Unfortunately, no acceptable bids were received. It also became apparent that, as SemCanada Crude's business was closely integrated with certain North Dakota transportation rights and assets owned by the U.S. Debtors, restructuring SemCanada Crude's operations on a stand alone basis would be problematic. The SemCanada Group turned to the alternative of joining in the restructuring of the entire SemGroup through concurrent and integrated plans of arrangement in both Canada and the United States.

Summary of the U.S. and Canadian Plans

12 The U.S. and Canadian plans are complex and need not be described in their entirety in these reasons. For the purpose of these reasons, the relevant aspects of the plans are as follows:

1. The disclosure statement relating to a joint plan of affiliated U.S. Debtors was approved for distribution to creditors by the U.S. Bankruptcy Court on July 21, 2009. Under the Chapter 11 process, meetings of creditors are not necessary. Voting takes place through a notice and balloting mechanism that has been approved by the U.S. Court and September 3, 2009 has been set as the voting deadline for acceptance or rejection of the U.S. plan.

2. The total distributable value of the SemGroup for the purpose of the plans is expected to be US $2.3 billion, consisting of US $965 million in cash, US $300 million in second lien term loan interests and US $1.035 billion in new common stock and warrants of the U.S. Debtors.

3. The SemCanada Group will contribute approximately US $161 million in available cash to the U.S. plan and US $54 million is expected to be received from SemCanada Crude relating to crude oil settlements that will occur after the effective date of the plans, being cash received from prepayments that are outstanding on the implementation date which will be replaced with letters of credit or other post-plan financing.

4. Approximately US $50 million will be retained by the corporate group for working capital and general corporate purposes, including for the post plan cash needs of SemCAMS and SemCanada Crude.

5. Certain U.S. causes of action will be contributed to a "litigation trust" and will be distributed through the U.S. Plan, including to the Secured Lenders on their deficiency claims. No value has been placed on the litigation trust by the U.S. Debtors. The Monitor reports that it is unable to make an informed assessment of the value of the litigation trust assets as the trust is a complicated legal mechanism that will likely require the expenditure of significant time and professional fees before there will be any recovery.

6. The U.S. plan contains a condition precedent that, on the effective date of the plan, the restructured corporate group will enter into a US $500 million exit financing facility, which will apply to all post-restructuring affiliates, including SemCAMS and SemCanada Crude, and which will allow the corporate group to re-enter the crude marketing business in the United States and to continue operations in Canada.

7. It is expected that the Secured Lenders will receive cash, second lien term loan interests and equity in priority to unsecured creditors on their secured guarantee claims of US $2.9 billion, which will leave them with a deficiency of approximately US $1.07 billion on the secured loans. The Secured Lenders are entitled under the U.S. Plan to a share in the litigation trust on their deficiency claim. If certain oth-

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er classes of creditors do not vote to approve the U.S. plan, the Secured Lenders may also receive equity of a value up to 4.53% of their deficiency, subject to other contingencies. The Monitor reports that the Secured Lenders are thus estimated to recover approximately 57.1% of their estimated claims of US $2.1 billion on secured working capital claims and 73.3% of their estimated claims of US $811 million on secured revolver/term claims. The Monitor estimates that the Secured Lenders will recover no value on their deficiency claims, assuming no reallocation of equity from other categories of debtors and no value for the litigation trust.

8. The holders of the US $600 million bonds (the "Noteholders") are entitled to receive common shares and warrants in the restructured corporate group, plus an interest in the litigation trust and certain trustee fees, for an estimated recovery of 8.34% on their claims of US $610 million under the U.S. plan, assuming all classes of Noteholders approve the plan and no value is given to the litigation trust. Depending on certain contingencies, the range of recovery is 0.44$ to 11.02% of their claim. Noteholders are treated more advantageously under the plans than general unsecured creditors in recognition that the Senior Notes are jointly and severally guaranteed by 23 U.S. debtors and the Canadian debtors, while in most instances only one SemGroup debtor is liable with respect to each ordinary unsecured creditor. In addition, the Noteholders have waived their right to receive distributions under the Canadian plans.

9. Under the U.S. Plan, general unsecured creditors will receive common shares, warrants and an interest in the litigation trust. Depending on the level of approval, recovery levels will range from 0.08% to 8.03% on claims of US $811 million. The Monitor reports that it expects recovery to general unsecured creditors under the U.S. Plan to be 2.09% of their claim.

10. Pursuant to section 503(b)(9) of the U.S. Bankruptcy Code, entities that provided goods to the U.S. Debtors in the ordinary course of business that were received within 20 days of the filing of Chapter 11 proceedings are entitled to a priority claim that ranks above the claims of the Secured Lenders.

11. There are 3 Canadian plans. As the Secured Lenders will be entitled to some recovery in respect of their deficiency claim and the Noteholders will be entitled to some recovery on their unsecured claim under the U.S. Plan, the Secured Lenders and the Noteholders are deemed to have waived their rights to any additional recovery under the Canadian plans for the most part. However, the votes of the Secured Lenders and the Noteholders entitled to vote on the U.S. Plan are deemed to be votes for the purpose of the Canadian plans, both with respect to numbers of parties and value of claims, and are to be included in the single class of "Affected Creditors" entitled to vote on the Canadian plans. Originally, the Canadian plans provided that the value attributable to the Secured Lenders' votes would be based on the full amount of their guarantee claim, approximately US $2.9 billion, and not only on their deficiency claim of approximately US $1.07 billion. Thus, the aggregate value of the Secured Lenders' voting claims would be:

a) US $2.939 billion for the SemCAMS plan;

b) US $2.939 billion less C $145 million for the SemCanada Crude plan, recognizing that the Secured Lenders would be entitled to receive C $145 million in respect of a negotiated Lenders' Secured Claim under the SemCanada Crude plan; and

c) US $2.939 billion less C $108 million for the SemCanada Energy plan, recognizing that the Secured Lenders will receive that amount in respect of a negotiated Lenders' Secured Claim under the

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SemCanada Energy plan.

At the conclusion of the classification hearing, the CCAA applicants proposed a revision to the proposed orders which stipulates that, if the approval of a plan by the creditors would be determined by the portion of the votes cast by the Secured Lenders that represents an amount of indebtedness that is greater than their estimated aggregate deficiency after taking into consideration the payments they are to receive under the U.S. plan and the Canadian plans, the Court shall determine whether the voting claim of the Secured Lenders should be limited to their estimated deficiency claim.

12. Only "Ordinary Creditors" receive any distribution under the Canadian Plans. Ordinary Creditors are defined as creditors holding "Affected Claims" other than the Secured Lenders, Noteholders, CCAA applicants and U.S. Debtors. Each plan provides that the Affected Creditors of the CCAA applicant will vote at the Creditors' Meeting as a single class.

13. The SemCAMS plan will be funded by a cash advance from SemCanada Crude and establishes two pools of cash. One pool will fund the full amount of secured claims which have not been paid prior to the implementation date of the plan up to the realizable value of the property secured, and the other pool will fund distributions to ordinary unsecured creditors. Ordinary unsecured creditors will receive cash subject to a maximum total payment of 4% of their proven claims. The Monitor estimates that the distribution will equal 4% of claims unless claims in excess of the current highest estimate are established.

14. The SemCanada Crude plan also establishes two pools of cash, one for secured claims and one for ordinary unsecured creditors. Again, the distribution to ordinary unsecured creditors is estimated to be 4% of claims unless claims in excess of the current highest estimate against SemCanada Crude are established.

15. Any cash remaining in SemCanada Crude after deducting amounts necessary to fund the above-noted payments to secured and unsecured ordinary creditors of SemCAMS and SemCanada Crude, unaffected claims and administrative costs, less a reserve for disputed claims, will be paid to the Secured Lenders through the U.S. plan as part of the payment on secured debt.

16. The SemCanada Energy distribution plan is funded from the cash received from the liquidation of the assets of the companies. It also establishes two pools of cash, one of which will be used to pay secured ordinary creditors and a one of which will be used to pay cash distributions to ordinary unsecured creditors. The Monitor estimates that the distribution to ordinary unsecured creditors will be in the range of 2.16% to 2.27% of their claims, unless claims in excess of the current maximum estimate are established. Any amounts outstanding after payment of these claims, unaffected claims and administration costs will be paid to the Secured Lenders. The proposed lower amount of recovery is stated to be in recognition of the fact that the SemCanada Energy Companies have been liquidated and have no going concern value.

17. As this summary indicates, the U.S. Plan and the Canadian plans are closely integrated and economically interdependent. Each of the plans requires that the other plans be approved by the requisite number of creditors and implemented on the same date in order to become effective. The receipt of at least $160 million from the SemCanada Group is a condition precedent to the implementation of the U.S. Plan.

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18. The Monitor reports that the SemCanada Group has indicated that there is no viable option to the proposed plans and that a formal liquidation under bankruptcy legislation would provide a lower recovery to creditors. The Monitor notes that the rationale for the treatment of the Secured Lenders and the ordinary unsecured creditors under the plans is that the Secured Lenders have valid and enforceable secured claims, and that, in the event of the liquidation of the Canadian companies, the Secured Lenders would be entitled to all proceeds, resulting in no recovery to ordinary creditors. Therefore, reports the Monitor, the CCAA plans are considered to be better than the alternative of a liquidation. The Secured Lenders derive some benefit from the plans through the preservation of the going concern value of SemCAMS and SemCanada Crude and by having a prompt distribution of funds held by the SemCanada Energy Companies.

19. The Monitor notes that the distribution to the SemGroup unsecured creditors under the U.S. plan is viewed as better than a liquidation, and that, therefore, given the effect of the U.S. Bankruptcy Code's "cram-down" provisions, it is likely that the U.S. plan will be confirmed. The Monitor comments that the proposed distribution to ordinary unsecured creditors under the CCAA plans is considered to be fair as it is comparable to and potentially slightly more favourable than the distributions being made to the U.S. ordinary unsecured creditors.

Positions of Various Parties

13 The SemCanada Group applied for orders

a) accepting the filing of, in the case of SemCAMS and SemCanada Crude, proposed plans of arrangement and compromise, and in the case of SemCanada Energy, a proposed plan of distribution;

b) authorizing the calling and holding of meetings of the Canadian creditors of these three CCAA applicants;

c) authorizing the establishment of a single class of creditors for each plan for the purpose of considering and voting on the plans;

d) approving procedures with respect to the calling and conduct of such meetings; and

e) other non-contentious enabling relief.

14 Certain unsecured creditors of the applicants objected to the proposed classification of creditors, submitting that the Secured Lenders should not be allowed a vote in the same class as the unsecured creditors either with respect to the secured portion of their overall claim or any deficiency in their claims that would remain unpaid, and that the Noteholders should not be allowed a vote in the same class as the rest of the unsecured creditors.

15 As noted previously, the CCAA applicants proposed a revision to the proposed orders at the conclusion of the classification hearing which would allow the Court to consider whether the voting claim of the Secured Lenders should be limited to their estimated deficiency claim. The objecting creditors continued to object to the proposed classification, even if eligible votes were limited to the deficiency claim of the Secured Lenders.

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Analysis

16 Section 6 of the CCAA provides that, where a majority in number representing two-thirds in value of "the creditors or class of creditors, as the case may be" vote in favour of a plan of arrangement or compromise at a meeting or meetings, the plan of arrangement may be sanctioned by the Court. There is little by way of specific statutory guidance on the issue of classification of claims, leaving the development of this issue in the CCAA process to case law. Prior decisions have recognized that the starting point in determining classification is the statute itself and the primary purpose of the statute is to facilitate the reorganization of insolvent companies: Paperny, J. in *Canadian Airlines Corp., Re* (2000), 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]), leave to appeal refused (2000), 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]), affirmed [2001] 4 W.W.R. 1 (Alta. C.A.), leave to appeal to SCC refused [2001] S.C.C.A. No. 60 (S.C.C.) at para. 14. As first noted by Forsyth, J. in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20, 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566 (Alta. Q.B.) at page 28, and often repeated in classification decisions since, "this factor must be given due consideration at every stage of the process, including the classification of creditors..."

17 Classification is a key issue in CCAA proceedings, as a proposed plan must achieve the requisite level of creditor support in order to proceed to the stage of a sanction hearing. The CCAA debtor seeks to frame a class or classes in order to ensure that the plan receives the maximum level of support. Creditors have an interest in classifications that would allow them enhanced bargaining power in the negotiation of the plan, and creditors aggrieved by the process may seek to ensure that classification will give them an effective veto (see *Rescue: The Companies' Creditors Arrangement Act*, Janis P. Sarra, 2007 ed. Thomson Carswell at page 234). Case law has developed from the comments of the British Columbia Court in *Woodward's Ltd., Re* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.) warning against the danger of fragmenting the voting process unnecessarily, through the identification of principles applicable to the concept of "commonality of interest" articulated in *Canadian Airlines Corp., Re* and elaborated further in Alberta in *San Francisco Gifts Ltd., Re*, 2004 CarswellAlta 1241, [2004] A.J. No. 1062 (Alta. Q.B.), leave to appeal refused (2004), 5 C.B.R. (5th) 300 (Alta. C.A.).

18 The parties in this case agree that "commonality of interest" is the key consideration in determining whether the proposed classification is appropriate, but disagree on whether the plans as proposed with their single class of voters meet that requirement. It is clear that classification is a fact-driven inquiry, and that the principles set out in the case law, while useful in considering whether commonality of interest has been achieved by the proposed classification, should not be applied rigidly: *Canadian Airlines Corp., Re* at para. 18; *San Francisco Gifts Ltd., Re* at para. 12; *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.) at para. 22.

19 Although there are no fixed rules, the principles set out by Paperny, J. in para. 31 of *Canadian Airlines Corp., Re* provide a useful structure for discussion of whether to the proposed classification is appropriate:

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

20 Under the now-rejected "identity of interest" test, all members of the class had to have identical interests. Under the non-fragmentation test, interests need not be identical. The interests of the creditors in the class need only be sufficiently similar to allow them to vote with a common interest: *Woodward's Ltd., Re* at para. 8.

21 The objecting creditors submit that the creation of two classes rather than one cannot be considered to be fragmentation. The issue, however, is not the number of classes, but the effect that fragmentation of classes may have on the ability to achieve a viable reorganization. As noted by Farley, J. in para. 13 of his reasons relating to

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the classification of creditors in *Stelco Inc., Re*, as endorsed by the Ontario Court of Appeal:

> ...absent valid reason to have separate classes it would be reasonable, logical, rational and practical to have all this unsecured debt in the same class. Certainly that would avoid fragmentation - and in this respect multiplicity of classes does not mean that fragmentation starts only when there are many classes. Unless more than one class is necessary, fragmentation would start at two classes. Fragmentation if necessary, but not necessarily fragmentation.

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

22 The classification of creditors is viewed with respect to the legal rights they hold in relation to the debtor company in the context of the proposed plan, as opposed to their rights as creditors in relation to each other: *Woodward's Ltd., Re* at para. 27, 29; *Stelco Inc., Re* at para. 30. In the proposed single classification, the rights of the creditors in the class against the debtor companies are unsecured (other than the proposed votes attributable to the secured portion of the debt of the Secured Lenders, which will be discussed separately).

23 With respect to the Secured Lenders' deficiency claim, there is a clear precedent for permitting a secured creditor to vote a substantial deficiency claim as part of the unsecured class: *Campeau Corp., Re* (1991), 10 C.B.R. (3d) 100 (Ont. Gen. Div.); *Canadian Airlines Corp., Re*, supra.

24 The classification issues in the *Campeau Corp., Re* restructuring were similar to the present issues. In *Campeau Corp., Re*, a secured creditor, Olympia & York, was included in the class of unsecured creditors for the deficiency in its secured claim, which represented approximately 88% of the value of the unsecured class. The Court rejected the submission that the legal interests of Olympia & York were different from other unsecured creditors in the class. Montgomery, J. noted at para. 16 that Olympic & York's involvement in the negotiation of the plan was necessary and appropriate given that the size of its claims would allow it a veto no matter how the classes were constituted and that its co-operation was necessary for the success of both the U.S. and Canadian plans.

25 In the same way, the size and scope of the Secured Lenders claim makes their participation in the negotiation and endorsement of the proposed plans essential. That participation does not disqualify them from a vote in the process, nor necessitate their isolation in a special class. While under the integrated plans, the Secured Lenders will receive a different kind of distribution on their unsecured deficiency claim (a share of the litigation trust), that is an issue of fairness for the sanction hearing and does not warrant the establishment of a separate class.

26 The interests of the Noteholders are unsecured. While it is true that under the integrated plans, the Noteholders would be entitled to a higher share of the distribution of assets than ordinary unsecured creditors, the rationale for such difference in treatment relates to the multiplicity of debtor companies that are indebted to the Noteholders, as compared to the position of the ordinary unsecured creditors. That difference, while it may be subject to submissions at the sanction hearing, is an issue of fairness, and not a difference material enough to warrant a separate class for the Noteholders in this case. A separate class for the Noteholders would only be necessary if, after considering all the relevant factors, it appeared that this difference would preclude reasonable consultation among the creditors of the class: *San Francisco Gifts Ltd., Re* at para. 24.

27 The question arises whether the fact that the Secured Lenders and the Noteholders have waived their

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rights to recover under the Canadian plans should result in either the requirement of separate classes or the forfeiture of their right to vote on the Canadian plans at all.

28 This is a unique case: a cross-border restructuring with separate but integrated and interdependent plans that are designed to comply with the restructuring legislation of two jurisdictions. As the applicants point out, the co-ordinated structure of the plans is designed to ensure that the Secured Lenders and the Noteholders receive sufficient recoveries under the U.S. plan to justify the sacrifices in recovery that result from their waiver of distributions under the Canadian plans. In considering the context of the proposed classification, it would be unrealistic and artificial to consider the Canadian plans in isolation, without regard to the commercial outcome to the creditors resulting from the implementation of the plans in both jurisdictions. Thus, the fact that the distributions to Secured Lenders and Noteholders will take place through the operation of the U.S. plan, and that the effective working of the plans require them to waive their rights to receive distributions under the Canadian plans does not deprive them of the right to an effective voice in the consideration of the Canadian plans through a meaningful vote.

29 It is not sufficient to say that the Secured Lenders and the Noteholders have a vote in the U.S. plans. The "cram down" power which exists under Chapter 11 of the U.S. Bankruptcy Code includes a "best interests test" that requires that if a class of holders of impaired claims rejects the plan, they can be "crammed down" and their claims will be satisfied if they receive property of a value that is not less than the value that the class would receive or retain if the debtor were liquidated under Chapter 7 of the U.S. Bankruptcy Code. Thus, the votes available to the Secured Lenders and the Noteholders with respect to their claims under the U.S. Plan do not give them the right available to creditors under Canadian restructuring law to vote on whether a proposed plan should proceed to the next step of a sanction hearing There is no reason to deprive the Secured Lenders and the Noteholders of that right as creditors of the Canadian debtors, even if the distributions they would be entitled to flow through the U.S. plan. The question becomes, then, whether that right should be exercised in a class with other unsecured creditors as proposed or in a separate class.

30 It is noteworthy that the proposed single classification does not have the effect of confiscating the legal rights of any of the unsecured creditors, or adversely affecting any existing security position. It is in fact arguable that seeking to exclude the Secured Lenders and the Noteholders from the class prejudices these similarly-placed creditors by denying them a meaningful voice in the approval or rejection of the plans in Canada.

31 A number of cases suggest that the Court should also consider the rights of the parties in liquidation in determining whether a proposed classification is appropriate: *Woodward's Ltd., Re* at para. 14; *San Francisco Gifts Ltd., Re* at para. 12.

32 Under a liquidation scenario, the Secured Lenders would be entitled to nearly all of the proceeds of the liquidated corporate group, other than the relatively few secured claims that have priority. This suggests that the Secured Lenders are entitled to a meaningful vote with respect to both the U.S. plan and the Canadian plans.

3. The commonality of interests is to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate organizations if possible.

4. In placing a broad and purposive interpretation on the CCAA, the Court should be careful to resist classification approaches that would potentially jeopardize viable plans.

33 The Ontario Court of Appeal in *Stelco Inc., Re* cautioned that, in addition to considering commonality of

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interest issues, the court in a classification application should be alert to concerns about the confiscation of legal rights and should avoid "a tyranny of the minority", citing the comments of Borins, J. in *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.), where he warned against creating "a special class simply for the benefit of the opposing creditor, which would give that creditor the potential to exercise an unwarranted degree of power": *Stelco Inc., Re* at para 28.

34 Excluding of the Secured Lenders and the Noteholders from the proposed single class would allow the objecting creditors to influence the voting process to a degree not warranted by their status. It is true that if the Secured Lenders and the Noteholders are not excluded from the class, even if only the votes related to the Secured Lenders' deficiency claim are tabulated, the positive vote will likely be enough to allow the proposed plans to proceed to a sanction hearing. It is also true that the Secured Lenders and the Noteholders may have been part of the negotiations that led to the proposed plans. Neither of those factors standing alone is sufficient to warrant a separate class unless rights are being confiscated or the classification creates an injustice.

35 The structure of the classification as proposed creates in effect what was imposed by the Court in *Canadian Airlines Corp., Re*, a method of allowing the "voice" of ordinary unsecured creditors to be heard without the necessity of a separate classification, thus permitting rather than ruling out the possibility that the plans might proceed to a sanction hearing. Given that the votes of the Secured Lenders and the Noteholders on the U.S. plan will be deemed to be votes of those creditors on the Canadian plans, there will be perforce a separate tabulation of those votes from the votes of the remaining unsecured creditors. In accordance with the revision to the plans made at the end of the classification hearing, there will be a separate tabulation of the votes of the Secured Lenders relating to the secured portion of their claims and the votes relating to the unsecured deficiency.

36 The situation in this classification dispute is essentially the same as that which faced Paperny, J. in *Canadian Airlines Corp., Re*. Fragmenting the classification prior to the vote raises the possibility that the plans may not reach the stage of a sanction hearing where fairness issues can be fully canvassed. This would be contrary to the purpose of the CCAA. This is particularly an issue recognizing that the U.S. plan and the Canadian plans must all be approved in order for any one of them to be implemented. Conrad, J.A. in denying leave to appeal in *San Francisco Gifts Ltd., Re*, 2004 ABCA 386 (Alta. C.A.) at para. 9 noted that the right to vote in a separate class and thereby defeat a proposed plan of arrangement is the statutory protection provided to the different classes of creditors, and thus must be determined reasonably at the classification stage. However, she also noted that "it is important to carefully examine classes with a view of protecting against injustice": para. 10. In this case, the goals of preventing confiscation of rights and protecting against injustice favour the proposed single classification.

37 This is the "pragmatic" factor referred to in *Campeau Corp., Re* at para. 21.The CCAA judge must keep in mind the interests of all stakeholders in reviewing the proposed classification, as in any step in the process. If a classification prevents the danger of a veto of a plan that promises some better return to creditors than the alternative of a liquidating insolvency, it should not be interfered with absent good reason. The classification hearing is not the only avenue of relief for aggrieved creditors. If a plan received the minimum required level of approval by vote of creditors, it must still be approved at a hearing where issues of fairness must be addressed.

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

38 As noted in *Canadian Airlines Corp., Re* at para. 35, fragmenting a class because of an alleged conflict of interest not based on legal rights is an error. The issue of the motivation of a party to vote for or against a

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plan is an issue for the fairness hearing. There is no doubt that the various affected creditors in the proposed single class may have differing financial or strategic interests. To recognize such differences at the classification stage, unless the proposed classification confiscates rights, results in an injustice or creates a situation where meaningful consultation is impossible, would lead to the type of fragmentation that may jeopardize the CCAA process and be counter-productive to the legislative intent to facilitate viable reorganizations.

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

39 The issue of meaningful consultation was addressed by both the supervising justice and the Court of Appeal in *San Francisco Gifts Ltd., Re*. In that case, Topolniski, J. noted that two corporate insiders that the proposed plan had included in the classification of affected creditors held claims that were uncompromised by the plan, that they gave up nothing, and that it "stretches the imagination to think other creditors in the class could have meaningful consultation [with them] about the Plan": para. 49. Her decision to place these parties in a separate class was confirmed by the Court of Appeal, which commented that Topolniski, J. was "absolutely correct" to find no ability to consult "between shareholders whose debts would not be cancelled and other unsecured creditors whose debts would be": para. 14.

40 That is not the situation here. The deficiency claims of the Secured Lenders and the unsecured claims of the Noteholders are being compromised in the U.S. plan, and there is nothing to block consultations among affected creditors on the basis of dissimilarity of legal interests. While there are differences in the proposed distributions on the unsecured claims, they are not so major that they would preclude consultation.

41 The objecting creditors point to statements made by counsel for the Secured Lenders during the classification application about the alternatives to approval of the plans, which they submit indicates the impossibility of consultation. These comments were made in the context of advocacy on behalf of the proposed classification, and I do not take them as a clear statement by the Secured Lenders that they would refuse to consult with the other creditors.

Secured Portion of Secured Lenders' Claim

42 The CCAA applicants and the Secured Lenders submit that it would be unfair and inappropriate to limit the votes of the Secured Lenders in the Canadian plans to the amount of the deficiency in their secured claim, rather than the entire amount owing under the guarantee. They argue that, by endorsing the plans, the Secured Lenders have in effect elected to treat their entire claim under the guarantee as unsecured with respect to the Canadian plans, except for relatively small negotiated secured claims under the SemCanada Crude plan and the SemCanada Energy plan. They also submit that the fact that under bankruptcy law, a creditor of a bankrupt debtor is entitled to prove for the full amount of its debt in the estates of both the debtor and a bankrupt guarantor of the debt justifies granting the Secured Lenders the right to vote the full amount of the guarantee claim, even if part of the claim is to be recovered through the U.S. plan, as long as they do not actually recover more than 100 cents on the dollar.

43 It became apparent during the course of the classification hearing that it may not matter whether the plans are approved by the requisite number of creditors and value of their claims if the Secured Lenders are only entitled to vote the deficiency portion of their claims or the full amount of their claims. It was this that led to the revision in the language of the voting provisions of the plans. I defer a decision on the question of whether or not the Secured Lenders are entitled to vote the entire amount of their guarantee claims until after the vote has

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been conducted and the votes separately tabulated as directed. As noted by the Court of Appeal in *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]) at para. 39, such a deferral of a voting issue is not an error of law and is in fact consistent with the purpose of the CCAA.

Recent Amendments

44 The following amendment to the CCAA that has been proclaimed in effect from September 18, 2009 sets out certain factors that may be considered in approving a classification for voting purposes:

> 22.2 (2)**Factors** - For the purpose of subsection (1), creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest, taking into account:
>
> (a) the nature of the debts, liabilities or obligations giving rise to their claims;
>
> (b) the nature and rank of any security in respect of their claims;
>
> (c) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and
>
> (d) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed. (R.S.C. 2005, c. 47, s. 131, amended R.S.C. 2007, Bill C -12, c.36, s.71)

45 These factors do not change in any material way the factors that have been identified in the case law and discussed in these reasons nor would they have a material effect on the consideration of the proposed classification in this case.

Creditors with Claims in Process

46 Two creditors advised that, because their claims of secured status had not yet been resolved with the applicants and the Monitor, they were not in a position to evaluate whether or not to object to the proposed classification. The plans were revised to ensure that the votes of creditors whose status as secured creditors remains unresolved until after the meetings of creditors be recorded with votes of creditors with disputed claims and reported to the Court by the Monitor if these votes affect the approval or non-approval of the plan in question.

Conclusion

47 In summary, I have concluded that there is no good reason to exclude the Secured Lenders and the Noteholders from the single classification of voters in the proposed plans, nor to create a separate class for their votes. There are no material distinctions between the claims of these two creditors and the claims of the remaining unsecured creditors that are not more properly the subject of the sanction hearing, apart from the deferred issue of whether the Secured Lenders are entitled to vote their entire guarantee claim. No rights of the remaining unsecured creditors are being confiscated by the proposed classification, and no injustice arises, particularly given the separate tabulation of votes which enables the voice of the remaining unsecured creditors to be heard and measured at the sanction hearing. There are no conflicts of interest so over-riding as to make consultation impossible. While there are differences of interests and treatment among the affected creditors in the class, these are issues that will be addressed at the sanction hearing. Approval of the proposed classification in the context of

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the integrated plans is in accordance with the spirit and purpose of the CCAA.

Applications granted.

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TAB 12

H

2004 CarswellAlta 1607, 2004 ABCA 386, [2005] A.W.L.D. 6, 5 C.B.R. (5th) 300, [2005] A.W.L.D. 710, 361 A.R. 220, 339 W.A.C. 220, 42 Alta. L.R. (4th) 371

San Francisco Gifts Ltd., Re

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) (Applicants) and Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc., 20 Vic Management Ltd., Morguard Investments Ltd., Morguard Real Estate Investments Trust, Riocan Property Services, and 1113443 Ontario Inc. (Respondents)

Alberta Court of Appeal

Conrad J.A.

Heard: November 24, 2004
Judgment: December 2, 2004
Docket: Edmonton Appeal 0403-0325-AC

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Proceedings: refused leave to appeal *San Francisco Gifts Ltd., Re* (2004), 2004 ABQB 705, 2004 CarswellAlta 1241 (Alta. Q.B.)

Counsel: R.T.G. Reeson, Q.C. for Applicants

J.H.H. Hockin for Respondents

M.J. McCabe, Q.C. for Court Appointed Monitor

Subject: Civil Practice and Procedure; Insolvency

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — To Court of Appeal — Availability — Leave by judge

SF group of companies was composed of operating company and several nominee companies — Operating company held all of SF's assets and was one hundred per cent owned by L Corp. — L Corp. was wholly owned by BS, who was also president and sole director of nearly all SF group of companies — BS and L Corp. were operating company's only secured creditors — On January 7, 2004, SF group of companies was granted protection under

2004 CarswellAlta 1607, 2004 ABCA 386, [2005] A.W.L.D. 6, 5 C.B.R. (5th) 300, [2005] A.W.L.D. 710, 361 A.R. 220, 339 W.A.C. 220, 42 Alta. L.R. (4th) 371

Companies' Creditors Arrangement Act ("CCAA") — On June 22, 2004, operating company was permitted to file plan of compromise or arrangement and submit it to its creditors for consideration and voting — Plan classified BS and L Corp. as "unaffected creditors", meaning that their claims survived reorganization and they would vote as unsecured creditors — On July 14, 2004, group of six objecting landlords asked court to create separate classes of creditors — Court removed BS and L Corp. from unsecured creditors class, placing them in separate class for voting purposes — SF group of companies applied for leave to appeal — Application dismissed — In arriving at her decision to place BS and L Corp. in separate class, chambers judge relied on different treatment afforded BS and L Corp. under plan — BS and L Corp. would be unaffected by bankruptcy of SF companies, whereas all other creditors in class would receive nothing — BS and L Corp. were in position to control vote and cancel all unsecured creditors' debt but their own — Under those circumstances, there would be no meaningful consultation about plan — Chambers judge correctly held that there was no "commonality of interest" between BS and L Corp. and other creditors — While questions of class in CCAA proceedings were important, application for leave failed to establish that appeal was prima facie meritorious.

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

SF group of companies was composed of operating company and several nominee companies — Operating company held all of SF's assets and was one hundred per cent owned by L Corp. — L Corp. was wholly owned by BS, who was also president and sole director of nearly all SF group of companies — BS and L Corp. were operating company's only secured creditors — On January 7, 2004, SF group of companies was granted protection under Companies' Creditors Arrangement Act ("CCAA") — On June 22, 2004, operating company was permitted to file plan of compromise or arrangement and submit it to its creditors for consideration and voting — Plan classified BS and L Corp. as "unaffected creditors", meaning that their claims survived reorganization and they would vote as unsecured creditors — On July 14, 2004, group of six objecting landlords asked court to create separate classes of creditors — Court removed BS and L Corp. from unsecured creditors class, placing them in separate class for voting purposes — SF group of companies applied for leave to appeal — Application dismissed — In arriving at her decision to place BS and L Corp. in separate class, chambers judge relied on different treatment afforded BS and L Corp. under plan — BS and L Corp. would be unaffected by bankruptcy of SF companies, whereas all other creditors in class would receive nothing — BS and L Corp. were in position to control vote and cancel all unsecured creditors' debt but their own — Under those circumstances, there would be no meaningful consultation about plan — Chambers judge correctly held that there was no "commonality of interest" between BS and L Corp. and other creditors — While questions of class in CCAA proceedings were important, application for leave failed to establish that appeal was prima facie meritorious.

Cases considered by *Conrad J.A.*:

Liberty Oil & Gas Ltd., Re (2003), 44 C.B.R. (4th) 96, 2003 ABCA 158, 2003 CarswellAlta 684 (Alta. C.A.) — followed

Royal Bank v. Fracmaster Ltd. (1999), 1999 CarswellAlta 539, (sub nom. *UTI Energy Corp. v. Fracmaster Ltd.*) 244 A.R. 93, (sub nom. *UTI Energy Corp. v. Fracmaster Ltd.*) 209 W.A.C. 93, 11 C.B.R. (4th) 230 (Alta. C.A.) — considered

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

Statutes considered:

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

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2004 CarswellAlta 1607, 2004 ABCA 386, [2005] A.W.L.D. 6, 5 C.B.R. (5th) 300, [2005] A.W.L.D. 710, 361 A.R. 220, 339 W.A.C. 220, 42 Alta. L.R. (4th) 371

Generally — referred to

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

Generally — considered

Tariffs considered:

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

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

APPLICATION by insolvent group of companies for leave to appeal from judgment reported at *San Francisco Gifts Ltd., Re* (2004), 5 C.B.R. (5th) 92, 42 Alta. L.R. (4th) 352, 359 A.R. 71, 2004 ABQB 705, 2004 CarswellAlta 1241 (Alta. Q.B.) with respect to classes of creditors under *Companies' Creditors Arrangement Act*.

***Conrad J.A.*:**

I. Introduction

1 The San Francisco group of companies ("San Francisco") seeks leave to appeal an order finding Barry Slawsky ("Slawsky") and Laurier Investments Corp. ("Laurier") do not share a "commonality of interest" with other unsecured creditors, and placing them in a separate class for purposes of voting on a plan of arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*").

II. Facts

2 San Francisco is composed of the operating company, San Francisco Gifts Ltd., and several nominee companies. The operating company holds all of San Francisco's assets and is 100% owned by Laurier. Laurier is wholly owned by Slawsky, who is also the president and sole director of nearly all of the San Francisco group of companies. Slawsky and Laurier are San Francisco's only secured creditors. In addition, they have substantial unsecured debt with the company.

3 On January 7, 2004, San Francisco was granted protection under the *CCAA*. The initial order was extended, and San Francisco remains in business. On June 22, 2004, San Francisco was permitted to file a Plan of Compromise or Arrangement ("Plan") and submit it to its creditors for consideration and voting. The Plan classified Slawsky and Laurier as "unaffected creditors," meaning that their claims survive the reorganization. Slawsky and Laurier would not share in the distribution of $500,000.00; however, they would value their security and vote as unsecured creditors.

4 On July 14, 2004, a group of six objecting landlords asked the Court to create a separate class or classes for landlords and any similarly-affected parties, to assist the Court-appointed monitor in identifying and preserving creditor claims, and to remove any "related parties" from the unsecured creditors class (or, alternatively, deny them a vote).

III. Decision Below

5 The motion was heard on September 1 and 2, 2004. In a reserved written judgment, the supervising chambers justice declined to create a separate class for landlords, but made provision for preserving certain landlords' claims

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relating to the right to distrain. The decision removed Slawsky and Laurier from the unsecured creditors class, placing them in a separate class for voting purposes, and awarded costs against San Francisco under Column 1. It is the removal of Slawsky and Laurier from the unsecured creditors class for which San Francisco seeks leave to appeal. If granted leave to appeal, San Francisco asks this Court to also review the costs award.

6 The chambers justice focused on the lack of "commonality of interest" between Slawsky and Laurier and the rest of the unsecured creditors. Her concerns centred on the different treatment afforded Slawsky and Laurier. Although Slawsky and Laurier would not share in the $500,000.00 distribution, their debt would not be compromised. If the reorganization failed and San Francisco became bankrupt, Slawsky and Laurier would be unaffected, whereas the rest of the unsecured creditors would receive nothing. The chambers justice concluded at para. 49 of her reasons that in light of their divergent interests, "[i]t stretches the imagination to think that other creditors in the class could have meaningful consultations about the Plan with Barry Slawsky and, through him with Laurier."

IV. Test for Leave to Appeal

7 Any person dissatisfied with an order under the *CCAA* is permitted an appeal of that order on obtaining leave: *CCAA*, s.13. The test for leave to appeal is set out in *Liberty Oil & Gas Ltd., Re* (2003), 44 C.B.R. (4th) 96, 2003 ABCA 158 (Alta. C.A.) at paras. 15 and 16:

> The test for granting leave, as articulated in this Court, involves a single criterion subsuming four factors. The single criterion is that there must be serious and arguable grounds that are of real and significant interest to the parties . . . .
>
> The four factors subsumed in an assessment whether the criterion is present are:
>
> (1) Whether the point on appeal is of significance to the practice;
>
> (2) Whether the point raised is of significance to the action itself;
>
> (3) Whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and
>
> (4) Whether the appeal will unduly hinder the progress of the action . . . .

V. Standard of Review

8 In considering whether the appeal is *prima facie* meritorious, it is necessary to consider the standard of review the Court would apply if leave was granted. This Court has stated that the supervising chambers justice in a *CCAA* matter is tasked with an ongoing management process similar to that of a judge in the course of a trial: *Liberty Oil & Gas Ltd., Re, supra* at para. 20. Consequently, the reviewing court will only interfere with the decision where the chambers justice "acted unreasonably, erred in principle or made a manifest error": *Royal Bank v. Fracmaster Ltd.* (1999), 244 A.R. 93 (Alta. C.A.) at para. 3.

VI. Decision

9 The applicants' main complaints are that the chambers justice erred in her application of the common-law "commonality of interests" test and she misunderstood the facts. The *CCAA* does not explicitly state what factors differentiate creditors so as to place them in separate classes for voting purposes. But in determining issues relating to class, it is important to recognize that the right to vote as a separate class and thereby defeat a proposed plan of arrangement is the statutory protection provided to the different classes of creditors. While fairness on many issues

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is assessed again at a later stage, it is the initial placing within a separate class that provides this non-discretionary right to creditors.

10 To give effect to this protection, a "commonality of interests" test was developed. The foundation for the "commonality of interests" test is that the classes must be structured so as to "prevent a confiscation and injustice" and to enable the members to "consult together with a view to their common interest": *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (Eng. C.A.), at 583. It follows that it is important to carefully examine classes with a view to protecting against injustice, and not simply rely on fairness being evaluated later.

11 The means of preventing confiscation and injustice raises some very interesting issues when it comes to determining who should be in a separate class for voting purposes. Unlike the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, the *CCAA* does not specifically provide for treatment of related parties. While unsecured creditors and shareholders have similar legal rights with respect to debts owing, a shareholder *qua* shareholder has other legal rights that may impact on, or make impossible, the ability of the class to hold a common interest. This is an important issue that has not yet been addressed by this Court. As interesting and important as that issue is, however, it is not the issue on this appeal and resolution of the issue must wait to another day.

12 The chambers judge did not need to, and did not, make her decision on commonality of interest based merely on the fact that Slawsky and Laurier were shareholders. Rather, in arriving at her decision to place the shareholders in a separate class, the chambers judge relied on the different treatment afforded Slawsky and Laurier under the Plan. She stated (at para. 49):

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

13 I do not accept the applicants' argument that the chambers judge failed to understand that Slawsky and Laurier *had* given up something in that the Plan did not provide for their participation in the $500,000.00 available for distribution. This judge was alive to that element of the Plan. When she said that "he gives up nothing," she was referring to the fact that under the Plan the shareholders' debt remains outstanding and is not compromised, unlike the other unsecured creditors' debt. In short, Slawsky and Laurier may be in a position to control the vote and cancel all unsecured creditors' debt but their own. Under these circumstances, there would be no meaningful consultation about the Plan.

14 In my view, the chambers judge was absolutely correct in her assessment that it stretches the imagination to think that there would be meaningful consultation about the Plan between shareholders whose debts would not be cancelled and other unsecured creditors whose debts would be. Certainly, bearing in mind the standard of review, there is absolutely no merit to this appeal.

15 Thus, while I acknowledge that questions of class are important, both to the practice and the parties, this application for leave must fail because it fails to establish that the appeal is *prima facie* meritorious.

16 In the result, the chambers judge did not err in principle, she did not misunderstand the evidence, and her decision to remove Slawsky and Laurier from the class of unsecured creditors was correct. In my view, any other decision would have resulted in an injustice to the other unsecured creditors. At a minimum, bearing in mind the standard of review, there is no chance of success on the appeal.

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17 Leave to appeal is denied.

(Counsel speaks to costs)

18 Costs are allowed to the Respondent in Column 1 and I allow costs for the filing of their Memorandum, notwithstanding the red stamp.

Application dismissed.

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TAB 13

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2001 CarswellAlta 1488, 2001 ABQB 983, [2002] A.W.L.D. 43, 29 C.B.R. (4th) 236, [2002] 3 W.W.R. 373, 98 Alta. L.R. (3d) 277, 306 A.R. 124

Ontario v. Canadian Airlines Corp.

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

AND IN THE MATTER OF THE BUSINESS CORPORATIONS ACT (ALBERTA), S.A. 1981, c. B.-15, AS AMENDED, SECTION 185;

AND IN THE MATTER OF CANADIAN AIRLINES CORPORATION AND CANADIAN AIRLINES INTERNATIONAL LTD.;

HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF ONTARIO (Applicant) and CANADIAN AIRLINES CORPORATION AND CANADIAN AIRLINES INTERNATIONAL LTD. (Respondents)

Alberta Court of Queen's Bench

Romaine J.

Judgment: November 16, 2001
Docket: Calgary 0001-05071

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Counsel: *Larry B. Robinson*, *Michael D. Aasen*, for Her Majesty the Queen in Right of the Province of Ontario

Chris Simard, for Canadian Airlines Corporation and Canadian Airlines International Ltd.

Sean Dunphy, for Air Canada

Subject: Corporate and Commercial; Insolvency; Provincial Tax

Banking and banks --- Letters of credit

Company self-assessed its tax liabilities and made instalment payments under provincial statutes — Province assessed company for taxes owing — Company filed notices of objections and appeals were ongoing — Company provided province with letters of credit to secure assessments under appeal — Until decisions were rendered in tax appeals, no amounts were payable and province was precluded from drawing on letters of credit — Company received protection under Companies' Creditors Arrangement Act — Company included province in list of "affected unsecured claims" — Province's claim was for greater amount than letters of credit — Company's plan of compro-

mise and arrangement was approved — Province brought application for declaration that debt secured by letters of credit was not compromised by plan — Issue arose as to appropriate characterization of portion of province's claim under letters of credit — Claim was secured — Letters of credit were not simply payment devices — Letters of credit provided province with form of security subject to conditions — That insolvency was irrelevant to letter of credit was reflected in s. 11.2 of Act — Province's forbearance in accepting letters of credit in lieu of cash was not waiver of anything other than immediate right to be paid — No evidence that in accepting letters of credit, province agreed to have its claims treated as unsecured — That no immediate enforcement rights of province were being compromised by plan did not convert nature of province's interest to unsecured claim — No implied agreement between province and company that debt underlying secured claims could be compromised by intervening events other than tax appeals — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.2.

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Effect of arrangement — General

Company self-assessed its tax liabilities and made instalment payments under provincial statutes — Province assessed company for taxes owing — Company filed notices of objections and appeals were ongoing — Company provided province with letters of credit to secure assessments under appeal — Company received protection under Companies' Creditors Arrangement Act — Company included province in list of "affected unsecured claims" — Province's claim was for greater amount than letters of credit — Company's plan of compromise and arrangement was approved — Province brought application for declaration that debt secured by letters of credit was not compromised by plan — Application granted — Plan made no express reference to letters of credit — Company provided no evidence that compromise of entirety of province's claim was required for company's ongoing survival or formed integral part of whole plan — No evidence that interpreting plan in manner proposed by province would be prejudicial to company — No evidence of prejudice to company's creditors — No suggestion of damage to integrity of plan — Disregarding letters of credit in company's insolvent circumstances was inconsistent with rationale of particular security devices — Compromising entirety of province's claim was inconsistent with general concept of plan — Company's interpretation resulted in anomalous treatment of secured creditor under plan — No evidence that any other secured creditor was included in "affected unsecured creditors" list — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Cases considered by *Romaine J.*:

Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303 (Ont. C.A.) — considered

Algoma Steel Corp. v. Royal Bank (1992), 94 D.L.R. (4th) vii, 10 O.R. (3d) xv, (sub nom. *Royal Insurance Co. of Canada v. Kelsey-Hayes Canada Ltd.*) 145 N.R. 391 (note), (sub nom. *Royal Insurance Co. of Canada v. Kelsey-Hayes Canada Ltd.*) 59 O.A.C. 326 (note) (S.C.C.) — referred to

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

Canada Deposit Insurance Corp. v. Canadian Commercial Bank, (sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidation)*) 232 A.R. 235, (sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidation)*) 195 W.A.C. 235, (sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidator of)*) 173 D.L.R. (4th) 309, (sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidator of)*) 70 Alta. L.R. (3d) 69, [1999] 10 W.W.R. 704, 10 C.B.R. (4th) 70 (Alta. C.A.) — referred to

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

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Canadian Airlines Corp., Re (2000), 2001 ABCA 9, 2000 CarswellAlta 1556, 277 A.R. 179, 242 W.A.C. 179, 88 Alta. L.R. (3d) 8, [2001] 4 W.W.R. 1, [2000] A.J. No. 1028 (Alta. C.A.) — referred to

Canadian Airlines Corp., Re, 2001 CarswellAlta 888, 2001 CarswellAlta 889, [2001] S.C.C.A. No. 60 (S.C.C.) — referred to

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

Horizon Village Corp., Canada, Re (1991), 8 C.B.R. (3d) 25, 82 Alta. L.R. (2d) 152, 122 A.R. 348 (Alta. Q.B.) — considered

Keddy Motor Inns Ltd., Re (1992), 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 110 N.S.R. (2d) 246, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4)*) 299 A.P.R. 246 (N.S. C.A.) — considered

Lindsay v. Transtec Canada Ltd. (1994), 28 C.B.R. (3d) 110, 5 C.C.P.B. 219, [1995] 2 W.W.R. 404, 99 B.C.L.R. (2d) 73 (B.C. S.C.) — considered

Lindsay v. Transtec Canada Ltd., 2 B.C.L.R. (3d) 304, [1995] 4 W.W.R. 364, 31 C.B.R. (3d) 157 (B.C. C.A.) — referred to

Meridian Development Inc. v. Toronto Dominion Bank, [1984] 5 W.W.R. 215, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Alta. Q.B.) — considered

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

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

Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re*) 12 O.R. (3d) 500 (Ont. Gen. Div.) — considered

Ontario v. Canadian Airlines Corp. (2000), (sub nom. *Canadian Airlines Corp., Re*) 276 A.R. 273 (Alta. Q.B.) — considered

366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd. (1996), 39 C.B.R. (3d) 134 (Alta. Q.B.) — considered

366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd. (1998), (sub nom. *366604 Alberta Ltd. (Bankrupt) v. Pensionfund Properties Ltd.*) 228 A.R. 59, (sub nom. *366604 Alberta Ltd. (Bankrupt) v. Pensionfund Properties Ltd.*) 188 W.A.C. 59, 7 C.B.R. (4th) 42 (Alta. C.A.) — referred to

885676 Ontario Ltd. (Trustee of) v. Frasmet Holdings Ltd. (1993), 17 C.B.R. (3d) 64, 12 O.R. (3d) 62, 99 D.L.R. (4th) 1, 30 R.P.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) — considered

Statutes considered:

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

Generally — considered

s. 6 — considered

s. 7 — considered

s. 11.2 [en. 1997, c. 12, s. 124] — considered

Corporations Tax Act, R.S.O. 1990, c. C.40

s. 81 [rep. & sub. 1994, c. 14, s. 39(1)] — considered

s. 103 — considered

Retail Sales Tax Act, R.S.O. 1990, c. R.31

ss. 18-20 — referred to

s. 18(9) [en. 1994, c. 13, s. 13] — referred to

s. 19(1) [rep. & sub. 1999, c. 9, s. 186] — referred to

s. 19(4) [am. 1994, c. 13, s. 14(2)] — referred to

s. 20(10) [am. 1994, c. 13, s. 15(3)] — referred to

s. 37(2) — considered

APPLICATION by province for declaraion that portion of debt secured by letters of credit was not compromised by company's plan of compromise and arrangement.

Romaine J.:

INTRODUCTION

1 Her Majesty the Queen in Right of the Province of Ontario ("Ontario") seeks an order for the following relief:

a. a declaration that the portion of the debt owed by Canadian Airlines International Ltd. ("Canadian") to Ontario as secured by three letters of credit is not compromised by the Amended and Restated Plan of Compromise and Arrangement (the "Plan") filed by Canadian Airlines Corporation and Canadian Airlines International Ltd. on May 25, 2000;

b. in the alternative, a declaration that the Plan allows the tax liability secured by the letters of credit to be considered a secured claim and that Canadian is liable for the full amount thereof up to the face value of the letters of credit;

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c. in the further alternative, an order varying the Plan to permit the tax liability secured by the letters of credit to be considered a secured claim and directing that Canadian is liable for the full amount thereof up to the value of the letters of credit.

FACTS

2 The relationship between the parties and the background to this application were set out succinctly by Paperny J.(as she then was) in an earlier, related application as follows:

Canadian Airlines International Ltd. ("Canadian") has followed a practice of self-assessing its tax liabilities and has made installment payments of tax under two Ontario statutes, the Retail Sales Tax Act and the Corporations Tax Act. Pursuant to an ongoing auditing process, Ontario has assessed Canadian for taxes owing under these two statutes. The assessments date back as far as 1981. Following the assessments, Canadian filed eight notices of objection and appeals are ongoing. Canadian has provided Ontario with three separate letters of credit to secure the assessments under appeal. The letters of credit have been renewed at least once.

Ontario estimates the total assessments at approximately $2 million. This may be subject to adjustment due to ongoing audits and the failure of Canadian to have completed its 1999 and 2000 tax returns. Canadian has disputed these assessments from the outset and as stated in the affidavit of Nhan Le, Canadian's Director of Taxation, is of the view that its liability to Ontario for these taxes is contingent and negligible. In short, the tax liability of Canadian to Ontario has been in dispute for several years.

Canadian received court protection under the Companies' Creditors Arrangement Act on March 24, 2000.

Canadian included Ontario in its list of "Affected Unsecured Claims" and quantified Ontario's claim at zero. Contrary to paragraph 27 of the March 24, 2000 order, Ontario was not served with a copy.

Ontario did not receive a copy of the March 24, 2000 order until it received it as part of the voting package sent out in accordance with my April 7, 2000 order in these proceedings. The package was mailed on April 25, 2000, the last possible day under the terms of the April 7, 2000 order and arrived in the mail room of the Corporations Tax Branch of the Revenue Division of Ontario on May 2, 2000, three days before the Claims Bar Date set in that order. The Revenue Division has nine branches. According to the affidavit of Rosita Vinkovic, Senior Collections Officer for the Bankruptcy and Insolvency Unit in the Collections and Compliance Branch of the Ministry of Finance, the normal procedure is for insolvency related documents to be mailed directly to the Insolvency Unit, not to the Corporations Tax Branch. According to Ms. Vinkovic, a notice to this effect was published by the Minister of Finance in a 1997 newsletter of the Canadian Insolvency Practitioners' Association. . .

The voting package did not make its way to the Insolvency Unit until May 18, 2000. Despite extensive inquiries, Ms. Vinkovic has been unable to determine the reason for this delay. The collection officer in the Insolvency Unit that received the package on May 18, 2000 did not have an opportunity to review it in its entirety until May 23, 2000, the first business day after the long weekend (and the date that a second package was sent by the monitor to the Ministry of Finance public inquiry desk and directly routed to the Insolvency Unit).

As Senior Collections Officer, Ms. Vinkovic was assigned to handle the matter on May 25, 2000. She immediately noted the May 5, 2000 Claims Bar Date and a proof of claim along with copies of the letters of credit were faxed to the monitor that same day. The amount claimed was expressed as preliminary due to the ongoing audit, which was lengthy due to the extent of Canadian's operations and its failure to timely respond to requests for information and documents. The monitor initially advised Ms. Vinkovic that the claim would not be accepted as it was past the Claims Bar Date, but changed its position upon being advised of the related security.

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On June 19, 2000, nearly one month later, Ontario received a letter from Canadian's counsel advising that its claim would not be accepted because it was submitted after the Claims Bar Date. Ms. Vinkovic was away on vacation from June 23, 2000 until July 10th. On her return on the 10th she read the June 19th letter and immediately sent a request for assistance to Joel Weintraub, Senior Legal Counsel in the Legal Services Branch. Mr. Weintraub contacted the Alberta firm that had handled a similar claim for the BC government and a request was sent to the Assistant Deputy Attorney General for Ontario to authorize the retention of outside counsel. Mr. Robinson advised that he was retained September 14, 2000 and immediately advised Canadian's counsel of his intention to bring [an application to extend time to file a proof of claim] but that it would take some time to prepare the necessary material and have it sworn. *Ontario v. Canadian Airlines Corp.* (2000), 276 A.R. 273 (Alta. Q.B.) paras.2 - 9;

3 Paperny J. heard the application to extend time to file a proof of claim and granted leave to Ontario to file its claim on November 7, 2000. She found that in the circumstances, Ontario's delay in filing its claim was due to inadvertence and not an attempt to circumvent the CCAA process or gain an advantage over other creditors. She also found that Canadian had contributed to the delay by its conduct: Canadian failed to serve Ontario with the March 24, 2000 order, it did not mail the voting package until the last possible day, it mailed it to the wrong office and waited until the last day of the sanction hearing, nearly one month after receiving Ontario's claim, to notify Ontario that its claim was rejected . She found no prejudice to Canadian or Air Canada, the funder of the Plan as they were specifically aware of the existence of Ontario's claim, and were, in fact, attempting to use the delay to avoid resolving the dispute with Ontario. Paperny J. found for these reasons it was not unfair to the funder of the Plan, Air Canada, to deal with Ontario's claim after the claims bar date.

4 The proof of claim faxed by Ontario to the monitor on May 25, 2000 divided Ontario's claim between an unsecured portion and a secured portion, and referred to a letter of credit. As it had been prepared in a hurry, the amount claimed was in error. Paperny J. allowed Ontario to file an amended claim and also allowed further amendments that may become necessary due to the late filing of Canadian's 1999 and 2000 tax returns. Ontario's amended claim is for $2,064,444.19. The three letters of credit lodged with Ontario total $1,248,324.84.

5 Canadian's position is that the effect of its Plan is that the debt due to Ontario, once quantified, is compromised in its entirety from $1.00 of proven claim to $0.14, as with all other Affected Unsecured Claims, and that the letters of credit only facilitate the payment of the reduced indebtedness. Ontario's position is that the only amount that is compromised by the Plan is the deficiency remaining after applying the amount of security represented by the letters of credit held by Ontario.

6 The Plan was approved at a meeting of affected creditors held on May 26, 2000, and was sanctioned by Paperny J. on June 27, 2000 after an extensive hearing that commenced on June 5, 2000. The last day of the hearing was June 19, 2000, the same day that Canadian advised Ontario that it was rejecting its claim as being out of time and not prepared in the proper form. Although there is no question that Canadian was aware of Ontario's claim and the provision of letters of credit, there is no reference to the letters of credit in the Plan or in the evidence that was put before the court in the sanction hearing.

ISSUES

7 The issues that arise in this application are as follows:

(1) What is the appropriate characterization of the letters of credit?

(2) What is the effect of the Plan on Ontario's claim and the letters of credit?

(3) If the Plan compromises the whole of Ontario's claim, should Ontario be granted relief from such compro-

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mise, in the form of an amendment to the Plan?

ANALYSIS

1. What is the appropriate characterization of the letters of credit?

8 The parties agreed that the letters of credit held by Ontario are not obligations that are compromised by the Plan: *Meridian Development Inc. v. Toronto Dominion Bank* (1984), 11 D.L.R. (4th) 576 (Alta. Q.B.); Section 11.2 of the *Companies Creditors Arrangement Act*, R.C.C. 1985 c.C-36, as amended. However, Canadian submitted that the Plan compromises the underlying debt, and the letters of credit operate only to facilitate the payment of Ontario's post-compromise debt and have no other effect on the nature of Ontario's claim. This interpretation of the nature of the letters of credit and the limitation of their effect is the expressed rationale for the inclusion of Ontario's claim in the "Affected Unsecured Claims" category and the lack of any reference to the letters of credit in the Plan that was put before the court for sanction.

9 Canadian submitted that such possession does not convert what it characterizes as an unsecured claim into some kind of secured claim. It argued that, since the letters of credit are not security interests in the assets of Canadian, but rather separate obligations between the relevant banks and Ontario, Ontario's claim is not secured.

10 I disagree with Canadian's characterization of the letters of credit and their effect on the nature of the relationship between Canadian and Ontario.

11 In suggesting that Ontario's claim is unsecured, Canadian appears to be including in the definition of "secured" the requirement that any security must be in the assets of Canadian. While that may be so in the context of the Plan drafted by Canadian, letters of credit are commonly used and recognized by the courts as a form of security: *885676 Ontario Ltd. (Trustee of) v. Frasmet Holdings Ltd.* (1993), 17 C.B.R. (3d) 64 (Ont. Gen. Div. [Commercial List]) at para. 35; *Meridian Development Inc.*, supra, at pp. 585 and 587; *Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1999), 232 A.R. 235 (Alta. C.A.). As pointed out by Blair, J. in *Frasmet*, supra, at para. 27:

> [t]here is a fundamental difference between a letter of credit, which is a very specialized form of security, and a guarantee, which is not a form of security at all (except in a loose, non-legal sense of the term).

12 Wachowich J. (as he then was) recognized the distinction between the use of letters of credit as security and as guarantees at p. 585 of *Meridian Development Inc.*:

> [*Aspen Planners Ltd. v. Commerce Masonry & Forming Ltd.* (1979), 100 D.L.R. (3d) 546 (Ont. H.C.)], as do the English cases cited by counsel, exemplifies the more traditional use of the letter to guarantee payment in commercial transactions where goods and services are bought and sold.
>
> Here, however, a more novel use has been made of the letter of credit as a security device...

13 Kevin McGuinness, in his text ***The Law of Guarantee*** (Scarborough: Carswell, 1996) emphasizes the difference between the payment and security functions of letters of credit at 815:

> In the case of a traditional letter of credit...[it] provides a payment facilitating mechanism...Thus the letter of credit is not intended as a security for payment...
>
> In contrast, a stand-by credit is not furnished as a means of making payment, but as a method of providing security against the possibility of default.

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Although Canadian agreed that the letters of credit it posted are "standby" (or security) letters of credit, it attempts to characterize them as simply payment devices. I do not agree.

14 While counsel for Air Canada also submitted that a letter of credit is basically a guarantee, that is not how it was characterized in *Frasmet*, supra and *Meridian Development Inc.*, supra and properly so, since an irrevocable standby letter of credit such as those held by Ontario represents the equivalent of cash, the advance of which is subject to the satisfaction of certain conditions.

15 The legislation under which the tax is payable to Ontario and the letters of credit were posted confirm that the letters of credit were provided as security. The *Corporations Tax Act, R.S.O. 1990, c. C-40*, as amended by S.O. 1994, c. 14, s. 39(1) provides in s. 81 that:

> Every corporation shall pay, immediately on receipt of a notice of assessment or reassessment or of a statement of account in respect of a taxation year, any part of the tax, interest, penalties and any other amounts then unpaid in respect of the taxation year, whether or not an objection to or an appeal from an assessment in respect of the taxation year is outstanding.

16 Section 103 of that Act provides that the Minister may accept security in lieu of this immediate payment:

> The Minister may, if he or she considers it advisable, accept security for the payment of taxes by a corporation by way of a mortgage or other charge of any kind upon the property of the corporation or of any other person, or by way of a guarantee of the payment of the taxes by another person.

17 The *Retail Sales Tax Act,* R.S.O. 1990, c. R-31, as amended by S.O. 1994, c. 13, ss 13, 14(2), 15(3), S.O. 1999, C. 9, s. 186 contains similar provisions for the immediate payment of assessed tax notwithstanding an objection by the taxpayer in ss. 18-20. Section 37(2) provides that "[w]here the Minister considers it advisable to do so, the Minister may accept security for the payment of taxes in any form that the Minister considers satisfactory".

18 In short, although Ontario's claim may not have been characterized as "secured" by Canadian in the Plan, the letters of credit provide Ontario with a form of security, albeit subject to certain conditions.

19 The letters of credit require Ontario to provide either a drawing certificate stating that the amount being drawn is "due and payable in accordance with the provisions of the [Ontario Retail Sales] Act" and remains unpaid, or a written demand stating that the amount demanded is "payable and the taxpayer has failed to pay it." The parties agreed that until decisions have been rendered in the tax appeals, no amounts are payable, and Ontario is therefore precluded from drawing on the letters of credit until that time. Canadian submitted that the effect of this agreed-upon forbearance by Ontario is that the underlying debt is subject, not only to potential reduction by virtue of the tax appeals in Ontario, but also to reduction by compromise in the CCAA proceedings. To hold otherwise, Canadian suggested, flies in the face of the explicit wording of the letters of credit and is an attempt to improve Ontario's pre-CCAA entitlement.

20 A finding that the requirement to provide a written confirmation of the amount of debt owing prior to drawing on a letter of credit renders the underlying debt subject to compromise through CCAA proceedings would undermine the commercial purpose of such instruments and frustrate their objectives. It would render any security provided by a letter of credit meaningless in the very situation it has been obtained to alleviate. As stated by Blair J. in *Frasmet*, supra at para. 36:

> In the case at bar, the stated purpose of the letter of credit is to secure Standford's obligations under the lease. It can scarcely be gain-said that an event which is sure to impair a tenant's ability to honour its obligations under

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the lease is its bankruptcy. Why should Frasmet, which had obtained for itself a stand-by letter of credit as collateral security in connection with the lease transaction, be precluded from calling upon that security when the very kind of situation for which security is most likely necessary arises? In my view, in the circumstances of this case, it should not be so precluded.

21 In *Frasmet*, supra, while the tenant's bankruptcy terminated its continuing obligations to pay rent, Blair J. found that there were other obligations under the lease that arose upon default, including accelerated rent, damages arising out of the breach and the landlord's right to recoup capital expenditures on leasehold improvements made at the outset of the lease. Blair J. allowed the landlord to draw upon the letter of credit, stating at para. 40 that:

> [w]hile the bankruptcy of Stanford and the subsequent disclaimer of the lease by the Trustee may release the Tenant and its Trustee from those obligations, they cannot in my opinion, deprive the landlord from having resort to the security for which it bargained in order to protect itself in the case of the very kind of eventuality which has occurred.

22 Similarly, in *366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd.* (1996), 39 C.B.R. (3d) 134 (Alta. Q.B.), aff'd(1998), 7 C.B.R. (4th) 42 (Alta. C.A.), Smith J. found that the bankruptcy of a tenant did not affect the right of a landlord to call on a letter of credit issued as security for the repayment of a cash inducement. Smith J. found that the landlord was entitled to call on the letter of credit "irrespective of any dispute arising as to entitlement to the fund." (p.137). A letter of credit is "a form of security which may be called upon by the secured creditor when the event for which the security has been given occurs, without regard to the circumstances existing between the parties to the underlying transaction": *Frasmet*, para. 35.

23 That insolvency is irrelevant to a letter of credit is reflected in s. 11.2 of the CCAA:

> No order may be made under section 11 staying or restraining any action, suit or proceeding against a person, other than a debtor company in respect of which an application has been made under this Act, who is obligated under a letter of credit or guarantee in relation to the company.

24 Canadian submited that, as the provision of a letter of credit involves three separate contracts (*Meridian Development Inc.*, supra at 586), it is necessary that I determine the terms of the contract between Ontario and Canadian. Canadian suggested that, based on the specific wording of the letters of credit, I should find that one term of such contract is that Ontario could not call on the letters of credit as long as they were kept current and until the final amount of tax debt owing by Canadian to Ontario was determined. Canadian then submitted that I should take an additional step and find that Ontario's forbearance is subject, not only to the result of the tax appeals, but to reduction of the claims pursuant to compromise in these proceedings. The argument is that, since Ontario has by its forbearance waived its right to immediate payment of the tax assessed, it has somehow without more left itself open to reduction of its claim through the Plan.

25 The answer to this argument again lies with the nature of the letters of credit and the nature of Canadian's obligation to the taxing authorities. Had Ontario not accepted the letters of credit from Canadian, Canadian would have been obliged to pay the entire amount of tax assessed pending the outcome of its appeals of the assessments, resulting in no debt to be compromised. Forbearance by Ontario in recognition of the possibility that Canadian's appeals of the assessments may be successful is not the equivalent of acceptance of the risk of Canadian's intervening insolvency. As set out by Lazar Sarna in the text ***Letters of Credit : The Law and Current Practice*** at p. 5-25 (quoted in *366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd.*, supra at para. 11 (Q.B.):

> . . .[O]ne of the fundamental commercial reasons for the use of the letter of credit mechanism is to secure anticipated payments in a manner which would not rely upon the will, status or financial faith of the applicant.

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26 I cannot find that Ontario's forbearance in accepting the letters of credit in lieu of cash was a waiver of anything other than an immediate right to be paid. Its forbearance is to delay such right until after the appeals have been concluded, for the amount determined to be payable on appeal. There is no evidence of any greater forbearance, either in the letters of credit or otherwise before me, and certainly no evidence that, in accepting the letters of credit, Ontario agreed to have its claims treated as unsecured. The nature of the letters of credit dictates the opposite conclusion, as does Ontario's response to that characterization when it finally became aware of how it was being treated under the Plan.

27 Canadian also sought to draw a distinction between Ontario's claim and other secured claims by noting that this is not a case in which Canadian has committed an act of default under a security agreement such that Ontario would be in a position to enforce its security rights. Ontario must still wait for the outcome of the tax appeals before drawing on the letters of credit. However, the fact that no immediate enforcement rights of Ontario are being compromised by the Plan does not convert the nature of Ontario's interest from a secured claim to an unsecured claim.

28 Canadian submitted that Ontario is seeking relief from the terms of its own letters of credit, in that it is asking to change the terms of the bargain it struck with Canadian upon acceptance of the letters of credit. I reject that submission and find the converse; Ontario is asking that the bargain be honoured. Ontario did not ask for any amendment to the letters of credit, but for recognition of the secured nature of part of its claim. Ontario argued that once that question is settled, the letters of credit can be exercised in due course after the appeals have been concluded and any difficulty arising from the necessity of making representations in a draw-down certificate or written demand will be resolved.

29 For the reasons discussed, I find that a portion of Ontario's claim is indeed secured, and that there was no implied agreement between Ontario and Canadian that the debt underlying the secured portion of the claims could be compromised by intervening events other than the tax appeals.

30 Despite this, there is no reference to the letters of credit anywhere in the Plan, nor any suggestion that Ontario's claim may be anything other than entirely unsecured. It is clear that Canadian had full knowledge of the letters of credit, and of the position taken by Ontario in its May 25, 2000 form of claim, that it was secured for part of its claim.

31 The court sanctioning the Plan did not have knowledge of Ontario's position, or the form of security that distinguished Ontario's claim from other, apparently unsecured claims in the same category. It is clear that the court proceeded on the assumption that Ontario's claim was completely unsecured, on the basis of an aggressive characterization of the letters of credit by Canadian. The question then becomes, what effect does the Plan have on Ontario's claim and the letters of credit? Specifically, it must be determined whether an interpretation of the Plan which disregards the security arrangements made between these parties should be adopted.

2. What is the effect of the Plan on Ontario's claim and the letters of credit?

32 After court approval of a CCAA plan, an application for directions may be made if a difficulty arises in its interpretation or application: *Re Horizon Village Corp., Canada* (1991), 8 C.B.R. (3d) 25 (Alta. Q.B.).

33 In that case, Wachowich J. (as he then was) was asked to interpret a court-sanctioned plan with respect to a federal tax rebate that had arisen in favour of the debtor company. The court-appointed manager sought a declaration that the rebate formed part of the estate of the debtor company. A secured creditor argued that it was entitled to the rebate because it held an assignment of the rebate as collateral security. Wachowich J. found in favour of the secured creditor.

34 He stated that as a starting point in such applications, the court must always keep in mind the purpose and

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effect of the CCAA: para. 5. He referred to the wide scope of the legislation in granting protection to debtor companies and enabling them to continue carrying on business. Commensurate with the court's protection of debtors under the CCAA, Wachowich J. noted, is the court's desire not to prejudice creditors: para. 7, quoting from *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.) at p. 6: "[the CCAA] was, in my view, never intended to disadvantage any group which, but for the Act, would have enjoyed rights and priorities vis-a-vis the debtor or the debtor's assets."

35 Wachowich J. found that the plan before him did not expressly refer to either the secured creditor's collateral security interest in the rebate, nor to the rebate itself. The rebate was not a source of funds contemplated by the plan. He considered, however, that the collateral security interest or the rebate might be impliedly included in the plan. He held that the court will be reluctant to imply terms which will alter the legal relationship between parties, but will do so if the purposes of the CCAA and any plan made under the CCAA will be defeated without such implied terms. He concluded that there were no implied inclusions in regard to the rebate, specifically rejecting that the rebate was impliedly caught by the plan's use of the words "proceeds of sale" or "funds generated".

36 The aim of minimizing prejudice to creditors embodied in the CCAA is a reflection of the cardinal principle of insolvency law: that relative entitlements created before insolvency are preserved: R. Goode, ***Principles of Corporate Insolvency Law***, 2nd ed. (London:Sweet & Maxwell, 1997) at 54. While the CCAA may qualify this principle, it does so only when it is consistent with the purpose of facilitating debtor reorganization and ongoing survival, and in the spirit of what is fair and reasonable.

37 Paperny J. (as she then was) also discussed the purpose of the CCAA in *Re Canadian Airlines Corp.* (2000), 265 A.R. 201 (Alta. Q.B.), aff'd [2000] A.J. No. 1028 (Alta. C.A.), leave refused [2001] S.C.C.A. No. 60 (S.C.C.). At para. 95, she stated that the purpose of the CCAA is to facilitate the reorganization of debtor companies for the benefit of a broad range of constituents.

38 Paperny J. also noted at para. 95 that, in dealing with applications under the CCAA, the court has a wide discretion to ensure the objectives of the CCAA are met. At para. 94, she identified guidance for the exercise of this discretion in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) at p. 9 as follows:

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

39 In addition to the purposes of the CCAA and the principles which guide the court's role in proceedings under that statute, the overall purpose and intention of the plan in question will also be considered by the court when faced with disputes in interpretation: *Lindsay v. Transtec Canada Ltd.* (1994), 28 C.B.R. (3d) 110 (B.C. S.C.), aff'd(1995), 31 C.B.R. (3d) 157 (B.C. C.A.)

40 With these guiding principles in mind, I now turn to the interpretation of the Plan.

41 As referenced above, Canadian submitted that the Plan must be interpreted as compromising the entirety of Ontario's claim, not just the portion remaining after the application of letters of credit. Its position is summarized in a letter sent by its counsel to Ontario's counsel, Exhibit "C" to the affidavit of Ontario's deponent, Susan Scarlett:

> ...We note that, in Canadian's...Plan, ..., approved by the Order of Madam Justice M.S. Paperny dated June 27, 2000, all Affected Unsecured Creditors (i.e. holders of Affected Unsecured Claims- art. 1.1) are to receive

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$0.14 for each $1.00 of Proven Unsecured Claim (arts. 1.1, 5.1(a)). "Affected Unsecured Claims" is defined in art. 1.1 as "all Claims listed in Part I of the Affected Unsecured Claims List or all Claims of any Person listed in Part II of the Affected Unsecured Claims List...". Your client is covered by each alternative branch in that definition. Listed at para. 2 of Part I of the Unsecured Claims List is "Claims in respect of any Tax Claims including, without limitation, those Claims listed on Part "II" to this Schedule "B". As well, Ontario is a person listed in Part II of the Affected Unsecured Claims List. The definition of "Tax Claim" (at art. 1.1 of the Plan) includes the following words:

> "Tax Claims" means any and all Claims for Taxes by any...provincial...authority, agency or government (including, without limitation, any and all Claims for Taxes by ...Her Majesty the Queen in right of any province or territory of Canada...) ... in respect of any taxation year or period ending on or before the Effective Date...

Thus, the entirety of your client's claim is an Affected Unsecured Claim, and your client will receive in payment thereof, $0.14 per $1.00 of Proven Claim.

42 Ontario suggested that the Plan should be interpreted as including the secured portion of its claim in the "Noteholders Claims List" under the Plan, which is characterized as secured. It pointed out that the Plan defines the "Noteholders Claims List" as "the list of Affected Secured Note Claims attached hereto as Schedule "C", as amended or supplemented from time to time as provided in the Creditors' Meetings Order". From that language, Ontario submitted that it is clear that the list of Noteholders was not intended to be complete or final. It also suggested that the secured portion of Ontario's claim could be considered to be an "unknown" claim in accordance with the definition of "Claims" under the Plan, and that, therefore, the addition of its claim to the Noteholders Claims List would not offend the Plan as sanctioned.

43 I disagree with Canadian's suggestion that its interpretation is the only or most reasonable interpretation of the Plan. I also do not find the interpretation suggested by Ontario to be persuasive. I do agree, however, with Ontario's position as reflected in the first ground of relief sought in this application, as paraphrased at the outset of these reasons: the Plan only compromises the balance of Ontario's claim after the letters of credit are applied. In my view, the language of the Plan, the general concept of the Plan as a whole and the purpose and philosophy of the CCAA support this result.

44 Although the Plan is capable of the interpretation that Canadian suggested, I find that interpretation should not be adopted in view of the purpose of the CCAA and the whole of the Plan itself. Specifically:

a. The Plan makes no express reference to the letters of credit. Implying that the treatment of Ontario's claim is entirely unsecured is not necessary to avoid defeating the purpose of the CCAA and the Plan. Canadian has not suggested nor provided any evidence that the compromise of the entirety of Ontario's claim is required for its ongoing survival, or formed an integral part of the whole of the Plan.

b. Not only is there is no evidence or suggestion that interpreting the Plan in the manner Ontario proposed would be prejudicial to Canadian or Air Canada, there is no evidence of prejudice to Canadian's creditors, nor can there be any suggestion of damage to the integrity of the Plan.

c. While certainly the alteration of legal relationships between creditors and debtors is a necessary incident of CCAA plans, the court also endeavours to minimize to the extent possible prejudice to creditors: *Horizon Village Corp., Canada (Re)*, supra. Canadian's interpretation is inconsistent with this goal.

d. The premise of Canadian's position is that the Plan compromises only the underlying debt to Ontario and leaves intact the letters of credit, which are mere payment devices. This wholly disregards the reality of the se-

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curity Canadian granted to Ontario pre-CCAA to avoid immediate payment of assessed tax, as well as the entire concept of the Plan, described below. This technical approach is to be discouraged in CCAA proceedings: *Lindsay v. Transtec Canada Ltd.*, supra at para. 26.

e. Disregarding the letters of credit in Canadian's insolvent circumstances is wholly inconsistent with the rationale of these particular security devices. Letters of credit are obtained to secure payments in a manner that does not rely on the financial position of the applicant. As recognized in s. 11.2 of the CCAA, letters of credit are designed to operate outside and not be subject to the compromises typically involved in insolvency.

f. Compromising the entirety of Ontario's claim, which in effect deprives Ontario of much of the value of its security, is inconsistent with the general concept of the Plan. This was to compromise the claims of certain of Canadian's unsecured creditors to the extent of 86 cents per dollar of proven claims (with no cap on total proven unsecured claims) and to compromise the claims of Affected Secured Noteholders to the extent of 3 cents per dollar of proven claims and allowing those secured creditors to receive the unsecured dividend on the deficiency.

g. Canadian's interpretation results in anomalous treatment of a secured creditor and tax claimant under the Plan. It treats a secured creditor as an unsecured creditor in compromising its entire claim at 14 cents on the dollar, while only the deficiency portion of the other secured creditors under the Plan (Affected Secured Noteholders) are treated in this fashion. Further, there is no evidence that any other secured creditor is included in the Affected Unsecured Creditors list, except for Ontario and the Affected Secured Noteholders (and then only to the extent of the deficiency). Similarly, there is no evidence that any other tax claimant was secured but deprived of that security by having the entirety of its claim compromised.

For these reasons and the reasons that follow, Canadian's interpretation is not fair and reasonable.

45 As noted, I am not persuaded by Ontario's suggested interpretation of the Plan. It would be a strained interpretation to include Ontario's secured claim with those of the Affected Secured Noteholders. It is not consistent with the overall concept of the Plan, as described above. It also appears that it is no longer possible to amend the Noteholders Claims List, since the power to do so expired on May 15, 2000.

46 However, the Plan can and should be interpreted as excluding secured claims from compromise as "Affected Unsecured Claims". Rather, the only secured claims compromised under the terms of the Plan are those of the Affected Secured Noteholders. These notes represented a principal debt to Canadian of US$ 175,000,000.00 with a provision that could increase the obligation to US $190,000,000.00. It is obvious why the compromise of those secured claims was integral to the success of the Plan and the ability of Canadian to carry on business.

47 While the Plan's definition of "Claim" is broad and refers to both unsecured and secured claims, the way the Plan was drafted requires that the term "Claim" be used in relation to both the secured (the "Affected Secured Note Claims") and the unsecured (the "Affected Unsecured Claims") claims. These two categories constitute the classification of compromised claims under the Plan (Section 5.1). It is true that "Tax Claims" are included within the definition of "Affected Unsecured Claims" and arguably the use of the word "Claims" in conjunction with "Tax" could incorporate a compromise of a secured claim. That result, however, amounts to including the whole of an apparently isolated secured claim, which is not an Affected Secured Note Claim, in a group of unsecured claims. There is no evidence before me to suggest that there are any other creditors in the Affected Unsecured Claims List that hold security, except for Ontario and creditors holding Senior Secured Notes, to the extent of any deficiency only. There is no other reference in the Plan that would suggest that the Affected Unsecured Creditors include secured claims.

48 The interpretation of the Plan to exclude compromise of secured claims except for those of Affected Secured Noteholders is consistent with the purposes of the CCAA, as well as the Plan itself. The letters of credit are not Ca-

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nadian's property and there is no evidence or suggestion that their intended use by Ontario will operate to defeat any aspect of the Plan, nor to prejudice Canadian's ongoing operations. The purpose of the CCAA to facilitate reorganization and ongoing survival of debtor companies is honoured. Honouring Ontario's secured claim is consistent with the general concept of compromising only the claims of unsecured creditors and Affected Secured Noteholders in the Plan.

49 Interpretation of the Plan in this way does not result in an enhancement of Ontario's rights or special treatment under the Plan. It honours the clear security arrangements made prior to the CCAA proceedings and treats the deficiency in a manner identical to the unsecured claims of all affected creditors.

50 Canadian emphasized in its written submissions that it was not compromising a secured claim in its proposed treatment of Ontario under the Plan. Not only did Canadian reject Ontario as a secured creditor, it stressed that the only compromise was of the underlying debt to Ontario. In substance, however, what Canadian hopes to achieve from its suggested interpretation is the effective disregard of Ontario's security. If Canadian had intended to compromise a secured claim within the Affected Unsecured Claims category, this should have been expressed clearly within the terms of the Plan, Ontario should have been expressly notified in a timely fashion, and the court should have been alerted to this anomalous treatment in the sanction hearing. Canadian did none of these things. It now relies on an interpretation of the language of the Plan to support its purported compromise of the whole of Ontario's claim without regard to its security. While I appreciate that CCAA proceedings necessarily change debtor-creditor relationships, this must be done clearly and fairly. Under the circumstances, the court cannot condone the change Canadian is seeking vis-a-vis Ontario's claim.

51 In summary, the evidence is clear that the letters of credit were granted by Canadian well prior to the March 24, 2000 stay order. Ontario's secured claim is not mentioned in the Plan, and the security would be effectively stripped of its value by the application of the Plan as proposed by Canadian, in a fashion that is aberrant to the treatment of any other creditor under the Plan and inconsistent with its general concept. This cannot be right and can be avoided by a reasonable interpretation of the Plan that is consistent with the general concepts of both the CCAA and the Plan.

52 This conclusion is strengthened by the role that Canadian played in the delay surrounding the submission of Ontario's claim, discussed further below.

3. Should Ontario be granted relief from the complete compromise of its claim under the Plan, in the form of an amendment to the Plan?

53 If I was unable to interpret the Plan in a manner which compromises only the unsecured portion of Ontario's claim, I would in any event have considered it appropriate to direct an amendment to the terms of the Plan to effect this result.

54 The Ontario Court of Appeal considered the question of whether the court has jurisdiction to amend a plan of arrangement in *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.), leave refused (1992), 10 O.R. (3d) xv (S.C.C.)

55 In that case, the plan of arrangement had been voted upon by creditors and sanctioned by the court, subject to the outcome of the appeal. The court found that, generally speaking, a plan of arrangement is consensual and the result of agreement, and that a plan found to be fair and reasonable ought not be amended by the court unless jurisdiction is found in the CCAA and there are compelling reasons to do so. The court also found that, generally speaking, the court ought not interfere by amendment in situations where to do so would prejudice the interests of the company or the creditors. In the facts of the *Algoma* situation, the court found that an amendment would be insignificant and technical as far as other creditors were concerned, and allowed the plan to be amended.

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56 Sections 6 and 7 of the CCAA deal with the authority of the court to sanction a plan of arrangement, and to alter or modify its terms. Section 7 provides that, when an amendment is proposed at any time after meetings of creditors have been summoned, the court may adjourn those meetings or may direct that no adjournment of the meetings or convening of additional meetings is necessary if the court is of the opinion that the creditors or shareholders are not adversely affected by the amendment proposed. Section 7 also provides that any arrangement so altered or modified may be sanctioned under section 6. The Plan was in fact amended pursuant to the authority of Section 7 in this manner by Paperny, J. Section 6 and 7 offer no guidance on whether a court-sanctioned plan may be subsequently amended.

57 As mentioned, the CCAA confers broad discretion on the court and is to be afforded a large and liberal interpretation: *Re Canadian Airlines Corp.*, supra at para 95; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.). It is silent, however, on many procedural issues. Given the lack of legislative guidance, the courts have used the basic purpose of the CCAA as a guide to its application and the exercise of its discretion in disposing of applications under the Act: *Re Canadian Airlines Corp.*, supra at para. 95. The keynote concepts of fairness and reasonableness have been recognized as the driving force behind the CCAA and the court's interpretation and application of the Act: *Re Canadian Airlines Corp.* at para. 95, *Olympia & York Developments Ltd. v. Royal Trust Co.*, supra at p. 9.

58 I have already described that the purposes of the CCAA are honoured in the interpretation of the Plan that would compromise only the unsecured portion of Ontario's claim. Those purposes are equally honoured in an amendment to the Plan to achieve this result. Further, the concepts of fairness and reasonableness are also recognized in such an amendment, in contrast to the existing effect of the Plan if my interpretation were not possible.

59 It would not be fair to Ontario, given the pre-existing arrangements made with Canadian to secure the payment of tax and the process by which it found itself faced with Canadian's attempt to compromise the entirety of its claim (discussed further below), to allow Canadian to succeed in this regard. Moreover, it is not unfair to either Canadian or Air Canada to allow an amendment to effect the result that only the deficiency portion of Ontario's claim is compromised as an unsecured claim. Canadian and Air Canada were well aware of the letters of credit and that Ontario had submitted a form of claim that recognized this security. There is no evidence or assertion of unfairness to any other party.

60 It would similarly not be reasonable to deprive Ontario of its security, as I found would be the effective result if Canadian's interpretation of the Plan were to prevail. While Canadian argued that the security itself is not compromised, that argument does not recognize the reality that if the letters of credit are to be treated as the simple payment mechanisms that Canadian asserted they were, their value is essentially reduced, cent for cent, in a manner identical to unsecured claims under the Plan. Ultimately, the letters of credit would be deprived of their value by Ontario's treatment under the Plan. This is not a reasonable result in view of the whole of the Plan and the anomalous treatment Canadian would have the court inflict on Ontario's secured claim.

61 The CCAA authorizes the court to amend a plan in appropriate circumstances, where there are compelling reasons to do so. Although the Act does not expressly state that such amendment could take place after the Plan is sanctioned, as pointed out in *Algoma*, supra there is no reason to suggest that the CCAA "contemplates a role for the court as a mere rubber stamp or one that is simply administrative rather than judicial." (p.103). While the circumstances justifying an amendment after a sanction hearing ought to be truly exceptional, in recognition of the potential violence done to the laudable goal of commercial certainty, there is no reason why subsequent amendments should be conclusively foreclosed in every case, without examination of the particular circumstances.

62 Are there compelling circumstances in this case that would justify a subsequent amendment? Ontario submitted that there are, in that it would be unfair to compel Ontario to be bound by the unilateral characterization of its

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claim by Canadian.

63 The process established by the April 7, 2000 order setting out the claims procedure was unique, in that it allowed Canadian to list its creditors under categories reflecting its opinion of their status. A creditor that did not agree with Canadian's characterization of the nature or amount of its claim was required to file a Dispute Notice.

64 In Ontario's case, for the reasons set out in Paperny J.'s findings of fact, the claims bar date intervened. Ontario filed a Dispute Notice on the basis of a partially secured claim. Ontario did not become aware that Canadian was rejecting its claim as being out of time until the last day evidence was presented at the sanction hearing, and no evidence of Ontario's position was presented to the court at the hearing.

65 While Ontario must bear some responsibility for its systemic internal delays, and while it would have been prudent for Ontario to have been represented at the hearing or to have followed-up its Dispute Notice to ensure that Canadian was in agreement with its claim, it was not aware of the position Canadian would take with respect to the validity of its claim until after the time it would have had an opportunity to appear at the sanction hearing. I note that in Canadian's June 19, 2000 letter to Ontario, it did not suggest that it was also taking the position that the security would not be honoured as originally intended by the parties. This was only raised after Canadian failed to have Ontario's claim barred in the late claim application.

66 Ontario never had a realistic opportunity to present its position to the court before the Plan was sanctioned, and the court was completely unaware of any issue involving the nature of Ontario's claim. It must surely never be the case that a creditor in CCAA proceedings is deprived of the opportunity to present its submissions on the nature and amount of its claim by reasons of procedural irregularities that do not arise from a lack of diligence or good faith. The wide scope and protection offered by the CCAA should not be allowed to operate to disadvantage or prejudice creditors without a fair hearing of their concerns and submissions.

67 This is not a situation, as in *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.), where the creditor had several opportunities to make submissions to the court and to appeal its classification and failed to pursue these options. While it is true that Ontario was aware of its proposed classification under the Plan, and also aware of the sanction hearing at which classification was to be approved, it had taken action to place its position on classification before the monitor and Canadian by filing its Dispute Notice. At the least, it was entitled to assume that, if Canadian disagreed with its position, it would give Ontario notice prior to the conclusion of the sanction hearing. It was not Ontario that was "lying in the weeds" in this case, delaying in the hopes of gaining an advantage.

68 There is no prejudice to other creditors if the Plan is amended as sought by Ontario. As was the case in *Algoma*, supra, the letters of credit are not the property of Canadian and there is no evidence or suggestion that there will be any prejudice or impairment of operations as a result of drawing on the letters of credit. Both Canadian and Air Canada were aware of Ontario's claim, and cannot be said to be prejudiced except to the extent that they disagree with the characterization of the claim. Paperny, J. specifically found no prejudice in the late claim application and also found that Canadian and Air Canada were attempting to use the delay to avoid resolving the dispute with Ontario. As I have stated previously, this is not an attempt by Ontario to improve its pre-insolvency rights, but merely to enforce them.

69 Canadian submitted that Ontario's request for amendment of the Plan is a procedurally improper method of attacking the sanction order. The Canadian process was unusual in that the classification of creditors was approved in the sanction order, and not previously. Canadian submitted that Ontario should have appealed the sanction order as it was the order approving the classification, relying on *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.).

70 The rationale of that case is that, while the proper procedure for attacking a classification order is by way of

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appeal from that order and not a subsequent sanction order, because of the overall supervisory duty of the court to ensure fairness of a plan, the court can intervene in the subsequent appeal of the sanction order "if necessary to avert substantial injustice" (para.21). In *Re: Keddy Motor Inns*, supra, the court found the circumstances did not warrant intervention.

71 Shortly before the sanction order was issued, Ontario was advised by Canadian that its claim would not be accepted because it was submitted after the claims bar date. Ontario's next step was to pursue its application for extension of time to file a proof of claim. It was successful in that application, and filed its amended claim, continuing to assert secured status. The decision of Paperny J. allowing Ontario's application does not restrict Ontario to making its claim as an "Affected Unsecured Creditor". In fact, in the decision, Paperny J. refers several times to the letters of credit as "security" for the assessments under appeal. It is arguable that, had Ontario chosen to appeal the sanction order because of the classification of its claim, it would have faced the objection that it lacked status as its claim was time-barred. The process followed by Ontario is not a collateral attack on the sanction order, but the logical outcome of the procedure followed to re-establish its claim.

72 Canadian also submitted that Ontario's classification as an "Affected Unsecured Creditor" is appropriate because it is in the same classification as other Tax Claimants, citing the principle of "commonality of interest" as enunciated by Forsyth, J. in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.). This is not, however, a case of a secured creditor attempting to be distinguished from other secured creditors, but of a secured creditor attempting to be characterized as secured. The distinction between a secured claim and an unsecured claim is surely sufficient to overcome the "commonality of interest" test.

73 Were it necessary, I would direct that the Plan be amended to provide that the portion of Ontario's claim that is secured by the letters of credit not be compromised.

CONCLUSION

74 In conclusion, I find that the Plan compromises only the unsecured portion of Ontario's claim. If I was unable to make that finding, I would have found compelling reasons in these very unusual circumstances for the court to take the extraordinary step of amending the Plan, even after its sanction. To do otherwise would be to allow Ontario to be prejudiced by a process that was flawed in its operation with respect to Ontario's claim. Canadian and Air Canada were aware both of Ontario's claim and its characterization of its security and there is no prejudice to either of them in the interpretation I have found, nor the amendment to effect it, if necessary. Canadian did not suggest nor is there any evidence of prejudice to the other creditors arising from this interpretation or amendment.

Application granted.

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TAB 14

1993 CarswellOnt 182, 17 C.B.R. (3d) 1, (sub nom. Olympia & York Developments Ltd., Re) 12 O.R. (3d) 500

Olympia & York Developments Ltd. v. Royal Trust Co.

Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36; Re plan of arrangement of OLYMPIA & YORK DEVELOPMENTS LIMITED and all other companies set out in Schedule "A" attached hereto

Ontario Court of Justice (General Division)

R.A. Blair J.

Heard: February 1 and 5, 1993
Oral reasons: February 5, 1993
Written reasons: February 24, 1993
Judgment: February 24, 1993
Docket: Doc. B125/92

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Counsel: [List of counsel attached as Schedule "A" hereto.]

Subject: Corporate and Commercial; Insolvency

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

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Plan of arrangement — Sanctioning of plan — Unanimous approval of plan by all classes of creditors not being necessary where plan being fair and reasonable.

Under the protection of the *Companies' Creditors Arrangement Act* ("CCAA"), O & Y negotiated a plan of arrangement. The final plan of arrangement was voted on by the numerous classes of creditors: 27 of the 35 classes voted in favour of the plan, eight voted against it. O & Y applied to the court under s. 6 of the CCAA for sanctioning of its final plan.

Held:

The application was allowed.

In considering whether to sanction a plan of arrangement, the court must consider whether: (1) there has been strict compliance with all statutory requirements; (2) all materials filed and procedures carried out are authorized by the CCAA; and (3) the plan is fair and reasonable.

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The court found that the first two criteria had been complied with. O & Y met the criteria for access to the protection of the CCAA, the creditors were divided into classes for the purpose of voting and those classes had voted on the plan. All meetings of creditors were duly convened and held pursuant to the court orders pertaining to them. Further, nothing had been done or purported to have been done that was not authorized by the CCAA.

In assessing whether a plan is fair and reasonable, the court must be satisfied that it is feasible and that it fairly balances the interests of all of the creditors, the company and its shareholders. One important measure of whether a plan is fair and reasonable is the parties' approval of the plan and the degree to which approval has been given. With the exception of the eight classes of creditors that did not vote to accept the plan, the plan met with the overwhelming approval of the secured creditors and unsecured creditors.

While s. 6 of the CCAA makes it clear that a plan must be approved by at least 50 per cent of the creditors of a particular class representing at least 75 per cent of the dollar value of the claims in that class, the section does not make it clear whether the plan must be approved by *every* class of creditors before it can be sanctioned by the court. A court would not sanction a plan if the effect of doing so were to impose it upon a class or classes of creditors who rejected it and to bind them by it. However, in this case, the plan provided that the claims of the creditors who rejected the plan were to be treated as "unaffected claims" not bound by its provisions. Further, even if they approved the plan, secured creditors had the right to drop out at any time by exercising their realization rights. Finally, there was no prejudice to the eight classes of creditors that did not approve the plan because nothing was being imposed upon them that they had not accepted and none of their rights were being taken away.

Cases considered:

Alabama, New Orleans, Texas & Pacific Junction Railway Co., Re, 2 Meg. 377, [1886-90] All E.R. Rep. Ext. 1143, [1891] 1 Ch. at 231 (C.A.) — *referred to*

Campeau Corp., Re (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) — *referred to*

Canadian Vinyl Industries Inc., Re (1978), 29 C.B.R. (N.S.) 12 (Que. S.C.) — *referred to*

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

École Internationale de Haute Esthétique Edith Serei Inc. (Receiver of) c. Edith Serei Internationale (1987), Inc. (1989), 78 C.B.R. (N.S.) 36 (C.S. Qué.) — *referred to*

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

Langley's Ltd., Re, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) — *referred to*

Multidev Immobilia Inc. v. S.A. Just Invest, 70 C.B.R. (N.S.) 91, [1988] R.J.Q. 1928 (S.C.) — *considered*

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

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.), affirmed (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195, 34 B.C.L.R. (2d) 122, [1989] 3 W.W.R. 363 (C.A.) — *referred to*

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey*) 41

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O.A.C. 282, 1 O.R. (3d) 289 (C.A.) — *considered*

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 193 (C.A.) [leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 B.C.L.R. xxxiii (note), 135 N.R. 317 (note)] — *considered*

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

Statutes considered:

Companies Act, The, R.S.O. 1927, c. 218.

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

s. 4

s. 5

s. 6

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

Application for sanctioning of plan under *Companies' Creditors Arrangement Act.*

***R.A. Blair J.*:**

1 On May 14, 1992, Olympia & York Developments Limited and 23 affiliated corporations ("the Applicants") sought, and obtained an Order granting them the protection of the *Companies' Creditors Arrangement Act* [R.S.C. 1985, c. C-36] for a period of time while they attempted to negotiate a Plan of Arrangement with their creditors and to restructure their corporate affairs. The Olympia & York group of companies constitute one of the largest and most respected commercial real estate empires in the world, with prime holdings in the main commercial centres in Canada, the U.S.A., England and Europe. This empire was built by the Reichmann family of Toronto. Unfortunately, it has fallen on hard times, and, indeed, it seems, it has fallen apart.

2 A Final Plan of Compromise or Arrangements has now been negotiated and voted on by the numerous classes of creditors. 27 of the 35 classes have voted in favour of the Final Plan; 8 have voted against it. The Applicants now bring the Final Plan before the Court for sanctioning, pursuant to section 6 of the *Companies' Creditors Arrangement Act.*

The Plan

3 The Plan is described in the motion materials as "the Revised Plans of Compromise and Arrangement dated December 16, 1992, as further amended to January 25, 1993". I shall refer to it as "the Plan" or "the Final Plan". Its purpose, as stated in Article 1.2,

> ... is to effect the reorganization of the businesses and affairs of the Applicants in order to bring stability to the Applicants for a period of not less than five years, in the expectation that all persons with an interest in the Applicants will derive a greater benefit from the continued operation of the businesses and affairs of the Applicants on such a basis than would result from the immediate forced liquidation of the Applicants' assets.

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4 The Final Plan envisages the restructuring of certain of the O & Y ownership interests, and a myriad of individual proposals — with some common themes — for the treatment of the claims of the various classes of creditors which have been established in the course of the proceedings.

5 The contemplated O & Y restructuring has three principal components, namely:

1. The organization of O & Y Properties, a company to be owned as to 90% by OYDL and as to 10% by the Reichmann family, and which is to become OYDL's Canadian Real Estate Management Arm;

2. Subject to certain approvals and conditions, *and provided the secured creditors do not exercise their remedies against their security*, the transfer by OYDL of its interest in certain Canadian real estate assets to O & Y properties, in exchange for shares; and,

3. A GW reorganization scheme which will involve the transfer of common shares of GWU holdings to OYDL, the privatization of GW utilities and the amalgamation of GW utilities with OYDL.

6 There are 35 classes of creditors for purposes of voting on the Final Plan and for its implementation. The classes are grouped into four different categories of classes, namely by claims of project lenders, by claims of joint venture lenders, by claims of joint venture co-participants, and by claims of "other classes".

7 Any attempt by me to summarize, in the confines of reasons such as these, the manner of proposed treatment for these various categories and classes would not do justice to the careful and detailed concept of the Plan. A variety of intricate schemes are put forward, on a class by class basis, for dealing with the outstanding debt in question during the 5 year Plan period.

8 In general, these schemes call for interest to accrue at the contract or some other negotiated rate, and for interest (and, in some cases, principal) to be paid from time to time during the Plan period if O & Y's cash flow permits. At the same time, O & Y (with, I think, one exception) will continue to manage the properties that it has been managing to date, and will receive revenue in the form of management fees for performing that service. In many, but not all, of the project lender situations, the Final Plan envisages the transfer of title to the newly formed O & Y Properties. Special arrangements have been negotiated with respect to lenders whose claims are against marketable securities, including the Marketable Securities Lenders, the GW Marketable Security and Other Lenders, the Carena Lenders and the Gulf and Abitibi Lenders.

9 It is an important feature of the Final Plan that secured creditors are ceded the right, if they so choose, to exercise their realization remedies at any time (subject to certain strictures regarding timing and notice). In effect, they can "drop out" of the Plan if they desire.

10 The unsecured creditors, of course, are heirs to what may be left. Interest is to accrue on the unsecured loans at the contract rate during the Plan period. The Final Plan calls for the administrator to calculate, at least annually, an amount that may be paid on the O & Y unsecured indebtedness out of OYDL's cash on hand, and such amount, if indeed such an amount is available, may be paid out on court approval of the payment. The unsecured creditors are entitled to object to the transfer of assets to O & Y Properties if they are not reasonably satisfied that O & Y Properties "will be a viable, self-financing entity". At the end of the Plan period, the members of this class are given the option of converting their remaining debt into stock.

11 The Final Plan contemplates the eventuality that one or more of the secured classes may reject it. Section 6.2 provides,

a) that if the Plan is not approved by the requisite majority of holders of any Class of Secured Claims before January 16, 1993, the stay of proceedings imposed by the initial CCAA order of May 14, 1992, as amended, shall be automatically

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lifted; and,

b) that in the event that Creditors (other than the unsecured creditors and one Class of Bondholders' Claims) do not agree to the Plan, any such Class shall be deemed not to have agreed to the Plan and to be a Class of Creditors not affected by the Plan, *and that the Applicants shall apply to the court for a Sanction Order which sanctions the Plan only insofar as it affects the classes which have agreed to the Plan.*

12 Finally, I note that Article 1.3 Of the Final Plan stipulates that the Plan document "constitutes a separate and severable plan of compromise and arrangement with respect to each of the Applicants."

The Principles to be Applied on Sanctioning

13 In *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289 (C.A.), Doherty J.A. concluded his examination of the purpose and scheme of the *Companies' Creditors Arrangement Act*, with this overview, at pp. 308-309:

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

14 Mr. Justice Doherty's summary, I think, provides a very useful focus for approaching the task of sanctioning a Plan.

15 Section 6 of the CCAA reads as follows:

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

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

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

16 Thus, the final step in the CCAA process is court sanctioning of the Plan, after which the Plan becomes binding on the creditors and the company. The exercise of this statutory obligation imposed upon the court is a matter of discretion.

17 The general principles to be applied in the exercise of the Court's discretion have been developed in a number of authorities. They were summarized by Mr. Justice Trainor in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.) and adopted on appeal in that case by McEachern C.J.B.C., who set them out in the following fashion at (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.), p. 201:

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The authorities do not permit any doubt about the principles to be applied in a case such as this. They are set out over and over again in many decided cases and may be summarized as follows:

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

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

(3) The plan must be fair and reasonable.

18 In an earlier Ontario decision, *Re Dairy Corp. of Canada*, [1934] O.R. 436 (C.A.), Middleton J.A. applied identical criteria to a situation involving an arrangement under the Ontario *Companies Act*. The N.S.C.A. recently followed *Re Northland Properties Ltd.* in *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S.C.A.). Farley J. did as well in *Re Campeau Corp.*, [1992] O.J. No. 237 (Ont. Ct. of Justice, Gen. Div.) [now reported at 10 C.B.R. (3d) 104].

Strict Compliance with Statutory Requirements

19 Both this first criterion, dealing with statutory requirements, and the second criterion, dealing with the absence of any unauthorized conduct, I take to refer to compliance with the various procedural imperatives of the legislation itself, or to compliance with the various orders made by the court during the course of the CCAA process: See *Re Campeau, supra.*

20 At the outset, on May 14, 1992 I found that the Applicants met the criteria for access to the protection of the Act — they are insolvent; they have outstanding issues of bonds issued in favour of a trustee, and the compromise proposed at that time, and now, includes a compromise of the claims of those creditors whose claims are pursuant to the trust deeds. During the course of the proceedings Creditors' Committees have been formed to facilitate the negotiation process, and creditors have been divided into classes for the purposes of voting, as envisaged by the Act. Votes of those classes of creditors have been held, as required.

21 With the consent, and at the request of, the Applicants and the Creditors' Committees, The Honourable David H.W. Henry, a former Justice of this Court, was appointed "Claims Officer" by Order dated September 11, 1992. His responsibilities in that capacity included, as well as the determination of the value of creditors' claims for voting purposes, the responsibility of presiding over the meetings at which the votes were taken, or of designating someone else to do so. The Honourable Mr. Henry, himself, or The Honourable M. Craig or The Honourable W. Gibson Gray — both also former Justices of this Court — as his designees, presided over the meetings of the Classes of Creditors, which took place during the period from January 11, 1993 to January 25, 1993. I have his Report as to the results of each of the meetings of creditors, and confirming that the meetings were duly convened and held pursuant to the provisions of the Court Orders pertaining to them and the CCAA.

22 I am quite satisfied that there has been strict compliance with the statutory requirements of the *Companies' Creditors Arrangement Act.*

Unauthorized conduct

23 I am also satisfied that nothing has been done or purported to have been done which is not authorized by the CCAA.

24 Since May 14, the court has been called upon to make approximately 60 Orders of different sorts, in the course of exercising its supervisory function in the proceedings. These Orders involved the resolution of various issues between the creditors by the court in its capacity as "referee" of the negotiation process; they involved the approval of the "GAR" Orders negotiated between the parties with respect to the funding of O & Y's general and administrative expenses and restructuring

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costs throughout the "stay" period; they involved the confirmation of the sale of certain of the Applicants' assets, both upon the agreement of various creditors and for the purposes of funding the "GAR" requirements; they involved the approval of the structuring of Creditors' Committees, the classification of creditors for purposes of voting, the creation and defining of the role of "Information Officer" and, similarly, of the role of "Claims Officer". They involved the endorsement of the information circular respecting the Final Plan and the mailing and notice that was to be given regarding it. The Court's Orders encompassed, as I say, the general supervision of the negotiation and arrangement period, and the interim sanctioning of procedures implemented and steps taken by the Applicants and the creditors along the way.

25 While the court, of course, has not been a participant during the elaborate negotiations and undoubted boardroom brawling which preceded and led up to the Final Plan of Compromise, I have, with one exception, been the Judge who has made the orders referred to. No one has drawn to my attention any instances of something being done during the proceedings which is not authorized by the CCAA.

26 In these circumstances, I am satisfied that nothing unauthorized under the CCAA has been done during the course of the proceedings.

27 This brings me to the criterion that the Plan must be "fair and reasonable".

Fair and reasonable

28 The Plan must be "fair and reasonable". That the ultimate expression of the Court's responsibility in sanctioning a Plan should find itself telescoped into those two words is not surprising. "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the *Companies' Creditors Arrangement Act*. "Fairness" is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation make its exercise an exercise in equity — and "reasonableness" is what lends objectivity to the process.

29 From time to time, in the course of these proceedings, I have borrowed liberally from the comments of Mr. Justice Gibbs whose decision in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A.) contains much helpful guidance in matters of the CCAA. The thought I have borrowed most frequently is his remark, at p. 116, that the court is "called upon to weigh the equities, or balance the relative degrees of prejudice, which would flow from granting or refusing" the relief sought under the Act. This notion is particularly apt, it seems to me, when consideration is being given to the sanctioning of the Plan.

30 If a debtor company, in financial difficulties, has a reasonable chance of staving off a liquidator by negotiating a compromise arrangement with its creditors, "fairness" to its creditors as a whole, and to its shareholders, prescribes that it should be allowed an opportunity to do so, consistent with not "unfairly" or "unreasonably" depriving secured creditors of their rights under their security. Negotiations should take place in an environment structured and supervised by the court in a "fair" and balanced — or, "reasonable" — manner. When the negotiations have been completed and a plan of arrangement arrived at, and when the creditors have voted on it — technical and procedural compliance with the Act aside — the plan should be sanctioned if it is "fair and reasonable".

31 When a plan is sanctioned it becomes binding upon the debtor company and upon creditors of that company. What is "fair and reasonable", then, must be addressed in the context of the impact of the plan on the creditors and the various classes of creditors, in the context of their response to the plan, and with a view to the purpose of the CCAA.

32 On the appeal in *Re Northland Properties Ltd., supra*, at p. 201, Chief Justice McEachern made the following comment in this regard:

> ... there can be no doubt about the purpose of the C.C.A.A. It is to enable compromises to be made for the common bene-

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fit of the creditors and of the company, particularly to keep a company in financial difficulties alive and out of the hands of liquidators. To make the Act workable, it is often necessary to permit a requisite majority of each class to bind the minority to the terms of the plan, but the plan must be fair and reasonable.

33 In *Re Alabama, New Orleans, Texas & Pacific Junction Railway Co.*, [1891] 1 Ch. at 231 (C.A.), a case involving a scheme and arrangement under the *Joint Stock Companies Arrangements Act, 1870* [(U.K.), 33 & 34 Vict., c. 104], Lord Justice Bowen put it this way, at p. 243:

> Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation ... Its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.

Again at p. 245:

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

34 Is the Final Plan presented here by the O & Y Applicants "fair and reasonable"?

35 I have reviewed the Plan, including the provisions relating to each of the Classes of Creditors. I believe I have an understanding of its nature and purport, of what it is endeavouring to accomplish, and of how it proposes this be done. To describe the Plan as detailed, technical, enormously complex and all-encompassing, would be to understate the proposition. This is, after all, we are told, the largest corporate restructuring in Canadian — if not, worldwide — corporate history. It would be folly for me to suggest that I comprehend the intricacies of the Plan in all of its minutiae and in all of its business, tax and corporate implications. Fortunately, it is unnecessary for me to have that depth of understanding. I must only be satisfied that the Plan is fair and reasonable in the sense that it is feasible and that it fairly balances the interests of all of the creditors, the company and its shareholders.

36 One important measure of whether a Plan is fair and reasonable is the parties' approval of the Plan, and the degree to which approval has been given.

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

38 This point has been made in numerous authorities, of which I note the following: *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175, at p. 184 (B.C.S.C.), affirmed (1989), 73 C.B.R. (N.S.) 195, at p. 205 (B.C.C.A.); *Re Langley's Ltd.*, [1938] O.R. 123 (C.A.), at p. 129; *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245; *École Internationale de Haute Esthétique Edith Serei Inc. (Receiver of) c. Edith Serei Internationale (1987) Inc.* (1989), 78 C.B.R. (N.S.) 36 (C.S. Qué.).

39 In *Re Keddy Motors Inns Ltd., supra*, the Nova Scotia Court of Appeal spoke of "a very heavy burden" on parties seeking to show that a Plan is not fair and reasonable, involving "matters of substance", when the Plan has been approved by the requisite majority of creditors (see pp. 257-258). Freeman J.A. stated at p. 258:

> The Act clearly contemplates rough-and-tumble negotiations between debtor companies desperately seeking a chance to survive and creditors willing to keep them afloat, but on the best terms they can get. What the creditors and the company

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must live with is a plan of their own design, not the creation of a court. The court's role is to ensure that creditors who are bound unwillingly under the Act are not made victims of the majority and forced to accept terms that are unconscionable.

40 In *École Internationale, supra* at p. 38, Dugas J. spoke of the need for "serious grounds" to be advanced in order to justify the court in refusing to approve a proposal, where creditors have accepted it, unless the proposal is unethical.

41 In this case, as Mr. Kennedy points out in his affidavit filed in support of the sanction motion, the final Plan is "the culmination of several months of intense negotiations and discussions between the applicants and their creditors, [reflects] significant input of virtually all of the classes of creditors and [is] the product of wide-ranging consultations, give and take and compromise on the part of the participants in the negotiating and bargaining process." The body of creditors, moreover, Mr. Kennedy notes, "consists almost entirely of sophisticated financial institutions represented by experienced legal counsel" who are, in many cases, "members of creditors' committees constituted pursuant to the amended order of may 14, 1992." Each creditors' committee had the benefit of independent and experienced legal counsel.

42 With the exception of the 8 classes of creditors that did not vote to accept the Plan, the Plan met with the overwhelming approval of the secured creditors and the unsecured creditors of the Applicants. This level of approval is something the court must acknowledge with some deference.

43 Those secured creditors who have approved the Plan retain their rights to realize upon their security at virtually any time, subject to certain requirements regarding notice. In the meantime, they are to receive interest on their outstanding indebtedness, either at the original contract rate or at some other negotiated rate, and the payment of principal is postponed for a period of 5 years.

44 The claims of creditors — in this case, secured creditors — who did not approve the Plan are specifically treated under the Plan as "unaffected claims" i.e. claims not compromised or bound by the provisions of the Plan. Section 6.2(C) of the Final Plan states that the applicants may apply to the court for a sanction Order which sanctions the Plan only insofar as it affects the classes which have agreed to the Plan.

45 The claims of unsecured creditors under the Plan are postponed for 5 years, with interest to accrue at the relevant contract rate. There is a provision for the administrator to calculate, at least annually, an amount out of OYDL's cash on hand which may be made available for payment to the unsecured creditors, if such an amount exists, and if the court approves its payment to the unsecured creditors. The unsecured creditors are given some control over the transfer of real estate to O & Y Properties, and, at the end of the Plan period, are given the right, if they wish, to convert their debt to stock.

46 Faced with the prospects of recovering nothing on their claims in the event of a liquidation, against the potential of recovering something if O & Y is able to turn things around, the unsecured creditors at least have the hope of gaining something if the Applicants are able to become the "self-sustaining and viable corporation" which Mr. Kennedy predicts they will become "in accordance with the terms of the Plan."

47 Speaking as co-chair of the Unsecured Creditors' Committee at the meeting of that Class of Creditors, Mr. Ed Lundy made the following remarks:

> Firstly, let us apologize for the lengthy delays in today's proceedings. It was truly felt necessary for the creditors of this Committee to have a full understanding of the changes and implications made because there were a number of changes over this past weekend, plus today, and we wanted to be in a position to give a general overview observation to the Plan.
>
> The Committee has retained accounting and legal professionals in Canada and the United States. The Co-Chairs, as well as institutions serving on the Plan and U.S. Subcommittees with the assistance of the Committee's professionals have worked for the past seven to eight months evaluating the financial, economic and legal issues affecting the Plan for the unsecured creditors.

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> In addition, the Committee and its Subcommittees have met frequently during the CCAA proceedings to discuss these issues. Unfortunately, the assets of OYDL are such that their ultimate values cannot be predicted in the short term. As a result, the recovery, if any, by the unsecured creditors cannot now be predicted.
>
> The alternative to approval of the CCAA Plan of arrangement appears to be a bankruptcy. The CCAA Plan of arrangement has certain advantages and disadvantages over bankruptcy. These matters have been carefully considered by the Committee.
>
> After such consideration, the members have indicated their intentions as follows ...
>
> Twelve members of the Committee have today indicated they will vote in favour of the Plan. No members have indicated they will vote against the Plan. One member declined to indicate to the committee members how they wished to vote today. One member of the Plan was absent. Thank you.

48 After further discussion at the meeting of the unsecured creditors, the vote was taken. The Final Plan was approved by 83 creditors, representing 93.26% of the creditors represented and voting at the meeting and 93.37% in value of the Claims represented and voting at the meeting.

49 As for the O & Y Applicants, the impact of the Plan is to place OYDL in the position of property manager of the various projects, in effect for the creditors, during the Plan period. OYDL will receive income in the form of management fees for these services, a fact which gives some economic feasibility to the expectation that the company will be able to service its debt under the Plan. Should the economy improve and the creditors not realize upon their security, it may be that at the end of the period there will be some equity in the properties for the newly incorporated O & Y Properties and an opportunity for the shareholders to salvage something from the wrenching disembodiment of their once shining real estate empire.

50 In keeping with an exercise of weighing the equities and balancing the prejudices, another measure of what is "fair and reasonable" is the extent to which the proposed Plan treats creditors equally in their opportunities to recover, consistent with their security rights, and whether it does so in as non-intrusive and as non-prejudicial a manner as possible.

51 I am satisfied that the Final Plan treats creditors evenly and fairly. With the "drop out" clause entitling secured creditors to realize upon their security, should they deem it advisable at any time, all parties seem to be entitled to receive at least what they would receive out of a liquidation, i.e. as much as they would have received had there not been a reorganization: See *Re NsC Diesel Power Inc.* (1990), 97 N.S.R. (2d) 295 (T.D.). Potentially, they may receive more.

52 The Plan itself envisages other steps and certain additional proceedings that will be taken. Not the least inconsiderable of these, for example, is the proposed GW reorganization and contemplated arrangement under the OBCA. These further steps and proceedings, which lie in the future, may well themselves raise significant issues that have to be resolved between the parties or, failing their ability to resolve them, by the Court. I do not see this prospect as something which takes away from the fairness or reasonableness of the Plan but rather as part of grist for the implementation mill.

53 For all of the foregoing reasons, I find the Final Plan put forward to be "fair and reasonable".

54 Before sanction can be given to the Plan, however, there is one more hurdle which must be overcome. It has to do with the legal question of whether there must be unanimity amongst the classes of creditors in approving the Plan before the court is empowered to give its sanction to the Plan.

Lack of unanimity amongst the classes of creditors

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55 As indicated at the outset, all of the classes of creditors did not vote in favour of the Final Plan. Of the 35 classes that voted, 27 voted in favour (overwhelmingly, it might be added, both in terms of numbers and percentage of value in each class). In 8 of the classes, however, the vote was either against acceptance of the Plan or the Plan did not command sufficient support in terms of numbers of creditors and/or percentage of value of claims to meet the 50%/75% test of section 6.

56 The classes of creditors who voted against acceptance of the Plan are in each case comprised of secured creditors who hold their security against a single project asset or, in the case of the Carena claims, against a single group of shares. Those who voted "no" are the following:

Class 2 — First Canadian Place Lenders

Class 8 — Fifth Avenue Place Bondholders

Class 10 — Amoco Centre Lenders

Class 13 — L'Esplanade Laurier Bondholders

Class 20 — Star Top Road Lenders

Class 21 — Yonge-Sheppard Centre Lenders

Class 29 — Carena Lenders

Class 33a — Bank of Nova Scotia Other Secured Creditors

57 While section 6 of the CCAA makes the mathematics of the approval process clear — the Plan must be approved by at least 50% of the creditors of a particular class representing at least 75% of the dollar value of the claims in that class — it is not entirely clear as to whether the Plan must be approved by every class of creditors before it can be sanctioned by the court. The language of the section, it will be recalled, is as follows:

> 6. *Where a majority* in number representing three-fourths in value *of the creditors, or class of creditors* ... agree to any compromise or arrangement ... the compromise or arrangement may be sanctioned by the court. (Emphasis added)

58 What does "a majority ... of the ... class of creditors" mean? Presumably it must refer to more than one group or class of creditors, otherwise there would be no need to differentiate between "creditors" and "class of creditors". But is the majority of the "class of creditors" confined to a majority within an individual class, or does it refer more broadly to a majority within each and every "class", as the sense and purpose of the Act might suggest?

59 This issue of "unanimity" of class approval has caused me some concern, because, of course, the Final Plan before me has not received that sort of blessing. Its sanctioning, however, is being sought by the Applicants, is supported by all of the classes of creditors approving, and is not opposed by any of the classes of creditors which did not approve.

60 At least one authority has stated that strict compliance with the provisions of the CCAA respecting the vote is a prerequisite to the court having jurisdiction to sanction a plan: See *Re Keddy Motor Inns Ltd., supra*, at p. 20. Accepting that such is the case, I must therefore be satisfied that unanimity amongst the classes is not a requirement of the Act before the court's sanction can be given to the Final Plan.

61 In assessing this question, it is helpful to remember, I think, that the CCAA is remedial and that it "must be given a wide and liberal construction so as to enable it to effectively serve this ... purpose": *Elan Corp. v. Comiskey, supra*, per Do-

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herty J.A., at p. 307. Speaking for the majority in that case as well, Finlayson J.A. (Krever J.A., concurring) put it this way, at p. 297:

> It is well established that the CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies ... are entitled to a broad and liberal interpretation of the jurisdiction of the court under the CCAA.

62 Approaching the interpretation of the unclear language of section 6 of the Act from this perspective, then, one must have regard to the purpose and object of the legislation and to the wording of the section within the rubric of the Act as a whole. Section 6 is not to be construed in isolation.

63 Two earlier provisions of the CCAA set the context in which the creditors' meetings which are the subject of section 6 occur. Sections 4 and 5 state that where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors (s. 4) or its secured creditors (s. 5), the court may order a meeting of the creditors to be held. The format of each section is the same. I reproduce the pertinent portions of s. 5 here only, for the sake of brevity. It states:

> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or *any* class of them, the court may, on the application in a summary way of the company or of any such creditor ... order a meeting of the creditors or class of creditors ... (Emphasis added)

64 It seems that the compromise or arrangement contemplated is one with the secured creditors (as a whole) or *any* class — as opposed to *all classes* — of them. A logical extension of this analysis is that, other circumstances being appropriate, the plan which the court is asked to approve may be one involving some, but not all, of the classes of creditors.

65 Surprisingly, there seems to be a paucity of authority on the question of whether a plan must be approved by the requisite majorities in *all* classes before the court can grant its sanction. Only two cases of which I am aware touch on the issue at all, and neither of these is directly on point.

66 In *Re Wellington Building Corp.*, [1934] O.R. 653 (S.C.), Mr. Justice Kingstone dealt with a situation in which the creditors had been divided, for voting purposes, into secured and unsecured creditors, but there had been no further division amongst the secured creditors who were comprised of first mortgage bondholders, second, third and fourth mortgagees, and lienholders. Kingstone J. refused to sanction the plan because it would have been "unfair" to the bondholders to have done so (p. 661). At p. 660, he stated:

> I think, while one meeting may have been sufficient under the Act for the purpose of having all the classes of secured creditors summoned, it was necessary under the Act that they should vote in classes and that three-fourths of the value *of each class* should be obtained in support of the scheme before the Court could or should approve of it. (Emphasis added)

67 This statement suggests that unanimity amongst the classes of creditors in approving the plan is a requirement under the CCAA. Kingstone J. went on to explain his reasons as follows (p. 600):

> Particularly is this the case where the holders of the senior securities' (in this case the bondholders') rights are seriously affected by the proposal, as they are deprived of the arrears of interest on their bonds if the proposal is carried through. It was never the intention under the act, I am convinced, to deprive creditors in the position of these bondholders of their right to approve as a class by the necessary majority of a scheme propounded by the company; otherwise this would permit the holders of junior securities to put through a scheme inimical to this class and amounting to confiscation of the vested interest of the bondholders.

68 Thus, the plan in *Re Wellington Building Corp.* went unsanctioned, both because the bondholders had unfairly been

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deprived of their right to vote on the plan as a class and because they would have been unfairly deprived of their rights by the imposition of what amounted to a confiscation of their vested interests as bondholders.

69 On the other hand, the Quebec Superior Court sanctioned a plan where there was a lack of unanimity in *Multidev Immobilia Inc. v. Société Anonyme Just Invest* (1988), 70 C.B.R. (N.S.) 91 (Que. S.C.). There, the arrangement had been accepted by all creditors except one secured creditor, Société Anonyme Just Invest. The company presented an amended arrangement which called for payment of the objecting creditor in full. The other creditors were aware that Just Invest was to receive this treatment. Just Invest, nonetheless, continued to object. Thus, three of eight classes of creditors were in favour of the plan; one, Bank of Montreal was unconcerned because it had struck a separated agreement; and three classes of which Just Invest was a member, opposed.

70 The Quebec Superior Court felt that it would be contrary to the objectives of the CCAA to permit a secured creditor who was to be paid in full to upset an arrangement which had been accepted by other creditors. Parent J. was of the view that the Act would not permit the Court to ratify an arrangement which had been refused by a class or classes of creditors (Just Invest), thereby binding the objecting creditor to something that it had not accepted. He concluded, however, that the arrangement could be approved *as regards the other creditors who voted in favour of the Plan*. The other creditors were cognizant of the arrangement whereby Just Invest was to be fully reimbursed for its claims, as I have indicated, and there was no objection to that amongst the classes that voted in favour of the Plan.

71 While it might be said that *Multidev, supra*, supports the proposition that a Plan will not be ratified if a class of creditors opposes, the decision is also consistent with the carving out of that portion of the Plan which concerns the objecting creditor and the sanctioning of the balance of the Plan, where there was no prejudice to the objecting creditor in doing so. To my mind, such an approach is analogous to that found in the Final Plan of the O & Y applicants which I am being asked to sanction.

72 I think it relatively clear that a court would not sanction a plan if the effect of doing so were to impose it upon a class, or classes, of creditors who rejected it and to bind them by it. Such a sanction would be tantamount to the kind of unfair confiscation which the authorities unanimously indicate is not the purpose of the legislation. That, however, is not what is proposed here.

73 By the terms of the Final Plan itself, the claims of creditors who reject the Plan are to be treated as "unaffected claims" not bound by its provisions. In addition, secured creditors are entitled to exercise their realization rights either immediately upon the "consummation date" (March 15, 1993) or thereafter, on notice. In short, even if they approve the Plan, secured creditors have the right to drop out at any time. Everyone participating in the negotiation of the Plan and voting on it, knew of this feature. There is little difference, and little different affect on those approving the Plan, it seems to me, if certain of the secured creditors drop out in advance by simply refusing to approve the Plan in the first place. Moreover, there is no prejudice to the eight classes of creditors which have not approved the Plan, because nothing is being imposed upon them which they have not accepted and none of their rights are being "confiscated".

74 From this perspective it could be said that the parties are merely being held to — or allowed to follow — their contractual arrangement. There is, indeed, authority to suggest that a Plan of compromise or arrangement is simply a contract between the debtor and its creditors, sanctioned by the court, and that the parties should be entitled to put anything into such a Plan that could be lawfully incorporated into any contract: See *Re Canadian Vinyl Industries Inc.* (1978), 29 C.B.R. (N.S.) 12 (Que. S.C.), at p. 18; L.W. Houlden & C.H. Morawetz, *Bankruptcy Law of Canada*, vol. 1 (Toronto: Carswell, 1984) pp. E-6 and E-7.

75 In the end, the question of determining whether a plan may be sanctioned when there has not been unanimity of approval amongst the classes of creditors becomes one of asking whether there is any unfairness to the creditors who have not approved it, in doing so. Where, as here, the creditors classes which have not voted to accept the Final Plan will not be bound by the Plan as sanctioned, and are free to exercise their full rights as secured creditors against the security they hold, there is

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nothing unfair in sanctioning the Final Plan without unanimity, in my view.

76 I am prepared to do so.

77 A draft Order, revised as of late this morning, has been presented for approval. It is correct to assume, I have no hesitation in thinking, that each and every paragraph and subparagraph, and each and every word, comma, semi-colon, and capital letter has been vigilantly examined by the creditors and a battalion of advisors. I have been told by virtually every counsel who rose to make submissions, that the draft as is exists represents a very "fragile consensus", and I have no doubt that such is the case. It's wording, however, has not received the blessing of three of the classes of project lenders who voted against the Final Plan — The First Canadian Place, Fifth Avenue Place and L'Esplanade Laurier Bondholders.

78 Their counsel, Mr. Barrack, has put forward their serious concerns in the strong and skilful manner to which we have become accustomed in these proceedings. His submission, put too briefly to give it the justice it deserves, is that the Plan does not and cannot bind those classes of creditors who have voted "no", and that the language of the sanctioning Order should state this clearly and in a positive way. Paragraph 9 of his Factum states the argument succinctly. It says:

> 9. It is submitted that if the Court chooses to sanction the Plan currently before it, it is incumbent on the Court to make clear in its Order that the Plan and the other provisions of the proposed Sanction Order apply to and are binding upon only the company, its creditors in respect of claims in classes which have approved the Plan, and trustees for such creditors.

79 The basis for the concern of these "No" creditors is set out in the next paragraph of the Factum, which states:

> 10. This clarification in the proposed Sanction Order is required not only to ensure that the Order is only binding on the parties to the compromises but also to clarify that if a creditor has multiple claims against the company and only some fall within approved classes, then the Sanction Order only affects those claims and is not binding upon and has no effect upon the balance of that creditor's claims or rights.

80 The provision in the proposed draft Order which is the most contentious is paragraph 4 thereof, which states:

> 4. THIS COURT ORDERS that subject to paragraph 5 hereof the Plan be and is hereby sanctioned and approved and will be binding on and will enure to the benefit of the Applicants and the Creditors holding Claims in Classes referred to in paragraph 2 of this Order in their capacities as such Creditors.

81 Mr. Barrack seeks to have a single, but much debated word — "only" — inserted in the second line of that paragraph after the word "will", so that it would read "and will *only* be binding on .... the Applicants and the Creditors Holding Claims in Classes" [which have approved the Plan]. On this simple, single, word, apparently, the razor-thin nature of the fragile consensus amongst the remaining creditors will shatter.

82 In the alternative, Mr. Barrack asks that para. 4 of the draft be amended and an additional paragraph added as follows:

> 35. It is submitted that to reflect properly the Court's jurisdiction, paragraph 4 of the proposed Sanction Order should be amended to state:
>
> 4. This Court Orders that the Plan be and is hereby sanctioned and approved and is binding only upon the Applicants listed in Schedule A to this Order, creditors in respect of the claims in those classes listed in paragraph 2 hereof, and any trustee for any such class of creditors.
>
> 36. It is also submitted that an additional paragraph should be added if any provisions of the proposed Sanction Order are

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granted beyond paragraph 4 thereof as follows:

> This Court Orders that, except for claims falling within classes listed in paragraph 2 hereof, no claims or rights of any sort of any person shall be adversely affected in any way by the provisions of the Plan, this Order or any other Order previously made in these proceedings.

83 These suggestions are vigorously opposed by the Applicants and most of the other creditors. Acknowledging that the Final Plan does not bind those creditors who did not accept it, they submit that no change in the wording of the proposed Order is necessary in order to provided those creditors with the protection to which they say they are entitled. In any event, they argue, such disputes, should they arise, relate to the interpretation of the Plan, not to its sanctioning, and should only be dealt with in the context in which they subsequently arise — if arise they do.

84 The difficulty is that there may or may not be a difference between the order "binding" creditors and "affecting" creditors. The Final Plan is one that has specific features for specific classes of creditors, and as well some common or generic features which cut across classes. This is the inevitable result of a Plan which is negotiated in the crucible of such an immense corporate re-structuring. It may be, or it may not be, that the objecting Project Lenders who voted "no" find themselves "affected" or touched in some fashion, at some future time by some aspect of the Plan. With a re-organization and corporate re-structuring of this dimension it may simply not be realistic to expect that the world of the secured creditor, which became not-so-perfect with the onslaught of the Applicants' financial difficulties, and even less so with the commencement of the CCAA proceedings, will ever be perfect again.

85 I do, however, agree with the thrust of Mr. Barrack's submissions that the Sanction Order and the Plan can be binding only upon the Applicants and the creditors of the Applicants in respect of claims in classes which have approved the Plan, and trustees for such creditors. That is, in effect, what the Final Plan itself provides for when, in section 6.2(C), it stipulates that, where classes of creditors do not agree to the Plan,

> (i) the Applicants shall treat such Class of Claims to be an Unaffected Class of Claims; and,
>
> (ii) the Applicants *shall* apply to the Court "for a Sanction Order which sanctions the Plan *only insofar as it affects the Classes which have agreed to the Plan.*

86 The Final Plan before me is therefore sanctioned on that basis. I do not propose to make any additional changes to the draft Order as presently presented. In the end, I accept the position, so aptly put by Ms. Caron, that the price of an overabundance of caution in changing the wording may be to destroy the intricate balance amongst the creditors which is presently in place.

87 In terms of the court's jurisdiction, section 6 directs me to sanction the Order, if the circumstances are appropriate, and enacts that, once I have done so, the Order "is binding ... on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors ... and on the company". As I see it, that is exactly what the draft Order presented to me does.

88 Accordingly, an order will go in terms of the draft Order marked "revised Feb. 5, 1993", with the agreed amendments noted thereon, and on which I have placed my fiat.

89 These reasons were delivered orally at the conclusion of the sanctioning Hearing which took place on February 1 and February 5, 1993. They are released in written form today.

Application allowed.

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Appendix "A" — Counsel for Sanctioning Hearing Order

Counsel	Party
David A. Brown, Q.C., Yoine Goldstein, Q.C., Stephen Sharpe and Mark E. Meland	-- For the Olympia & York Applicants
Ronald N. Robertson, Q.C.	-- For Hong Kong & Shanghai Banking Corporation
David E. Baird, Q.C., and Ms Patricia Jackson	-- For Bank of Nova Scotia
Michael Barrack and S. Richard Orzy	-- For the First Canadian Place Bondholders, the Fifth Avenue Place Bondholders and the L'Esplanade Lauriere Bondholders
William G. Horton	-- For Royal Bank of Canada
Peter Howard and Ms J. Superina	-- For Citibank Canada
Frank J. C. Newbould, Q.C.	-- For the Unsecured/Under-Secured Creditors Committee
John W. Brown, Q.C., and J.J. Lucki	-- For Canadian Imperial Bank of Commerce
Harry Fogul and Harold S. Springer	-- For the Exchange Tower Bondholders
Allan Sternberg and Lawrence Geringer	-- For the O & Y Eurocreditco Debenture Holders
Arthur O. Jacques and Paul M. Kennedy	-- For Bank of Nova Scotia, Agent for Scotia Plaza Lenders
Lyndon Barnes and	-- For Credit Lyonnais,
J.E. Fordyce	Credit Lyonnais Canada
J. Carfagnini	-- For National Bank of Canada
J.L. McDougall, Q.C.	-- For Bank of Montreal

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Carol V.E. Hitchman	-- For Bank of Montreal (Phase I First Canadian Place)
James A. Grout	-- For Credit Suisse
Robert I. Thornton	-- For I.B.J. Market Security Lenders
Ms C. Carron	-- For European Investment Bank
W.J. Burden	-- For some debtholders of O & Y Commercial Paper II Inc.
G.D. Capern	-- For Robert Campeau
Robert S. Harrison and A.T. Little	-- For Royal Trust Co. as Trustee

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TAB 15

2009 CarswellOnt 2383, 2009 ONCA 377, 249 O.A.C. 58, 95 O.R. (3d) 767, 72 C.P.C. (6th) 1

Fantl v. Transamerica Life Canada

Joseph Fantl (Plaintiff / Respondent) and Transamerica Life Canada (Defendant / Respondent)

Ontario Court of Appeal

W.K. Winkler C.J.O., S.T. Goudge, J.M. Simmons JJ.A.

Heard: April 6, 2009
Judgment: May 7, 2009
Docket: CA C50166

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Proceedings: affirming *Fantl v. Transamerica Life Canada* (2008), 2008 CarswellOnt 7270, 66 C.P.C. (6th) 203, 244 O.A.C. 183 (Ont. Div. Ct.); affirming *Fantl v. Transamerica Life Canada* (2008), 2008 CarswellOnt 2249, 60 C.P.C. (6th) 326 (Ont. S.C.J.)

Counsel: Alan J. Lenczner, Q.C., Naomi Loewith for Appellant, Kim Orr Barristers P.C.

Bonnie A. Tough, Jennifer M. Lynch for Respondent, Joseph Fantl

Mary Jane Stitt for Respondent, Transamerica Life Canada

Subject: Civil Practice and Procedure; Public; Torts

Civil practice and procedure --- Parties — Representative or class proceedings under class proceedings legislation — Conduct of class proceeding — Stay of other proceedings

Representative plaintiff, F, retained law firm REKO to prosecute class action against insurance company under Class Proceedings Act, 1992 (original action) — REKO lawyers, including K, worked on original action — REKO dissolved in pre-trial phase of original action — Certain lawyers formerly engaged on original action joined new law firm of REO, while others followed former REKO partner, K, to new law firm of KO — F served notice of change of solicitors naming REO as counsel — KO unsuccessfully brought motion for relief, including order striking notice of change of solicitors and order requiring F to retain KO, or alternatively, order removing F as representative plaintiff and substituting new representative plaintiffs (motion) — KO then commenced action against insurance company with one of new representative plaintiffs proposed on motion (competing action) — Competing action overlapped significantly with original action — KO's appeal from motion decision was dismissed — KO appealed and F and insurance company sought stay of competing action — Appeal dismissed; competing action stayed — Competing action amounted to abuse of process — KO com-

menced competing action following dismissal of motion, notwithstanding its admission before motions judge that such move would be disingenuous — Only possible purpose for bringing competing action was to provide platform for carriage motion to challenge original action — Competing action would inevitably be stayed in any event on ground that original action was more advanced — Further, as original action was on cusp of settlement, delay caused by carriage motion would only serve to postpone class members' access to justice — Class members were entitled to certainty.

Civil practice and procedure --- Parties — Representation by solicitor

Choice of new counsel by representative plaintiff — Representative plaintiff, F, retained law firm REKO to prosecute class action against insurance company under Class Proceedings Act, 1992 (CPA) — REKO lawyers worked on action, with K acting as lead counsel — REKO dissolved in pre-trial phase of action — Certain lawyers formerly engaged on action joined law firm of REO, while others followed former REKO partner, K, to law firm of KO — F served notice of change of solicitors naming REO as counsel — KO unsuccessfully brought motion for relief, including order striking notice of change of solicitors and order requiring F to retain KO — KO's appeal from decision of motions judge decision was dismissed — KO appealed — Appeal dismissed — There was no reason to interfere with F's choice of counsel — Competence of REO was not in issue — There was no evidence of improper purpose or considerations in F's choice of counsel — F's friendship with one of partners of REO did not constitute improper purpose — While this friendship was consideration, F was also attracted to REO because of undisputed competence of counsel and its reputation in class action work — There was no demonstrated prejudice to class from F's choice of counsel — F's choice of counsel was not prejudicial or unfair despite K's investment of time and effort as lead counsel — CPA does not provide lawyers with vested interest in subject matter of lawsuit entitling them to override choices of representative plaintiff.

Civil practice and procedure --- Parties — Representative or class proceedings under class proceedings legislation — Certification — Amendment of order for certification

Motion to replace representative plaintiff — Representative plaintiff, F, retained law firm REKO to prosecute class action against insurance company under Class Proceedings Act, 1992 — REKO dissolved in pre-trial phase of original action — Certain lawyers formerly engaged on original action joined law firm of REO, while others followed former REKO partner, K, to law firm of KO — F served notice of change of solicitors naming REO as counsel — KO unsuccessfully brought motion for relief, including order removing F as representative plaintiff and substituting new representative plaintiffs — KO's appeal from decision of motions judge was dismissed — KO appealed — Appeal dismissed — There was no basis to interfere with decision of motions judge not to remove or replace F as representative plaintiff — F had prosecuted action to point of settlement and there was no suggestion that he had been less than diligent in this respect — Further, F agreed to represent class after being approached by solicitors from REKO — While not determinative, REKO's choice to approach F indicated that none of its counsel had any concerns about his ability to perform role of representative plaintiff — Moreover, when F assumed representation of class, it must have been implicitly understood by his solicitors that he would be providing litigation instructions.

Cases considered by *W.K. Winkler C.J.O.*:

Cassano v. Toronto Dominion Bank (2007), 47 C.P.C. (6th) 209, 87 O.R. (3d) 401, 2007 ONCA 781, 2007 CarswellOnt 7341, 230 O.A.C. 224, (sub nom. *Cassano v. Toronto-Dominion Bank)* 287 D.L.R. (4th) 703 (Ont. C.A.) — referred to

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Ford v. F. Hoffmann-La Roche Ltd. (2005), 74 O.R. (3d) 758, 12 C.P.C. (6th) 252, 2005 CarswellOnt 1095 (Ont. S.C.J.) — referred to

Heron v. Guidant Corp. (2007), 2007 CarswellOnt 9010 (Ont. S.C.J.) — considered

Heron v. Guidant Corp. (2008), 232 O.A.C. 366, 2008 CarswellOnt 47 (Ont. Div. Ct.) — referred to

Housen v. Nikolaisen (2002), 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, 286 N.R. 1, [2002] 7 W.W.R. 1, 2002 CarswellSask 178, 2002 CarswellSask 179, 2002 SCC 33, 30 M.P.L.R. (3d) 1, 219 Sask. R. 1, 272 W.A.C. 1, [2002] 2 S.C.R. 235 (S.C.C.) — followed

Ontario New Home Warranty Program v. Chevron Chemical Co. (1999), 37 C.P.C. (4th) 175, 46 O.R. (3d) 130, 1999 CarswellOnt 1851 (Ont. S.C.J.) — referred to

Parsons v. Canadian Red Cross Society (1999), 1999 CarswellOnt 2932, 40 C.P.C. (4th) 151, 103 O.T.C. 161 (Ont. S.C.J.) — referred to

Ricardo v. Air Transat A.T. Inc. (2002), 2002 CarswellOnt 1394, 21 C.P.C. (5th) 297 (Ont. S.C.J.) — referred to

Setterington v. Merck Frosst Canada Ltd. (2006), 26 C.P.C. (6th) 173, 2006 CarswellOnt 506 (Ont. S.C.J.) — referred to

VitaPharm Canada Ltd. v. F. Hoffmann-La Roche Ltd. (2000), 4 C.P.C. (5th) 169, 2000 CarswellOnt 4681 (Ont. S.C.J.) — referred to

Ward-Price v. Mariners Haven Inc. (2004), 3 C.P.C. (6th) 116, 2004 CarswellOnt 2238, 71 O.R. (3d) 664 (Ont. S.C.J.) — referred to

Western Canadian Shopping Centres Inc. v. Dutton (2001), (sub nom. *Western Canadian Shopping Centres Inc. v. Bennett Jones Verchere)* 201 D.L.R. (4th) 385, [2002] 1 W.W.R. 1, 286 A.R. 201, 253 W.A.C. 201, 8 C.P.C. (5th) 1, 94 Alta. L.R. (3d) 1, 272 N.R. 135, 2001 SCC 46, 2001 CarswellAlta 884, 2001 CarswellAlta 885, [2001] 2 S.C.R. 534 (S.C.C.) — considered

Statutes considered:

Class Proceedings Act, 1992, S.O. 1992, c. 6

Generally — referred to

s. 5(1) — referred to

s. 12 — referred to

s. 13 — referred to

s. 20 — referred to

s. 29(1) — referred to

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s. 29(2) — referred to

s. 32(2) — referred to

s. 33(1) — considered

s. 33(4) — considered

Courts of Justice Act, R.S.O. 1990, c. C.43

s. 134(1) — referred to

APPEAL by law firm from judgment reported at *Fantl v. Transamerica Life Canada* (2008), 2008 CarswellOnt 7270, 66 C.P.C. (6th) 203, 244 O.A.C. 183 (Ont. Div. Ct.), dismissing its appeal from decision of motion judge refusing to grant orders requiring representative plaintiff to retain it as counsel or, alternatively, order replacing representative plaintiff.

***W.K. Winkler C.J.O.*:**

Overview

1 This appeal relates to a representative plaintiff's right to choose new counsel in a class proceeding, following the dissolution of the law firm originally retained by the plaintiff to prosecute the action.

2 The appellant is a law firm, Kim Orr Barristers P.C. ("KO"). Joseph Fantl is the representative plaintiff in a class proceeding brought against the defendant Transamerica Life Canada ("Transamerica"). Both Mr. Fantl and Transamerica are respondents in this appeal.

3 In 2006, Mr. Fantl retained the law firm of Roy Elliott Kim O'Connor ("REKO") to act in the prosecution of the intended class action lawsuit against Transamerica. A team of REKO lawyers worked on the matter. Toward the end of 2007, REKO dissolved.

4 Certain of the team of lawyers formerly engaged on the file joined the newly formed law firm of Roy Elliott O'Connor ("REO"). Others followed one of REKO's former partners, Won Kim, to form the appellant law firm KO, while the remaining lawyer chose to go elsewhere. Because of the disbanding of REKO, Mr. Fantl was forced to decide what firm to retain to continue the matter. He chose REO because he knew and was a friend of Peter Roy, and because he had some experience with, and respected members of, the firm. As such, he trusted them to carry the case forward.

5 Mr. Fantl served a notice of change of solicitors naming REO as counsel. KO brought a motion pursuant to s. 12 of the *Class Proceedings Act 1992*, S.O. 1992, c.6 (the "CPA"), asking for various forms of relief, including an order striking the notice of change of solicitors and an order requiring Mr. Fantl to retain KO. In the alternative, KO sought to have Mr. Fantl removed as representative plaintiff and two new representative plaintiffs (Yi-Yea (Riya) Kang and Jeong-Ae Seok) substituted in his stead. The motion judge dismissed the motion in its entirety. KO appealed the decision of the motion judge to the Divisional Court, which dismissed the appeal. KO appeals to this court, with leave. An expedited hearing was granted given that a settlement has been reached and the settlement approval hearing relating to the case is imminent.

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6 The motion judge, in refusing to grant the relief requested, held that a representative plaintiff has a right to retain counsel of his or her choice. He found that the test to be applied in determining whether the plaintiff's choice of counsel should stand is whether the counsel is adequate. Thus, he adopted the same test for counsel as is required by s. 5(1) of the CPA in determining whether a representative plaintiff may carry an action forward.

7 In this context, the motion judge noted that while the court has a broad supervisory jurisdiction in class proceedings, it should not intervene in a plaintiff's choice of counsel unless the choice would deny putative class members adequate legal representation. He rejected the appellant's theory that the proper test to be applied is whether the plaintiff's choice is in the best interests of the class. Hence, he refused to engage in a comparison of the two law firms to determine which group was superior. The Divisional Court upheld the reasons of the motion judge on these central issues.

8 Following the dismissal of the motion, KO brought a competing action against Transamerica, with Ms. Kang as the proposed representative plaintiff (the "Kang action"). The Kang action overlaps significantly with Mr. Fantl's action.

9 The appellant advances the same arguments on this appeal as were made to the courts below, contending that the motion judge erred by applying the wrong test. The competence of REO to act as class counsel is not in issue. This notwithstanding, on a comparison basis applying the test of best interests of the class, the appellant submits that the plaintiff ought to be directed to retain the KO firm. Consequently, the plaintiff's choice of counsel ought to be set aside and new representative plaintiffs appointed in place of Mr. Fantl.

10 The respondent submits that the motion judge applied the appropriate test and suggests that the key consideration in the analysis should be whether the plaintiff's decision caused any prejudice to the class members. Since there is no dispute as to the competence of REO counsel, and since the settlement discussions have advanced to the point of a settlement approval hearing, the motion judge's decision not to interfere with Mr. Fantl's choice of counsel should be upheld.

11 I cannot accede to the appellant's submissions. In my view, the representative plaintiff is entitled to select, and is indeed responsible for selecting, class counsel. In a circumstance like this, when a decision properly comes before the supervisory court for review, the criteria to be considered in determining whether the plaintiff's choice of counsel can stand are: competence of counsel; whether the choice was based on any improper considerations; and whether the choice resulted in any prejudice to the class. In the present case, competence of counsel is conceded. There is no evidence of any improper purpose in the selection of counsel or of any prejudice to the class as a result of that decision. Furthermore, the Kang action, commenced after the motion judge dismissed the appellant's motion, is an abuse of process.

12 I would dismiss the appeal, and exercise my discretion under s. 134(1) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 (the "CJA") and s. 13 of the CPA, to stay the Kang action. My reasons, which differ from those of the motion judge, follow.

The Issues

13 There are three central issues on this appeal. First, is the representative plaintiff in an intended class proceeding, who is required to retain new counsel after the proceeding has been commenced, entitled to select counsel of his or her own choosing or is the court, in the exercise of its supervisory jurisdiction under the CPA, always required to approve class counsel?

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14 Second, regardless of the answer to the first question, if the selection of counsel comes before the court for review, what is the proper test to be applied in determining whether the plaintiff's selection of class counsel should stand?

15 Third, the appellant has asked this court to review whether Mr. Fantl should be replaced as the representative plaintiff. This requested relief bears on the status of a competing action, launched by the appellant following the dismissal of its motion, in which Ms. Kang is the representative plaintiff.

Facts

16 This appeal arises from a proposed class action against Transamerica that has yet to be certified. Mr. Fantl is not the original representative plaintiff in this action. The action was initially started by Michael Millman, a chartered accountant in British Columbia who owned an insurance policy issued by the company that is now Transamerica, and which contained an investment option known as the Can-Am Fund. Mr. Millman sought to sue Transamerica on the basis that: (1) Transamerica had overcharged him for management expenses; and (2) that the Can-Am fund had not tracked or replicated the results of the S&P 500 total return index as had been promised.

17 The lawyer retained by Mr. Millman referred the claims to Sutts, Strosberg LLP in Ontario for the purpose of commencing a class action. On December 29, 2003, a statement of claim was issued by Mr. Millman's new counsel against Transamerica.

18 Although there is disputed evidence as to the timing and roles of the parties, the motion judge found that by autumn 2005, the case had been transferred to the law firm REKO. He further found that, upon the transfer of the file, Mr. Kim became the supervising lawyer on the case. Shortly thereafter, Mr. Millman indicated that he was no longer prepared to act as the representative plaintiff in the case.

19 Mr. Fantl was a long-standing friend of REKO partner Mr. Roy, and had been seeking legal advice from the firm on an unrelated matter at about the time that the original representative plaintiff removed himself from the file. During discussions, it emerged that Mr. Fantl was also an investor in the Can-Am Fund operated by Transamerica. REKO's lawyers invited him to act as the new representative plaintiff in the action and he accepted.

20 In May 2006, Mr. Fantl signed a retainer agreement with REKO. The retainer agreement was between Mr. Fantl and the law firm, and not between Mr. Fantl and any of REKO's individual lawyers.

21 Between September 2005 and April 2007, the case progressed. The statement of claim was amended, material for the certification was prepared and cross-examinations were conducted. The certification motion did not proceed in May 2007, as scheduled, because Mr. Kim and counsel for Transamerica began to explore the idea of consent certification and a settlement of the management expenses claim. The parties indicated in a case conference on September 12, 2007 that there was a prospect of settlement but that the scope of the funds implicated in the claim was growing significantly, beyond just the Can-Am fund.

22 The motion judge found that Mr. Kim had been the partner at REKO with the most involvement in Mr. Fantl's case, and that Mr. Kim had been assisted in this work to varying degrees by six associate lawyers. The motion judge also noted Mr. Fantl's evidence that he had had minimal contact with Mr. Kim throughout the course of the class action and that Mr. Kim had not provided him with any reports or advice on the case, apart

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from one brief conversation.

23 For reasons not disclosed to the motion judge, REKO dissolved on December 31, 2007. Mr. Kim established the firm now known as KO, and REKO's other former partners established the new firm called REO.

24 Mr. Roy wrote to Mr. Fantl to inform him of REKO's dissolution and to seek instructions with respect to carriage of the class action. On January 5, 2008, Mr. Fantl wrote to REO to say that he had chosen the firm to act as his lawyers for the class action. He cited his "personal knowledge of Mr. Roy, his abilities and integrity as a lawyer and my confidence in his judgment" as among the reasons for his choice. In this regard, the motion judge noted that Mr. Fantl had been the best man at Mr. Roy's wedding. In his affidavit evidence, Mr. Fantl also noted that his choice of counsel was influenced by the fact that "REO has extensive class action experience and the senior partners have a great deal of experience in complex litigation, including settlement of complicated cases." Mr. Fantl was not cross-examined on his affidavit. REO served the notice of change of solicitors and came on the record on January 18, 2008.

25 KO subsequently brought a motion to set aside the notice of change of solicitors, and to disqualify Mr. Fantl from being the representative plaintiff in the class action. It argued before the motion judge that Mr. Fantl had breached his duty to the intended class members by choosing REO and that, based on the success and progress achieved by Mr. Kim in the action, it was in the best interests of the class that KO be appointed as solicitor of record. KO also argued that, in the alternative, the court should replace Mr. Fantl with two new proposed representative plaintiffs, Ms. Seok and Ms. Kang. Mr. Fantl argued that the court's jurisdiction to govern the solicitor-client relationship was limited to the post-certification phase and that, in any event, Mr. Fantl had fulfilled his duty to the intended class members by choosing adequate counsel.

26 KO's motion was dismissed. The dismissal was upheld by the Divisional Court. Following the dismissal of the motion, KO brought a competing action against Transamerica, with Ms. Kang as the proposed representative plaintiff. The Kang action covers 25 of the 26 investment funds that are the subject of the proposed settlement agreement in the instant case. The only distinction between the two is that the Kang action does not include the Can-Am fund.

Decision of the motion judge

27 In his reasons, the motion judge characterized the "overarching issue in the case" as being whether the court has the jurisdiction to supervise the relationships arising in a class proceeding, both pre- and post- certification: para. 56. He held that, on the basis of the court's inherent jurisdiction to control its own process and the powers derived from s. 12 of the CPA, the court's jurisdiction to supervise a class proceeding "exists from the outset of the litigation and the Court has the jurisdiction to make orders to protect putative class members as potential parties to the litigation": para. 58.

28 Having determined that the court has the jurisdiction to supervise all relationships arising out of a class proceeding from the outset of the litigation, the motion judge turned specifically to a consideration of the solicitor-client relationship. He recognized that in an ordinary action, well established principles dictate that a litigant has the autonomy to choose counsel without court interference. However, he noted that these principles cannot be transferred directly to the class action context due to the responsibilities owed by the representative plaintiff, class counsel and the court to absent class members.

29 The motion judge acknowledged previous case law suggesting that a solicitor-client relationship - with

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all its concomitant duties and obligations - may not exist between class counsel and proposed class members in the pre-certification stage. However, he held that a *sui generis* relationship exists between class counsel and proposed class members, and that at least some of the responsibilities inherent in the solicitor-client relationship are owed by counsel to the proposed class.

30 In considering the proper test for determining whether Mr. Fantl's choice of counsel should stand, the motion judge reviewed the case law that had developed in relation to the adequacy of the representative plaintiff, carriage motions and the removal or change of counsel. Ultimately, he likened the fact situation of the instant case as being akin to that of choosing a solicitor of record at the outset of litigation. He thus applied the standard applied by the court on a certification motion: whether the representative plaintiff has selected "competent counsel that will adequately represent the proposed class if the action is certified": para. 105.

31 In so deciding, the motion judge noted that this standard did not require the representative plaintiff to choose the best or more superior counsel. In this respect, while he stated that "Mr. Kim might or might not be a better choice", Mr. Fantl's choice of REO as solicitor of record met the standard of competency and adequacy: para. 110. Accordingly, the motion was dismissed.

Decision of the Divisional Court

32 On appeal, the appellant submitted before the Divisional Court that the motion judge had applied the wrong legal test when determining whether Mr. Fantl had properly appointed REO as the new class counsel.

33 The Divisional Court reviewed the motion judge's conclusions and found that he had committed no error of law. In particular, the Divisional Court endorsed the motion judge's central conclusion that, "having selected competent counsel to represent the class, the fact there are other counsel who may be a better choice does not change the standard Mr. Fantl must meet": para. 37.

Positions of the Parties

34 The thrust of the appellant's argument is that, even though the litigation is being conducted by a representative or intended representative plaintiff, where a decision is required in the conduct of the proceeding, including one that occurs at the pre-certification stage, the decision of the plaintiff must receive the court's approval.

35 The appellant contends that this is necessitated by an overriding concern for the interests of the absent class members. Accordingly, in its submission, the test to be applied by the court is whether the decision made by the plaintiff is in the best interests of the class. This, says the appellant, is the test to be applied by a court throughout a class proceeding, regardless of the issue to be decided or the stage of the proceeding.

36 The respondents advance a more limited view of the supervisory role of the court in the exercise of its jurisdiction under the CPA. They caution that it is not appropriate for the court to "descend into the arena" and assume the responsibility of the plaintiff in conducting the litigation.

Analysis

37 In addressing the issues raised in this appeal, I am guided by the reasons of the Supreme Court of Canada in *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 (S.C.C.), which sets out the standards of review in appeals from a judge's order.

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Issue 1: Supervisory jurisdiction of the court

38 It is now well settled that class proceedings are *sui generis* litigation. In part, this is because of the existence of the proposed class in addition to the putative representative plaintiff. As stated by Cullity J. in *Heron v. Guidant Corp.*, [2007] O.J. No. 3823 (Ont. S.C.J.), leave to appeal refused (2008), 232 O.A.C. 366 (Ont. Div. Ct.), at para. 10:

> From the commencement of a class proceeding the court, as well as the named plaintiff has responsibilities to members of the class....They are not parties to the proceeding but they are not strangers. Their rights are as much at stake as those of the plaintiffs. It is consistent with their *sui generis* status, and the objectives of the CPA, that their interests should not be vulnerable to the deficiencies in the ability of the named plaintiff to represent them.
>
> [Citations omitted.]

39 The existence of the absent class members, among other factors, is the reason that the court's supervisory jurisdiction is engaged from the inception of an intended class proceeding. It continues throughout the "stages" of the proceeding until a final disposition, including the implementation of the administration of a settlement or, where applicable, a resolution of all individual issues.

40 The supervisory jurisdiction of the court over the class proceeding is not in issue on this appeal. The parties acknowledge that the court has supervisory jurisdiction throughout the proceeding. They do, however, posit markedly different theories as to the circumstances in which this jurisdiction must or ought to be exercised.

41 While I do not agree with the appellant's position that the court must be actively engaged at every turn in the proceeding, I am equally circumspect about the "hands off" approach advocated by the respondents. Neither view accurately captures the role of the court in respect of a class proceeding.

42 The CPA is specific as to certain matters arising out of litigation conducted under the aegis of the statute that require court approval. These include, *inter alia*, the abandonment or discontinuance of an action, approval of settlements, notice to class members and class counsel fees: see ss. 29(1), 29(2), 20, and 32(2) of the CPA respectively. In addition to such enumerated and specific matters requiring court approval, the legislature has also seen fit to provide the court, under s. 12 of the CPA, with a broad, discretionary jurisdiction to "make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination". Although the court's ongoing supervisory jurisdiction is manifest in the CPA, this is not to say that every decision made by the plaintiff or counsel in the prosecution of the class action lawsuit requires the sanction of the court.

43 The motion under appeal was brought pursuant to s. 12 of the CPA. The appellant argues that a notice of change of solicitors should not have been delivered without first obtaining an order of the court on motion brought by the representative plaintiff, so as to have the court approve the new class counsel. Further, the appellant contends that this determination should only be made on the basis of the "best interests of the class".

44 I disagree. The position advanced by the appellant appears to be an attempt to combine certain developed principles of class action jurisprudence so as to elevate the court's supervisory role over the proceeding to one of mandatory intervention. While it is true that the court has a responsibility to the absent class members, the prosecution of the action rests squarely with the representative plaintiff. The representative plaintiff in a class ac-

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tion lawsuit is a genuine plaintiff, who chooses, retains and instructs counsel and to whom counsel report.

45 This is clear from a reading of the CPA. In order to obtain certification, s. 5(1) of the CPA requires that the court be satisfied that the representative plaintiff "has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class". In other words, as stated by the Supreme Court of Canada in *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534 (S.C.C.), at para. 41:

> In assessing whether the proposed representative is adequate, the court may look to the motivation of the representative, the competence of the representative's counsel, and the capacity of the representative to bear any costs that may be incurred by the representative in particular (as opposed to by counsel or by the class members generally). The proposed representative need not be "typical" of the class, nor the "best" possible representative. The court should be satisfied, however, that the proposed representative will vigorously and capably prosecute the interests of the class.
>
> [Citations omitted.]

46 As is also stated in this passage, an important part of this representative plaintiff's plan is the retention of "competent" counsel.

47 I do not view it as necessary for the plaintiff to seek and obtain approval of the court for every decision involving the selection or change of counsel. However, I am of the view that the case management judge charged with responsibility for the supervision of the proceeding should be immediately and directly notified of such a change. Further, if this decision is contested and properly comes before the court on motion, the court is well within its jurisdiction to review the plaintiff's decision.

Issue 2: Test for reviewing a plaintiff's choice of counsel

48 The parties vigorously disputed the test to be applied when the court reviews a representative plaintiff's choice of counsel. In his reasons, the motion judge correctly identified the issues and canvassed the relevant case law in deciding that question. In my view, he made no error in holding that the choice of counsel upon REKO's dissolution was a matter for Mr. Fantl to deal with and that his decision did not warrant interference by the court. Nonetheless, I would arrive at that result for different reasons and based on a different analysis than that of the motion judge.

49 The appellant has argued that this court should evaluate Mr. Fantl's choice of counsel by determining whether he was acting in the "best interests of the class" in so choosing. On the other hand, the respondent contends that the motion judge was correct in applying a test of adequacy to Mr. Fantl's choice of counsel. In my view, both approaches miss the mark. Once the court's jurisdiction is engaged, any review by the court of a decision as to choice of counsel must be directed to three factors:

> (1) Has the plaintiff chosen competent counsel?
>
> (2) Were there any improper considerations underlying the choice made by the plaintiff? and
>
> (3) Is there prejudice to the class as a result of the choice?

50 Unless this inquiry reveals something unsatisfactory to the court, it ought not to interfere with the choice

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of counsel made by the plaintiff. The court is not a substitute decision maker for the plaintiff in the litigation. Accordingly, any intervention based on its supervisory jurisdiction must be limited to situations where there is cogent evidence that steps taken may have an adverse impact on the absent class members.

51 In formulating these criteria for review of the choice of counsel by the plaintiff, I am necessarily rejecting the argument of the appellant that the only test to be applied by the court is whether the choice is "in the best interests of the class". It must be remembered that the broad and guiding "best interests" principle developed in recognition of the distinction that must be made between the interests of individual class members and the interests of the class as a whole when the court is considering certain issues: see *Parsons v. Canadian Red Cross Society* (1999), 40 C.P.C. (4th) 151 (Ont. S.C.J.), *Ford v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (Ont. S.C.J.), and *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130 (Ont. S.C.J.). Here, the context is very different.

52 Moreover, where the issue before the court is the plaintiff's choice of counsel, insofar as the "interests of the class" must be considered, they are sufficiently addressed under the prejudice criterion. Where there is no prejudice, the choice of "competent counsel" who has not been selected for any improper purpose will also be in the interests of the class.

53 By applying these criteria, the court avoids the "contest" approach proposed by the appellant, which pits two sets of competing lawyers against each other and undermines the role of the representative plaintiff in selecting counsel. Such an approach is neither necessary nor productive where, as here, competence is conceded and there is no evidence that the plaintiff has acted improperly or in a manner that prejudices the interests of the class.

54 The appellant contends that the "contest" approach is appropriate in the present circumstances because the choice of counsel is analogous to a carriage motion. I disagree. A carriage motion is a motion to determine which of two or more overlapping, competing intended class actions should be allowed to proceed and which should be stayed. A carriage motion involves a competition which, of necessity, requires a comparison of the competing proceedings. Unlike a carriage motion, there is no competition between proceedings here. It is for this reason that any analogy between a carriage motion and the present circumstances breaks down.

Application of the test to the instant case

55 The instant proceeding involves the choice of counsel upon dissolution of the class counsel law firm. The retainer agreement was entered into between Mr. Fantl and REKO, and not with Mr. Kim or any other individual lawyer. A team of lawyers at the predecessor firm dealt with the case.

56 On dissolution, some of the team formed the appellant, some formed REO and one lawyer joined another firm. Lawyers in each of these factions had participated in the work on the file to varying degrees. The lawyer who did the most work on the file was the associate who left and went to an unrelated firm.

57 The record indicates that, although Mr. Kim was the senior partner on the case, he did not take instructions from, or report to, Mr. Fantl, and that he only accompanied Mr. Fantl to cross-examinations. He attended one settlement meeting with the defendant at which defendant's counsel offered to settle the claim, expand the class definition and communicate this development to class members.

58 In the context of this file, and in the eyes of Mr. Fantl, there was more to the REKO firm than just Mr.

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Kim. Mr. Fantl was faced with three choices. He could go with the appellant, the REO firm or choose a different firm. He chose the REO firm.

59 The appellant argues that the failure to retain KO was akin to a dismissal of counsel. I do not accept this characterization of the facts before this court. The appellant was not terminated by the plaintiff. Indeed, KO had no relationship with the plaintiff capable of termination. Rather, its complaint is that the plaintiff did not choose to retain its lawyers after REKO's dissolution.

60 Turning to the first factor of the test, competence of counsel of choice was conceded in the present case. I note the appellant's submission that competence of counsel is not a useful benchmark since every lawyer in Ontario is competent and thus no motion challenging a plaintiff's choice of counsel is likely to ever be successful. I disagree. Where competence is a live issue, the court should consider under this head:

(1) The nature of the lawsuit;

(2) The complexity of the litigation;

(3) The fact that it was a class proceeding;

(4) The experience of counsel as to subject matter and class actions;

(5) The resources of counsel;

(6) The stage of the proceedings at which the review occurs; and

(7) Any other considerations the court might deem to be appropriate.

61 Moreover, when considering competence of counsel, the court must take into account the fact that, after certification, class counsel will be in a solicitor-client relationship with the class members, with all of the responsibilities that entails, extending until the implementation of a settlement or final disposition of any individual issues. In other words, given that the class may include a large number of people, this obligation may be significant and prolonged: see generally *Cassano v. Toronto Dominion Bank* (2007), 87 O.R. (3d) 401 (Ont. C.A.), and *Ward-Price v. Mariners Haven Inc.* (2004), 71 O.R. (3d) 664 (Ont. S.C.J.), at para. 7.

62 These criteria serve to advance an object of the CPA, namely to obtain first class representation for class members.

63 Turning to the second factor, there is no evidence of any improper purpose or motive on the part of the plaintiff in making his decision to retain REO. The appellant points to the plaintiff's friendship with Mr. Roy, one of the partners of REO, as the driving factor in choice of counsel. While that was a consideration, it was not the only factor for the plaintiff's choice of counsel. As noted by the motion judge and as indicated in the record, Mr. Fantl was attracted to REO because of the competence of counsel, which is not disputed, and its reputation in class action work.

64 In any event, I would not accept that the fact of an acknowledged friendship between the plaintiff and his counsel of choice would constitute an improper purpose in and of itself. An improper purpose would be one where the plaintiff was seeking to gain a personal advantage, the hope of an advantage not shared by the class members or was motivated in some way that was inconsistent with the interests of the class.

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65 Turning to the third factor, to the extent that prejudice was argued by the appellant, this line of argument focused on the economic prejudice to the appellant rather than on any prejudice to the interests of the class. The appellant emphasized what was characterized as the policy arguments in support of entrepreneurial lawyers, which were said to advance one of the goals of the CPA - access to justice. Effectively, the appellant's argument is that it would be unfair for a plaintiff, upon dissolution of his or her counsel's law firm, to choose any lawyer other than the lawyer who had previously acted as the lead counsel. In other words, in a class action, the lawyer's time and effort on the file constitutes an equity investment by the lawyer in the case. It is argued that if representative plaintiffs are allowed to switch counsel at will, there will be less of an incentive for counsel to take on class actions and make an investment of time and effort that may be lost.

66 There is no question that class proceedings are entrepreneurial in nature. However, the proposition advanced by the appellant would only be supportable if the creation of an entrepreneurial class action bar was a policy goal underpinning the CPA. This argument fails because as far as the CPA is concerned, the entrepreneurial lawyer is a means to an end, not an end in and of itself. Were it otherwise, one of the criticisms of the CPA, that it promulgates plaintiff-less litigation benefiting only the lawyers involved, would be well founded. Such is not the case.

67 Sections 33(1) and (4) of the CPA, which provide for contingency fees and a multiplier effect on fees to reward risk and success, are intended to provide sufficient incentives for lawyers to take on class proceedings that would not otherwise be attractive. This is the entrepreneurial aspect of class proceedings legislation that enhances access to justice. The CPA does not, nor was it ever intended to, provide lawyers with a vested interest in the subject matter of the lawsuit entitling them to override the choices of the representative plaintiff in the litigation, including the choice of counsel.

68 In any event, Mr. Kim's investment of time and effort in the action while at REKO will be protected through the process of dissolving that firm.

69 In conclusion, in light of the three factors set out above, namely, that competence of counsel is not in issue, there is no evidence of any improper purpose or considerations in choice of counsel, and no demonstrated prejudice to the class, there is no reason to interfere with the choice of counsel by Mr. Fantl.

Issue 3: Substitution of the representative plaintiff and the status of the Kang action

70 Before Perell J., the appellant sought an order adding Ms. Seok and Ms. Kang as potential representative plaintiffs to replace Mr. Fantl as the plaintiff. Perell J. denied its request.

71 On appeal, the appellant argued that Mr. Fantl's decision not to retain the appellant, in the face of Mr. Kim's success on the file, suggests that Mr. Fantl will not best represent the class members, and, thus, ought to be removed. On behalf of Ms. Kang and Ms. Seok, it argued that they should be substituted as representative plaintiffs. The respondents opposed, saying that, as with the commencement of the Kang action, this is simply an attempt to determine who will represent the interests of the class.

72 Mr. Fantl has prosecuted the action to the point of settlement. There is no suggestion that he has been less than diligent in this respect. Indeed, Mr. Fantl stepped in to represent the class when the original representative plaintiff chose to abandon that role. He did so after being approached by solicitors from REKO, some of whom now stand with opposing interests on this appeal.

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73 While not necessarily determinative, the choice to approach Mr. Fantl to act in the representative capacity indicates that none of the counsel had any concerns about his ability to perform that role at that time. Moreover, when the plaintiff assumed the representation of the class, it must have been implicitly understood by his solicitors that he would be the one providing instructions for the litigation of the action.

74 In light of these factors and my conclusion above that Mr. Fantl chose competent counsel, did not act with an improper purpose or act to the prejudice of the class, there is no basis to interfere with the decision of the motion judge not to remove or replace Mr. Fantl as the representative plaintiff in this action.

Stay of Kang Action

75 The appellant commenced the Kang action following the dismissal of the motion to strike the notice of change of solicitors and replace the representative plaintiff, notwithstanding its admission before the motion judge that such a move would be "disingenuous": para. 99. Indeed, the Divisional Court commented on this development in the following terms at para. 11 of its reasons:

> Most remarkable of all, and independent of this motion under appeal, the lawyer has started a separate class proceeding against Transamerica in the name of Ms. Kang, the proposed representative plaintiff. This is the same Ms. Kang whom the lawyer seeks to have added as representative plaintiff with Mr. Fantl, or, in the alternative, to replace Mr. Fantl, his former client, with Ms. Kang and Ms. Seok.

76 I agree with the observation of the Divisional Court that the bringing of the Kang action after having lost the motion before the motion judge was "most remarkable". The only purpose for doing this can be to provide a platform for a carriage motion to challenge the instant proceeding as the proper proceeding to take the action forward to settlement on behalf of the class.

77 Apart from the fact that the appellant brought the second duplicative proceeding, which would in my view be determinative in and of itself, a carriage motion would also involve the appellant in bringing a proceeding against its former client.

78 The essence of the respondents' argument is that the Kang action amounts to an abuse of process. I agree. Accordingly, pursuant to the jurisdiction conferred upon this court under s. 134(1) of the CJA and s. 13 of the CPA, I would stay the Kang action.

79 If allowed to proceed, the Kang action would inevitably be stayed in any event. Considering the factors outlined by Cumming J. in *VitaPharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2000), 4 C.P.C. (5th) 169 (Ont. S.C.J.), at para. 49, there is no question that Mr. Fantl's action would proceed over the Kang action given that it is so "significantly more advanced than the other": *Setterington v. Merck Frosst Canada Ltd.* (2006), 26 C.P.C. (6th) 173 (Ont. S.C.J.), at para. 22, and *Ricardo v. Air Transat A.T. Inc.* (2002), 21 C.P.C. (5th) 297 (Ont. S.C.J.), at para. 24.

80 Further, as this action is on the cusp of settlement, the delay caused by a carriage motion would only serve to postpone the class members' access to justice. Even the appellant recognized that time was of the essence in this case, given the imminent settlement approval hearing, when it sought and was granted an expedited hearing of this appeal. Therefore, regardless of whether the competing actions are analyzed through the lens of best interests of the class or through that of prejudice, I reach the same inevitable conclusion that the Kang action should be stayed. The class members are entitled to certainty.

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Conclusion

81 In conclusion, I would dismiss the appeal. Further, I would grant a stay of the Kang action. Mr. Fantl shall receive costs of $10,000 for the appeal and $5,000 for the leave motion inclusive of disbursements and G.S.T. The appellant shall also pay to Transamerica its costs of $6,350 for the appeal and $2,000 for the leave motion, inclusive of disbursements and G.S.T.

***S.T. Goudge J.A.*:**

I agree.

***J.M. Simmons J.A.*:**

I agree.

Appeal dismissed.

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TAB 16

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2009 CarswellOnt 3028, 53 C.B.R. (5th) 196, 75 C.C.P.B. 206

Nortel Networks Corp., Re

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

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

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

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: April 20, 2009
Judgment: May 27, 2009[FN*]
Docket: 09-CL-7950

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Counsel: Janice Payne, Steven Levitt, Arthur O. Jacques for Steering Committee of Recently Severed Canadian Nortel Employees

Barry Wadsworth for CAW-Canada, George Borosh, Debra Connor

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

Alan Mersky, Derrick Tay for Applicants

Henry Juroviesky, Eli Karp, Kevin Caspersz, Aaron Hershtal for Steering Committee for the Nortel Terminated Canadian Employees Owed Termination and Severance Pay

M. Starnino for Superintendent of Financial Services or Administrator of the Pension Benefits Gurantee Fund

Leanne Williams for Flextronics Telecom Systems Ltd.

Jay Carfagnini, Chris Armstrong for Monitor, Ernst & Young Inc.

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Gail Misra for Communication, Energy and Paperworkers Union of Canada

J. Davis-Sydor for Brookfield Lepage Johnson Controls Facility Management Services

Mark Zigler, S. Philpott for Certain Former Employees of Nortel

G.H. Finlayson for Informal Nortel Noteholders Group

A. Kauffman for Export Development Canada

Alex MacFarlane for Unsecured Creditors' Committee (U.S.)

Subject: Insolvency

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

Appointment of representative counsel — Telecommunication company entered protection under Companies' Creditors Arrangement Act — Telecommunications company ceased paying former employees with unsecured claims — Several groups of employees claimed entitlement to assets of company, including current working employees, and pensioners — Several law firms maintained that different classes should be established representing employees with different interests, with different legal representatives for each — Five law firms brought motions regarding representation — Law firm KM appointed representative for all potential classes of employee — Court has broad power to appoint representative counsel — Employees and retirees were vulnerable creditors, and had little means to pursue claims beyond representative counsel — No party denied choice of counsel as employees entitled to obtain individual counsel — No current conflict of interest between pensioned and non-pensioned employees — Many classes of employee had similar interest in pension plan — Claims under pension, to extend it was funded, not affected by CCAA proceedings — Pension claims by terminated employees creating conflict with other claims was only hypothetical — All former employees had community of interest.

Cases considered by *Morawetz J.*:

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

Stelco Inc., Re (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — considered

Statutes considered:

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

Generally — referred to

s. 11 — considered

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)

Generally — referred to

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Pension Benefits Act, R.S.O. 1990, c. P.8

Generally — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 10 — referred to

R. 10.01 — considered

R. 12.07 — considered

MOTIONS regarding appointment of counsel in proceedings under *Companies' Creditors Arrangement Act.*

***Morawetz J.*:**

1 On May 20, 2009, I released an endorsement appointing Koskie Minsky as representative counsel with reasons to follow. The reasons are as follows.

2 This endorsement addresses five motions in which various parties seek to be appointed as representative counsel for various factions of Nortel's current and former employees (Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation are collectively referred to as the "Applicants" or "Nortel").

3 The proposed representative counsel are:

(i) Koskie Minsky LLP ("KM") who is seeking to represent all former employees, including pensioners, of the Applicants or any person claiming an interest under or on behalf of such former employees or pensioners and surviving spouses in respect of a pension from the Applicants. Approximately 2,000 people have retained KM.

(ii) Nelligan O'Brien Payne LLP and Shibley Righton LLP (collectively "NS") who are seeking to be co-counsel to represent all former non-unionized employees, terminated either prior to or after the CCAA filing date, to whom the Applicants owe severance and/or pay in lieu of reasonable notice. In addition, in a separate motion, NS seeks to be appointed as co-counsel to the continuing employees of Nortel. Approximately 460 people have retained NS and a further 106 have retained Macleod Dixon LLP, who has agreed to work with NS.

(iii) Juroviesky and Ricci LLP ("J&R") who is seeking to represent terminated employees or any person claiming an interest under or on behalf of former employees. At the time that this motion was heard approximately 120 people had retained J&R. A subsequent affidavit was filed indicating that this number had increased to 186.

(iv) Mr. Lewis Gottheil, in-house legal counsel for the National Automobile, Aerospace, Transportation and General Workers Union of Canada ("CAW") who is seeking to represent all retirees of the Applicants who were formerly members of one of the CAW locals when they were employees. Approximately 600

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people have retained Mr. Gottheil or the CAW.

4 At the outset, it is noted that all parties who seek representation orders have submitted ample evidence that establishes that the legal counsel that they seek to be appointed as representative counsel are well respected members of the profession.

5 Nortel filed for CCAA protection on January 14, 2009 (the "Filing Date"). At the Filing Date, Nortel employed approximately 6,000 employees and had approximately 11,700 retirees or their spouses receiving pension and/or benefits from retirement plans sponsored by the Applicants.

6 The Monitor reports that the Applicants have continued to honour substantially all of the obligations to active employees. However, the Applicants acknowledge that upon commencement of the CCAA proceedings, they ceased making almost all payments to former employees of amounts that would constitute unsecured claims. Included in those amounts were payments to a number of former employees for termination and severance, as well as amounts under various retirement and retirement transition programs.

7 The Monitor is of the view that it is appropriate that there be representative counsel in light of the large number of former employees of the Applicants. The Monitor is of the view that former employee claims may require a combination of legal, financial, actuarial and advisory resources in order to be advanced and that representative counsel can efficiently co-ordinate such assistance for this large number of individuals.

8 The Monitor has reported that the Applicants' financial position is under pressure. The Monitor is of the view that the financial burden of multiple representative counsel would further increase this pressure.

9 These motions give rise to the following issues:

(i) when is it appropriate for the court to make a representation and funding order?

(ii) given the completing claims for representation rights, who should be appointed as representative counsel?

Issue 1 - Representative Counsel and Funding Orders

10 The court has authority under Rule 10.01 of the *Rules of Civil Procedure* to appoint representative counsel where persons with an interest in an estate cannot be readily ascertained, found or served.

11 Alternatively, Rule 12.07 provides the court with the authority to appoint a representative defendant where numerous persons have the same interests.

12 In addition, the court has a wide discretion pursuant to s. 11 of the CCAA to appoint representatives on behalf of a group of employees in CCAA proceedings and to order legal and other professional expenses of such representatives to be paid from the estate of the debtor applicant.

13 In the KM factum, it is submitted that employees and retirees are a vulnerable group of creditors in an insolvency because they have little means to pursue a claim in complex CCAA proceedings or other related insolvency proceedings. It was further submitted that the former employees of Nortel have little means to pursue their claims in respect of pension, termination, severance, retirement payments and other benefit claims and that the former employees would benefit from an order appointing representative counsel. In addition, the granting of a representation order would provide a social benefit by assisting former employees and that representative counsel would provide a

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reliable resource for former employees for information about the process. The appointment of representative counsel would also have the benefit of streamlining and introducing efficiency to the process for all parties involved in Nortel's insolvency.

14 I am in agreement with these general submissions.

15 The benefits of representative counsel have also been recognized by both Nortel and by the Monitor. Nortel consents to the appointment of KM as the single representative counsel for all former employees. Nortel opposes the appointment of any additional representatives. The Monitor supports the Applicants' recommendation that KM be appointed as representative counsel. No party is opposed to the appointment of representative counsel.

16 In the circumstances of this case, I am satisfied that it is appropriate to exercise discretion pursuant to s. 11 of the CCAA to make a Rule 10 representation order.

Issue 2 - Who Should be Appointed as Representative Counsel?

17 The second issue to consider is who to appoint as representative counsel. On this issue, there are divergent views. The differences primarily centre around whether there are inherent conflicts in the positions of various categories of former employees.

18 The motion to appoint KM was brought by Messrs. Sproule, Archibald and Campbell (the "Koskie Representatives"). The Koskie Representatives seek a representation order to appoint KM as representative counsel for all former employees in Nortel's insolvency proceedings, except:

(a) any former chief executive officer or chairman of the board of directors, any non-employee members of the board of directors, or such former employees or officers that are subject to investigation and charges by the Ontario Securities Commission or the United States Securities and Exchange Commission:

(b) any former unionized employees who are represented by their former union pursuant to a Court approved representation order; and

(c) any former employee who chooses to represent himself or herself as an independent individual party to these proceedings.

19 Ms. Paula Klein and Ms. Joanne Reid, on behalf of the Recently Severed Canadian Nortel Employees ("RSCNE"), seek a representation order to appoint NS as counsel in respect of all former Nortel Canadian non-unionized employees to whom Nortel owes termination and severance pay (the "RSCNE Group").

20 Mr. Kent Felske and Mr. Dany Sylvain, on behalf of the Nortel Continuing Canadian Employees ("NCCE") seek a representative order to appoint NS as counsel in respect of all current Canadian non-unionized Nortel employees (the "NCCE Group").

21 J&R, on behalf of the Steering Committee (Mr. Michael McCorkle, Mr. Harvey Stein and Ms. Marie Lunney) for Nortel Terminated Canadian Employees ("NTCEC") owed termination and severance pay seek a representation order to appoint J&R in respect of any claim of any terminated employee arising out of the insolvency of Nortel for:

(a) unpaid termination pay;

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(b) unpaid severance pay;

(c) unpaid expense reimbursements; and

(d) amounts and benefits payable pursuant to employment contracts between the Employees and Nortel

22 Mr. George Borosh and/or Ms. Debra Connor seek a representation order to represent all retirees of the Applicants who were formerly represented by the CAW (the "Retirees") or, alternatively, an order authorizing the CAW to represent the Retirees.

23 The former employees of Nortel have an interest in Nortel's CCAA proceedings in respect of their pension and employee benefit plans and in respect of severance, termination pay, retirement allowances and other amounts that the former employees consider are owed in respect of applicable contractual obligations and employment standards legislation.

24 Most former employees and survivors of former employees have basic entitlement to receive payment from the Nortel Networks Limited Managerial and Non-negotiated Pension Plan (the "Pension Plan") or from the corresponding pension plan for unionized employees.

25 Certain former employees may also be entitled to receive payment from Nortel Networks Excess Plan (the "Excess Plan") in addition to their entitlement to the Pension Plan. The Excess Plan is a non-registered retirement plan which provides benefits to plan members in excess of those permitted under the registered Pension Plan in accordance with the *Income Tax Act*.

26 Certain former employees who held executive positions may also be entitled to receive payment from the Supplementary Executive Retirement Plan ("SERP") in addition to their entitlement to the Pension Plan. The SERP is a non-registered plan.

27 As of Nortel's last formal valuation dated December 31, 2006, the Pension Plan was funded at a level of 86% on a wind-up basis. As a result of declining equity markets, it is anticipated that the Pension Plan funding levels have declined since the date of the formal valuation and that Nortel anticipates that its Pension Plan funding requirements in 2009 will increase in a very substantial and material matter.

28 At this time, Nortel continues to fund the deficit in the Pension Plan and makes payment of all current service costs associated with the benefits; however, as KM points out in its factum, there is no requirement in the Initial Order compelling Nortel to continue making those payments.

29 Many retirees and former employees of Nortel are entitled to receive health and medical benefits and other benefits such as group life insurance (the "Health Care Plan"), some of which are funded through the Nortel Networks' Health and Welfare Trust (the "HWT").

30 Many former employees are entitled to a payment in respect of the Transitional Retirement Allowance ("TRA"), a payment which provides supplemental retirement benefits for those who at the time of their retirement elect to receive such payment. Some 442 non-union retirees have ceased to receive this benefit as a result of the CCAA proceedings.

31 Former employees who have been recently terminated from Nortel are owed termination pay and severance pay. There were 277 non-union former employees owed termination pay and severance pay at the Filing Date.

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32 Certain former unionized employees also have certain entitlements including:

(a) Voluntary Retirement Option ("VRO");

(b) Retirement Allowance Payment ("RAP"); and

(c) Layoff and Severance Payments

33 The Initial Order permitted Nortel to cease making payments to its former employees in respect of certain amounts owing to them and effective January 14, 2009, Nortel has ceased payment of the following:

(a) all supplementary pensions which were paid from sources other than the Registered Pension Plan, including payments in respect of the Excess Plan and the SERP;

(b) all TRA agreements where amounts were still owing to the affected former employees as at January 14, 2009;

(c) all RAP agreements where amounts were still owing to the affected former employees as at January 14, 2009;

(d) all severance and termination agreements where amounts were still owing to the affected former employees as at January 14, 2009; and

(e) all retention bonuses where amounts were still owing to affected former employees as at January 14, 2009.

34 The representatives seeking the appointment of KM are members of the Nortel Retiree and Former Employee Protection Committee ("NRPC"), a national-based group of over 2,000 former employees. Its stated mandate is to defend and protect pensions, severance, termination and retirement payments and other benefits. In the KM factum, it is stated that since its inception, the NRPC has taken steps to organize across the country and it has assembled subcommittees in major centres. The NRPC consists of 20 individuals who it claims represent all different regions and interests and that they participate in weekly teleconference meetings with legal counsel to ensure that all former employees' concerns are appropriately addressed.

35 At paragraph 49 of the KM factum, counsel submits that NRPC members are a cross-section of all former employees and include a variety of interests, including those who have an interest in and/or are entitled to:

(a) the basic Pension Plan as a deferred member or a member entitled to transfer value;

(b) the Health Care Plan;

(c) the Pension Plan and Health Care Plan as a survivor of a former employee;

(d) Supplementary Retirement Benefits from the Excess Plan and the SERP plans;

(e) severance and termination pay ; and

(f) TRA payments.

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36 The representatives submit that they are well suited to represent all former employees in Nortel's CCAA proceedings in respect of all of their interests. The record (Affidavit of Mr. D. Sproule) references the considerable experience of KM in representing employee groups in large-scale restructurings.

37 With respect to the allegations of a conflict of interest as between the various employee groups (as described below), the position of the representatives seeking the appointment of KM is that all former employees have unsecured claims against Nortel in its CCAA proceedings and that there is no priority among claims in respect of Nortel's assets. Further, they submit that a number of former employees seeking severance and termination pay also have other interests, including the Pension Plan, TRA payments and the supplementary pension payments and that it would unjust and inefficient to force these individuals to hire individual counsel or to have separate counsel for separate claims.

38 Finally, they submit that there is no guarantee as to whether Nortel will emerge from the CCAA, whether it will file for bankruptcy or whether a receiver will be appointed or indeed whether even a plan of compromise will be filed. They submit that there is no actual conflict of interest at this time and that the court need not be concerned with hypothetical scenarios which may never materialize. Finally, they submit that in the unlikely event of a serious conflict in the group, such matters can be brought to the attention of the court by the representatives and their counsel on a *ex parte* basis for resolution.

39 The terminated employee groups seeking a representation order for both NS and J&R submit that separate representative counsel appointments are necessary to address the conflict between the pension group and the employee group as the two groups have separate legal, procedural, and equitable interests that will inevitably conflict during the CCAA process.

40 They submit that the pensioners under the Pension Plan are continuing to receive the full amount of the pension from the Pension Plan and as such they are not creditors of Nortel. Counsel submits that the interest of pensioners is in continuing to receive to receive their full pension and survivor benefits from the Pension Plan for the remainder of their lives and the lives of surviving spouses.

41 In the NS factum at paragraphs 44 - 58, the argument is put forward as to why the former employees to whom Nortel owes severance and termination pay should be represented separately from the pensioners. The thrust of the argument is that future events may dictate the response of the affected parties. At paragraph 51 of the factum, it is submitted that generally, the recently severed employees' primary interest is to obtain the fastest possible payout of the greatest amount of severance and/or pay in lieu of notice in order to alleviate the financial hardships they are currently experiencing. The interests of pensioners, on the other hand, is to maintain the status quo, in which they continue to receive full pension benefits as long as possible. The submission emphasizes that issues facing the pensioner group and the non-pensioner group are profoundly divergent as full monthly benefit payments for the pensioner group have continued to date while non-pensioners are receiving 86% of their lump sums on termination of employment, in accordance with the most recently filed valuation report.

42 The motion submitted by the NTCEC takes the distinction one step further. The NTCEC is opposed to the motion of NS. NS wishes to represent both the RSCNE and the NCCE. The NTCEC believes that the terminated employees who are owed unpaid wages, termination pay and/or severance should comprise their own distinct and individual class.

43 The NTCEC seek payment and fulfillment of Nortel's obligations to pay one or several of the following:

(a) TRA;

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(b) 2008 bonuses; and

(c) amendments to the Nortel Pension Plan

44 Counsel to NTCEC submits that the most glaring and obvious difference between the NCCE and the NTCEC, is that NCCE are still employed and have a continuing relationship with Nortel and have a source of employment income and may only have a contingent claim. The submission goes on to suggest that, if the NCCE is granted a representation order in these proceedings, they will seek to recover the full value of their TRA claim from Nortel during the negotiation process notwithstanding that one's claim for TRA does not crystallize until retirement or termination. On the other hand, the terminated employees, represented by the NTCEC and RSCNE are also claiming lost TRA benefits and that claim has crystallized because their employment with Nortel has ceased. Counsel further submits that the contingent claim of the NCCE for TRA is distinct and separate with the crystallized claim of the NTCEC and RSCNE for TRA.

45 Counsel to NTCEC further submits that there are difficulties with the claim of NCCE which is seeking financial redress in the CCAA proceedings for damages stemming from certain changes to the Nortel Networks Limited Managerial and Non-negotiated Pension Plan effective June 1, 2008 and Nortel's decision to decrease retirees benefits. Counsel submits that, even if the NCCE claims relating to the Pension Plan amendment are quantifiable, they are so dissimilar to the claims of the RSCNE and NTCEC, that the current and former Nortel employees cannot be viewed as a single group of creditors with common interests in these proceedings, thus necessitating distinct legal representation for each group of creditors.

46 Counsel further argues that NTCEC's sole mandate is to maximize recovery of unpaid wages, termination and severance pay which, those terminated employees as a result of Nortel's CCAA filing, have lost their employment income, termination pay and/or severance pay which would otherwise be protected by statute or common law.

47 KM, on behalf of the Koskie Representatives, responded to the concerns raised by NS and by J&R in its reply factum.

48 KM submits that the conflict of interest is artificial. KM submits that all members of the Pension Plan who are owed pensions face reductions on the potential wind-up of the Pension Plan due to serious under-funding and that temporarily maintaining of status quo monthly payments at 100%, although required by statute, does not avoid future reductions due to under-funding which offset any alleged overpayments. They submit that all pension members, whether they can withdraw 86% of their funds now and transfer them a locked-in vehicle or receive them later in the form of potentially reduced pensions, face a loss and are thus creditors of Nortel for the pension shortfalls.

49 KM also states that the submission of the RSCNE that non-pensioners may put pressure on Nortel to reduce monthly payments on pensioners ignores the *Ontario Pension Benefits Act* and its applicability in conjunction with the CCAA. It further submits that issues regarding the reduction of pensions and the transfers of commuted values are not dealt with through the CCAA proceedings, but through the Superintendent of Financial Services and the Plan Administrator in their administration and application of the PBA. KM concludes that the Nortel Pension Plans are not applicants in this matter nor is there a conflict given the application of the provisions of the PBA as detailed in the factum at paragraphs 11 - 21.

50 KM further submits that over 1,500 former employees have claims in respect of other employment and retirement related benefits such as the Excess Plan, the SERP, the TRA and other benefit allowances which are claims that have "crystallized" and are payable now. Additionally, they submit that 11,000 members of the Pension Plan are entitled to benefits from the Pensioner Health Care Plan which is not pre-funded, resulting in significant claims in Nortel's CCAA proceedings for lost health care benefits.

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51 Finally, in addition to the lack of any genuine conflict of interest between former employees who are pensioners and those who are non-pensioners, there is significant overlap in interest between such individuals and a number of the former employees seeking severance and termination pay have the same or similar interests in other benefit payments, including the Pension Plan, Health Care Plan, TRA, SERP and Excess Plan payments. As well, former employees who have an interest in the Pension Plan also may be entitled to severance and termination pay.

52 With respect to the motions of NS and J&R, I have not been persuaded that there is a real and direct conflict of interest. Claims under the Pension Plan, to the extent that it is funded, are not affected by the CCAA proceedings. To the extent that there is a deficiency in funding, such claims are unsecured claims against Nortel. In a sense, deficiency claims are not dissimilar from other employee benefit claims.

53 To the extent that there may be potentially a divergence of interest as between pension-based claims and terminated-employee claims, these distinctions are, at this time, hypothetical. At this stage of the proceeding, there has been no attempt by Nortel to propose a creditor classification, let alone a plan of arrangement to its creditors. It seems to me that the primary emphasis should be placed on ensuring that the arguments of employees are placed before the court in the most time efficient and cost effective way possible. In my view, this can be accomplished by the appointment of a single representative counsel, knowledgeable and experienced in all facets of employee claims.

54 It is conceivable that there will be differences of opinion between employees at some point in the future, but if such differences of opinion or conflict arise, I am satisfied that this issue will be recognized by representative counsel and further directions can be provided.

55 A submission was also made to the effect that certain individuals or groups of individuals should not be deprived of their counsel of choice. In my view, the effect of appointing one representative counsel does not, in any way, deprive a party of their ability to be represented by the counsel of their choice. The Notice of Motion of KM provides that any former employee who does not wish to be bound by the representative order may take steps to notify KM of their decision and may thereafter appear as an independent party.

56 In the responding factum at paragraphs 28 - 30, KM submits that each former employee, whether or not entitled to an interest in the Pension Plan, has a common interest in that each one is an unsecured creditor who is owed some form of deferred compensation, being it severance pay, TRA or RAP payments, supplementary pensions, health benefits or benefits under a registered Pension Plan and that classifying former employees as one group of creditors will improve the efficiency and effectiveness of Nortel's CCAA proceedings and will facilitate the reorganization of the company. Further, in the event of a liquidation of Nortel, each former employee will seek to recover deferred compensation claims as an unsecured creditor. Thus, fragmentation of the group is undesirable. Further, all former employees also have a common legal position as unsecured creditors of Nortel in that their claims all arise out of the terms and conditions of their employment and regardless of the form of payment, unpaid severance pay and termination pay, unpaid health benefits, unpaid supplementary pension benefits and other unpaid retirement benefits are all remuneration of some form arising from former employment with Nortel.

57 The submission on behalf of KM concludes that funds in a pension plan can also be described as deferred wages. An employer who creates a pension plan agrees to provide benefits to retiring employees as a form of compensation to that employee. An underfunded pension plan reflects the employer's failure to pay the deferred wages owing to former employees.

58 In its factum, the CAW submits that the two proposed representative individuals are members of the Nortel Pension Plan applicable to unionized employees. Both individuals are former unionized employees of Nortel and were members of the CAW. Counsel submits that naming them as representatives on behalf of all retirees of Nortel who were members of the CAW will not result in a conflict with any other member of the group.

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59 Counsel to the CAW also stated that in the event that the requested representation order is not granted, those 600 individuals who have retained Mr. Lewis Gottheil will still be represented by him, and the other similarly situated individuals might possibly be represented by other counsel. The retainer specifically provides that no individual who retains Mr. Gottheil shall be charged any fees nor be responsible for costs or penalties. It further provides that the retainer may be discontinued by the individual or by counsel in accordance with applicable rules.

60 Counsel further submits that the 600 members of the group for which the representation order is being sought have already retained counsel of their choice, that being Mr. Lewis Gottheil of the CAW. However, if the requested representative order is not granted, there will still be a group of 600 individual members of the Pension Plan who are represented by Mr. Gottheil. As a result, counsel acknowledges there is little to no difference that will result from granting the requested representation order in this case, except that all retirees formerly represented by the union will have one counsel, as opposed to two or several counsel if the order is not granted.

61 In view of this acknowledgement, it seems to me that there is no advantage to be gained by granting the CAW representative status. There will be no increased efficiencies, no simplification of the process, nor any real practical benefit to be gained by such an order.

62 Notwithstanding that creditor classification has yet to be proposed in this CCAA proceeding, it is useful, in my view, to make reference to some of the principles of classification. In *Stelco Inc., Re*, the Ontario Court of Appeal noted that the classification of creditors in the CCAA proceeding is to be determined based on the "commonality of interest" test. In *Stelco Inc., Re*, the Court of Appeal upheld the reasoning of Paperny J. (as she then was) in *Canadian Airlines Corp., Re* and articulated the following factors to be considered in the assessment of the "commonality of interest".

> In summary, the case has established the following principles applicable to assessing commonality of interest:
>
> 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
>
> 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.
>
> 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate reorganizations if possible.
>
> 4. In placing a broad and purposive interpretation on the CCAA, the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
>
> 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
>
> 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.

Stelco Inc., Re (2005), 15 C.B.R. (5th) 307 (Ont. C.A.), paras 21-23; *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), para 31.

63 I have concluded that, at this point in the proceedings, the former employees have a "commonality of interest" and that this process can be best served by the appointment of one representative counsel.

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64 As to which counsel should be appointed, all firms have established their credentials. However, KM is, in my view, the logical choice. They have indicated a willingness to act on behalf of all former employees. The choice of KM is based on the broad mandate they have received from the employees, their experience in representing groups of retirees and employees in large scale restructurings and speciality practice in the areas of pension, benefits, labour and employment, restructuring and insolvency law, as well as my decision that the process can be best served by having one firm put forth the arguments on behalf of all employees as opposed to subdividing the employee group.

65 The motion of Messrs. Sproule, Archibald and Campbell is granted and Koskie Minsky LLP is appointed as Representative Counsel. This representation order is also to cover the fees and disbursements of Koskie Minsky.

66 The motions to appoint Nelligan O'Brien Payne and Shibley Righton, Juroviesky and Ricci, and the CAW as representative counsel are dismissed.

67 I would ask that counsel prepare a form of order for my consideration.

Order accordingly.

FN* Additional reasons at *Nortel Networks Corp., Re* (2009), 2009 CarswellOnt 3530 (Ont. S.C.J. [Commercial List]).

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TAB 17

C

2009 CarswellOnt 6169

Fraser Papers Inc., Re

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

IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO FRASER PAPERS INC., FPS CANADA INC., FRASER PAPERS HOLDINGS INC., FRASER TIMBER LTD., FRASER PAPERS LIMITED and FRASER N.H.LLC (collectively, the "Applicants" or "Fraser Papers")

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Judgment: September 17, 2009
Docket: CV-09-8241-OOCL

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Counsel: M. Barrack, D.J. Miller for Applicants

R. Chadwick, C. Costa for Monitor

D. Wray, J. Kugler for Communications, Energy and Paper Workers Union of Canada

D. Wray, J. Kugler (Agent) for Pink Larkin

C. Sinclair for United Steelworkers

T. McRae, S. Levitt for Steering Committee of Fraser Papers' Salaried Retirees Committee

M.P. Gottlieb, S. Campbell for Committee for Salaried Employees and Retirees

M. Sims for Her Majesty the Queen in Right of the Province of New Brunswick as represented by the Minister of Business of New Brunswick

Chriss Burr for CIT Business Credit Canada Inc.

D. Chernos for Brookfield Asset Management Inc.

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2009 CarswellOnt 6169,

Subject: Insolvency; Civil Practice and Procedure

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

Cases considered by *Pepall J.*:

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

Nortel Networks Corp., Re (2009), 53 C.B.R. (5th) 196, 75 C.C.P.B. 206, 2009 CarswellOnt 3028 (Ont. S.C.J. [Commercial List]) — referred to

Stelco Inc., Re (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — referred to

Statutes considered:

Bankruptcy Code, 11 U.S.C. 1982

Generally — referred to

Chapter 15 — referred to

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

Generally — referred to

s. 11 — referred to

Employee Retirement Income Security Act, 1974, 29 U.S.C.

Generally — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

Generally — referred to

***Pepall J.*:**

Relief Requested

1 There are four motions before me that request the appointment of representatives and representative counsel for various groups of unrepresented current and former employees and other beneficiaries of the pension plans and other retirement and benefit plans of the Applicants ("Fraser Papers"). With the exception of the motion of the United Steel, Paper, Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers Union (the "USW"), all motions include a request that Fraser Papers pay the fees and disbursements of representative counsel.

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2 The motions are brought by the following moving parties:

(a) the USW who seeks to represent its former members. It already represents its current members.

(b) the Communications Energy and Paperworkers Union of Canada (the "CEP") who also seeks to represent its former members. It too already represents its current members.

(c) the Steering Committee of Fraser Papers' Salaried Retirees Committee who request that Nelligan O'Brian Payne LLP and Shibley Righton LLP ("Nelligan/Shibley") be appointed to act for all non-unionized retirees and their successors.

(d) the Committee of Salaried Employees and Retirees who request that Davies Ward Phillips & Vineberg LLP ("Davies") be appointed to act for all unrepresented employees, be they active or retired, and their successors.

3 A third union, the CMAW, did not bring a motion but Mr. Wray, counsel for the CEP, acted as agent for CMAW's counsel, Pink Larkin on these motions. He advised that the CMAW will represent its current members but not its retirees who are approximately 25 in number.[FN1] These retirees therefore would only be encompassed by the Davies proposed retainer.

Discussion

4 The Applicants employ approximately 2,500 personnel. They are located in Canada and the U.S. A substantial majority is unionized. Of the 2,500, 1,729 employees participate in five defined benefit pension plans. In addition, 3,246 retirees receive benefits from these plans. Fraser Papers maintains certain other plans and benefits including supplementary employee retirement programmes ("SERPs").

5 On June 18, 2009, the Applicants obtained an Initial Order pursuant to the provisions of the *CCAA*. On July 13, 2009, the U.S. Bankruptcy Court for the District of Delaware designated these proceedings as foreign main proceedings pursuant to Chapter 15 of the U.S. Bankruptcy Code.

6 Fraser Papers is insolvent and is under significant financial pressure. Absent the DIP financing, a restructuring would be impossible. The Applicants have not generated positive cash flow from operations for three years. Their largest unsecured claims relate to the pension plans and the SERPs. Their accrued pension benefit obligations in these plans and the SERPs exceed the value of the plan assets by approximately USD $171.5 million as at December 31, 2008.

7 Representative counsel should be appointed in this case and I have jurisdiction to do so. Section 11 of the *CCAA* and the Rules of Civil Procedure provide the Court with broad jurisdiction in this regard. No one challenges either of these propositions. The employees and retirees not otherwise represented are a vulnerable group who require assistance in the restructuring process and it is beneficial that representative counsel be appointed. The balance of convenience favours the granting of such an order and it is in the interests of justice to do so. The real issues are who should be appointed and whether Fraser Papers should fund the proposed representation.

(A) USW and CEP Motions

8 Dealing firstly with the motions brought by the unions, the USW is the exclusive bargaining agent for the unionized employees of the Applicants working in Madawaska, Maine and Berlin- Gorham, New Hampshire. Personnel at these facilities participate in a defined benefit pension plan and a defined contribution pension plan. The U.S. law applicable to pension plans is the *Employee Retirement Income Security Act of 1974* ("ERISA")[FN2]. The evi-

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dence filed by the USW suggests that a labour organization that negotiated a pension plan has a role in legal proceedings involving termination of that plan. If voluntary, consent of the union is required and if involuntary, an order of the bankruptcy court under the appropriate provisions of U.S. bankruptcy law is necessary. The USW has extensive experience representing the rights of employees and retirees in these sorts of proceedings. It is also noteworthy that, although the collective agreements between the USW and the Applicants do not provide for retiree health and life insurance benefits, the U.S. Bankruptcy Code provides that a labour organization is deemed to be the authorized representative of retirees, surviving spouses, and dependents receiving benefits pursuant to its collective bargaining agreements, unless the union opts not to serve as the authorized representative or the bankruptcy court determines that different representation is appropriate.

9 In my view, the USW should be appointed as the representative for its former members who are retired subject to a retiree's ability to opt out of such representation should he or she so desire. The union already has a relationship with the USW retirees. It also has the means with which to communicate quickly with its members and former members. It is familiar with the relevant collective agreements and plans and has experience and a presence in both Canada and the U.S. De facto, the USW is already the representative of the USW retirees pursuant to the law in the U.S. Lastly, the Monitor and the Applicants support the USW's request to be appointed as representative counsel for its former members. As mentioned, the USW does not seek funding.

10 Although CEP plays no role in Fraser Papers' U.S. operations, with that exception, for similar reasons and in the interests of consistency, the CEP should be appointed as the representative for its former members who are retirees subject to the aforementioned opt out provision. The Monitor and the Applicants are supportive of this position. Counsel for the CEP indicated that while it is unclear as a matter of law that the union is bound to represent former members in circumstances such as those facing Fraser Papers, the CEP would represent them with or without funding. Given Fraser Papers' insolvency, it seems to me that funding by the Applicants should only be provided for the benefit of those who otherwise would have no legal representation. The request for funding by CEP is refused.

(b) Nelligan/Shibley and Davies

11 Turning to the requests of the Steering Committee of Fraser Papers Salaried Retirees Committee which favours the appointment of Nelligan/Shibley and the Committee for Salaried Employees and Retirees which favours Davies, firstly commonality of interest should be considered. In *Nortel Networks Corp., Re*[FN3], Morawetz J. applied the Court of Appeal's decision in *Stelco Inc., Re*[FN4] and the decision of *Canadian Airlines Corp., Re*[FN5] to enumerate the following principles applicable to an assessment of commonality of interest:

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

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

3. The commonality of interests are to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate reorganizations if possible.

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

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

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

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12 Once commonality of interest has been established, other factors to be considered in the selection of representative counsel include: the proposed breadth of representation; evidence of a mandate to act; legal expertise; jurisdiction of practice; the need for facility in both official languages; and estimated costs.

13 Davies is proposing to represent all unrepresented employees, former employees and their successors. In my view, there is a commonality of interest amongst the members of this group. In essence, they engage unsecured obligations. Arguably those proposed to be represented by the unions could also be included, and indeed absent a change of position by the CMAW, former members of the CMAW will be. That said, for the reasons outlined above, I am satisfied in this case that it is desirable to have the unions act for their members and former members if so willing. Indeed, no one took an opposing position.

14 I am not persuaded that there is a need for separate representation as advocated by the Committee supporting the Nelligan/Shibley retainer. Appointing only Davies avoids excessive fragmentation and duplication and minimizes costs. In addition, no one will be excluded unless he or she so desires. Davies is also the only counsel whose retainer would extend to the CMAW retirees.

15 Davies has already received a broad mandate in that it has close to 700 retainers from employees in each facet of Fraser Papers' operations and from all current and former employee groups. It has the necessary legal expertise and has offices in Toronto, Montreal and New York. It also has the necessary language capability.

16 In contrast, Nelligan/Shibley is only proposing to represent retirees. It has a mandate of approximately 211 retirees. Clearly it has the requisite legal and language expertise but does not have the benefit associated with having offices in as many relevant jurisdictions. One may reasonably conclude from the evidence before me that the proposed fee structure would be less than that advanced by Davies although the scope of the retainer is more limited. Davies' appointment is not diminished because initially they were identified by the Applicants as appropriate counsel unlike Nelligan/Shibley whose group grew organically to use its counsel's terminology. Nor am I persuaded that Davies will be enfeebled as a result of the composition of the Steering Committee or due to past unrelated retainers by Brookfield Asset Management Inc. The Monitor supports the appointment of Davies as do the Applicants and the DIP lenders.

17 In the event that a real as opposed to a hypothetical or speculative conflict arises at some point in the future, parties may seek directions from the Court. As with the unions, the order appointing Davies will allow anyone to opt out of the representation.

18 Unlike the unions, absent funding, Davies would not be expected to serve as representative counsel. Accordingly, funding is ordered to be provided by Fraser Papers. Again, the funding request is supported by the Monitor, the Applicants and the DIP lenders.

19 The objective of my order is to help those who are otherwise unrepresented but to do so in an efficient and cost effective manner and without imposing an undue burden on insolvent entities struggling to restructure. It seems to me that in the future, parties should make every effort to keep the costs associated with contested representation motions in insolvency proceedings to a minimum. In addition, as I indicated in open court, while a successful moving party may expect to recover a good portion of the legal fees associated with such a motion, there is an element of business development involved in these motions which in my view is a cost of doing business and should not be visited upon the insolvent Applicants. I will leave it to the Monitor to address what an appropriate reduction would be and this no doubt will be addressed very briefly in a subsequent Monitor's report.

Summary

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20 In summary, the USW, CEP and Davies representation requests are granted. Only the Davies funding request is granted. The motion relating to Nelligan/ Shibley is dismissed. Counsel submitted proposed orders without prejudice to the Applicants to make submissions. Counsel should confer on the appropriate form of orders and then a representative may attend before me at a 9:30 appointment to have them approved and signed.

FN1 This is contrary to the contents of paragraph 24 of the Monitor's 4th Report but, being more recent, I accept counsel's oral representation as being accurate.

FN2 29 U.S.C.

FN3 (Ont. S.C.J. [Commercial List]).

FN4 (2005), 15 C.B.R. (5th) 307 (Ont. C.A.)

FN5 (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.).

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TAB 18

C

2010 CarswellOnt 1344, 2010 ONSC 1328, 65 C.B.R. (5th) 152

Canwest Publishing Inc./Publications Canwest Inc., Re

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

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

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Judgment: March 5, 2010
Docket: CV-10-8533-00CL

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Counsel: Lyndon Barnes, Alex Cobb for Canwest LP Entities

Maria Konyukhova for Monitor, FTI Consulting Canada Inc.

Hilary Clarke for Bank of Nova Scotia, Administrative Agent for Senior Secured Lenders' Syndicate

Janice Payne, Thomas McRae for Canwest Salaried Employees and Retirees (CSER) Group

M.A. Church for Communications, Energy and Paperworkers' Union

Anthony F. Dale for CAW-Canada

Deborah McPhail for Financial Services Commission of Ontario

Subject: Insolvency; Civil Practice and Procedure

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

In January 2010 LP Entities obtained order pursuant to Companies' Creditors Arrangement Act staying all proceedings and claims against them — Order permitted, but did not require, payments to employees and pension plans — There were approximately 45 non-unionized employees who were still owed termination and severance payments,

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as well as accrual of pensionable service — There were further nine employees who were, or would be, entitled pursuant to executive pension plan to pension benefits in excess of those under main pension plan — Moving parties sought order permitting them to represent those employees, for appointment of counsel, and for funding of counsel — Respondents did not object to appointment representatives or counsel, but opposed funding of counsel — Motion granted — All four proposed representatives had claims against LP Entities that were representative of claims that would be advanced by former employees — Individuals at issue were unsecured creditors whose recovery expectations might be non-existent, however they found themselves facing legal proceedings of significant complexity — Evidence was that members of group had little means to pursue representation and were unable to afford proper legal representation at this time — Employees were vulnerable group and there was no other counsel available to represent their interests — Canadian courts did not typically appoint unsecured creditors committees — It would be of considerable benefit to have representatives and representative counsel who could represent interests of salaried employees and retirees — There were three possible sources of funding: LP Entities, Monitors, or senior secured lenders — Court had power to compel senior secured lenders to fund or alternatively to compel LP Administrative Agent to consent to funding — Source of funding other than salaried employees themselves should be identified now — Funding would be prospective in nature and would not extend to investigation of or claims against directors — Counsel were directed to communicate with one another to ascertain how best to structure funding and report back to court by certain date.

Statutes considered:

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

Generally — referred to

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)

Generally — referred to

MOTION by group of employees for funding for appointment of representatives, appointment of counsel, and funding of counsel.

***Pepall J.*:**

Reasons for Decision

Relief Requested

1 Russell Mills, Blair MacKenzie, Rejean Saumure and Les Bale (the "Representatives") seek to be appointed as representatives on behalf of former salaried employees and retirees of Canwest Publishing Inc./Publications Canwest Inc., Canwest Books Inc., Canwest (Canada) and Canwest Limited Partnership and the Canwest Global Canadian Newspaper Entities (collectively the "LP Entities") or any person claiming an interest under or on behalf of such salaried employees or retirees including beneficiaries and surviving spouses ("the Salaried Employees and Retirees"). They also seek an order that Nelligan O'Brien Payne LLP and Shibley Righton LLP be appointed in these proceedings to represent the Salaried Employees and Retirees for all matters relating to claims against the LP Entities and any issues affecting them in the proceedings. Amongst other things, it is proposed that all reasonable legal, actuarial and financial expert and advisory fees be paid by the LP Entities.

2 On February 22, 2010, I granted an order on consent of the LP Entities authorizing the Communications, Energy and Paperworker's Union of Canada ("CEP") to continue to represent its current members and to represent former members of bargaining units represented by the union including pensioners, retirees, deferred vested partici-

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pants and surviving spouses and dependants employed or formerly employed by the LP Entities. That order only extended to unionized members or former members. The within motion focused on non-unionized former employees and retirees although Ms. Payne for the moving parties indicated that the moving parties would be content to include other non-unionized employees as well. There is no overlap between the order granted to CEP and the order requested by the Salaried Employees and Retirees.

Facts

3 On January 8, 2010 the LP Entities obtained an order pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") staying all proceedings and claims against the LP Entities. The order permits but does not require the LP Entities to make payments to employee and retirement benefit plans.

4 There are approximately 66 employees, 45 of whom were non-unionized, whose employment with the LP Entities terminated prior to the Initial Order but who were still owed termination and severance payments. As of the date of the Initial Order, the LP Entities ceased making those payments to those former employees. As many of these former employees were owed termination payments as part of a salary continuance scheme whereby they would continue to accrue pensionable service during a notice period, after the Initial Order, those former employees stopped accruing pensionable service. The Representatives seek an order authorizing them to act for the 45 individuals and for the aforementioned law firms to be appointed as representative counsel.

5 Additionally, seven retirees and two current employees are (or would be) eligible for a pension benefit from Southam Executive Retirement Arrangements ("SERA"). SERA is a non-registered pension plan used to provide supplemental pension benefits to former executives of the LP Entities and their predecessors. These benefits are in excess of those earned under the Canwest Southam Publications Inc. Retirement Plan which benefits are capped as a result of certain provisions of the *Income Tax Act*. As of the date of the Initial Order, the SERA payments ceased also. This impacts beneficiaries and spouses who are eligible for a joint survivorship option. The aggregate benefit obligation related to SERA is approximately $14.4 million. The Representatives also seek to act for these seven retirees and for the aforementioned law firms to be appointed as representative counsel.

6 Since January 8, 2010, the LP Entities have being pursuing the sale and investor solicitation process ("SISP") contemplated by the Initial Order. Throughout the course of the CCAA proceedings, the LP Entities have continued to pay:

(a) salaries, commissions, bonuses and outstanding employee expenses;

(b) current services and special payments in respect of the active registered pension plan; and

(c) post-employment and post-retirement benefits to former employees who were represented by a union when they were employed by the LP Entities.

7 The LP Entities intend to continue to pay these employee related obligations throughout the course of the CCAA proceedings. Pursuant to the Support Agreement with the LP Secured Lenders, AcquireCo. will assume all of the employee related obligations including existing pension plans (other than supplemental pension plans such as SERA), existing post-retirement and post-employment benefit plans and unpaid severance obligations stayed during the CCAA proceeding. This assumption by AcquireCo. is subject to the LP Secured Lenders' right, acting commercially reasonably and after consultation with the operational management of the LP Entities, to exclude certain specified liabilities.

8 All four proposed Representatives have claims against the LP Entities that are representative of the claims that would be advanced by former employees, namely pension benefits and compensation for involuntary terminations.

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In addition to the claims against the LP Entities, the proposed Representatives may have claims against the directors of the LP Entities that are currently impacted by the CCAA proceedings.

9 No issue is taken with the proposed Representatives nor with the experience and competence of the proposed law firms, namely Nelligan O'Brien Payne LLP and Shibley Righton LLP, both of whom have jointly acted as court appointed representatives for continuing employees in the Nortel Networks Limited case.

10 Funding by the LP Entities in respect of the representation requested would violate the Support Agreement dated January 8, 2010 between the LP Entities and the LP Administrative Agent. Specifically, section 5.1(j) of the Support Agreement states:

> The LP Entities shall not pay any of the legal, financial or other advisors to any other Person, except as expressly contemplated by the Initial Order or with the consent in writing from the Administrative Agent acting in consultation with the Steering Committee.

11 The LP Administrative Agent does not consent to the funding request at this time.

12 On October 6, 2009, the CMI Entities applied for protection pursuant to the provisions of the CCAA. In that restructuring, the CMI Entities themselves moved to appoint and fund a law firm as representative counsel for former employees and retirees. That order was granted.

13 Counsel were urged by me to ascertain whether there was any possibility of resolving this issue. Some time was spent attempting to do so, however, I was subsequently advised that those efforts were unsuccessful.

Issues

14 The issues on this motion are as follows:

(1) Should the Representatives be appointed?

(2) Should Nelligan O'Brien Payne LLP and Shibley Righton LLP be appointed as representative counsel?

(3) If so, should the request for funding be granted?

Positions of Parties

15 In brief, the moving parties submit that representative counsel should be appointed where vulnerable creditors have little means to pursue a claim in a complex CCAA proceeding; there is a social benefit to be derived from assisting vulnerable creditors; and a benefit would be provided to the overall CCAA process by introducing efficiency for all parties involved. The moving parties submit that all of these principles have been met in this case.

16 The LP Entities oppose the relief requested on the grounds that it is premature. The amounts outstanding to the representative group are prefiling unsecured obligations. Unless a superior offer is received in the SISP that is currently underway, the LP Entities will implement a support transaction with the LP Secured Lenders that does not contemplate any recoveries for unsecured creditors. As such, there is no current need to carry out a claims process. Although a superior offer may materialize in the SISP, the outcome of the SISP is currently unknown.

17 Furthermore, the LP Entities oppose the funding request. The fees will deplete the resources of the Estate without any possible corresponding benefit and the Support Agreement with the LP Secured Lenders does not au-

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thorize any such payment.

18 The LP Senior Lenders support the position of the LP Entities.

19 In its third report, the Monitor noted that pursuant to the Support Agreement, the LP Entities are not permitted to pay any of the legal, financial or other advisors absent consent in writing from the LP Administrative Agent which has not been forthcoming. Accordingly, funding of the fees requested would be in contravention of the Support Agreement with the LP Secured Lenders. For those reasons, the Monitor supported the LP Entities refusal to fund.

Discussion

20 No one challenged the court's jurisdiction to make a representation order and such orders have been granted in large CCAA proceedings. Examples include Nortel Networks Corp., Fraser Papers Inc., and Canwest Global Communications Corp. (with respect to the television side of the enterprise). Indeed, a human resources manager at the Ottawa Citizen advised one of the Representatives, Mr. Saumure, that as part of the CCAA process, it was normal practice for the court to appoint a law firm to represent former employees as a group.

21 Factors that have been considered by courts in granting these orders include:

- the vulnerability and resources of the group sought to be represented;
- any benefit to the companies under CCAA protection;
- any social benefit to be derived from representation of the group;
- the facilitation of the administration of the proceedings and efficiency;
- the avoidance of a multiplicity of legal retainers;
- the balance of convenience and whether it is fair and just including to the creditors of the Estate;
- whether representative counsel has already been appointed for those who have similar interests to the group seeking representation and who is also prepared to act for the group seeking the order; and
- the position of other stakeholders and the Monitor.

22 The evidence before me consists of affidavits from three of the four proposed Representatives and a partner with the Nelligan O'Brien Payne LLP law firm, the Monitor's Third Report, and a compendium containing an affidavit of an investment manager for noteholders filed on an earlier occasion in these CCAA proceedings. This evidence addresses most of the aforementioned factors.

23 The primary objection to the relief requested is prematurity. This is reflected in correspondence sent by counsel for the LP Entities to counsel for the Senior Lenders' Administrative Agent. Those opposing the relief requested submit that the moving parties can keep an eye on the Monitor's website and depend on notice to be given by the Monitor in the event that unsecured creditors have any entitlement. Counsel for the LP Entities submitted that counsel for the proposed representatives should reapply to court at the appropriate time and that I should dismiss the motion without prejudice to the moving parties to bring it back on.

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24 In my view, this watch and wait suggestion is unhelpful to the needs of the Salaried Employees and Retirees and to the interests of the Applicants. I accept that the individuals in issue may be unsecured creditors whose recovery expectation may prove to be non-existent and that ultimately there may be no claims process for them. I also accept that some of them were in the executive ranks of the LP Entities and continue to benefit from payment of some pension benefits. That said, these are all individuals who find themselves in uncertain times facing legal proceedings of significant complexity. The evidence is also to the effect that members of the group have little means to pursue representation and are unable to afford proper legal representation at this time. The Monitor already has very extensive responsibilities as reflected in paragraph 30 and following of the Initial Order and the CCAA itself and it is unrealistic to expect that it can be fully responsive to the needs and demands of all of these many individuals and do so in an efficient and timely manner. Desirably in my view, Canadian courts have not typically appointed an Unsecured Creditors Committee to address the needs of unsecured creditors in large restructurings. It would be of considerable benefit to both the Applicants and the Salaried Employees and Retirees to have Representatives and representative counsel who could interact with the Applicants and represent the interests of the Salaried Employees and Retirees. In that regard, I accept their evidence that they are a vulnerable group and there is no other counsel available to represent their interests. Furthermore, a multiplicity of legal retainers is to be discouraged. In my view, it is a false economy to watch and wait. Indeed the time taken by counsel preparing for and arguing this motion is just one such example. The appointment of the Representatives and representative counsel would facilitate the administration of the proceedings and information flow and provide for efficiency.

25 The second basis for objection is that the LP Entities are not permitted to pay any of the legal, financial or other advisors to any other person except as expressly contemplated by the Initial Order or with consent in writing from the LP Administrative Agent acting in consultation with the Steering Committee. Funding by the LP Entities would be in contravention of the Support Agreement entered into by the LP Entities and the LP Senior Secured Lenders. It was for this reason that the Monitor stated in its Report that it supported the LP Entities' refusal to fund.

26 I accept the evidence before me on the inability of the Salaried Employees and Retirees to afford legal counsel at this time. There are in these circumstances three possible sources of funding: the LP Entities; the Monitor pursuant to paragraph 31 (i) of the Initial Order although quere whether this is in keeping with the intention underlying that provision; or the LP Senior Secured Lenders. It seems to me that having exercised the degree of control that they have, it is certainly arguable that relying on inherent jurisdiction, the court has the power to compel the Senior Secured Lenders to fund or alternatively compel the LP Administrative Agent to consent to funding. By executing agreements such as the Support Agreement, parties cannot oust the jurisdiction of the court.

27 In my view, a source of funding other than the Salaried Employees and Retirees themselves should be identified now. In the CMI Entities' CCAA proceeding, funding was made available for Representative Counsel although I acknowledge that the circumstances here are somewhat different. Staged payments commencing with the sum of $25,000 may be more appropriate. Funding would be prospective in nature and would not extend to investigation of or claims against directors.

28 Counsel are to communicate with one another to ascertain how best to structure the funding and report to me if necessary at a 9:30 appointment on March 22, 2010. If everything is resolved, only the Monitor need report at that time and may do so by e-mail. If not resolved, I propose to make the structuring order on March 22, 2010 on a nunc pro tunc basis. Ottawa counsel may participate by telephone but should alert the Commercial List Office of their proposed mode of participation.

Motion granted.

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TAB 19

2009 CarswellOnt 9398

Canwest Global Communications Corp., Re

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

In the Matter of a Proposed Plan of Compromise or Arrangement of Canwest Global Communications Corp. and the Other Applicants listed on Schedule "A"

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Judgment: October 27, 2009
Docket: CV-09-8396-00CL

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Counsel: Lyndon Barnes, Shawn Irving, for Applicants

Alan Merskey, for Special Committee of the Board of Directors

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

Benjamin Zarnett, for Ad Hoc Committee of Noteholders

Hilary Clarke, for Bank of Nova Scotia

Steve Weisz, for CIT Business Credit Canada Inc.

Hugh O'Reilly, Amanda Darrach, for CHCH Retirees

Douglas Wray, Jesse Kugler, for Communications, Energy and Paperworkers Union of Canada

Deborah McPhail, for FSCO

Subject: Civil Practice and Procedure; Insolvency

Bankruptcy and insolvency --- Practice and procedure in courts — Miscellaneous.

Statutes considered:

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

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s. 11 — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 10 — referred to

***Pepall J.*:**

Relief Requested

1 The CMI Entities seek an order appointing David Cremasco, Rose Stricker and Lawrence Schnurr as representatives of certain retirees ("Retirees"). The Retirees are all former employees of the CMI Entities (or their predecessors) or their surviving spouses who receive or are entitled to receive a pension from a pension plan sponsored by a CMI Entity or who, prior to October 6, 2009, were entitled to receive non-pension benefits from a CMI Entity. The proposed order would encompass former members of the Communications, Energy and Paper-workers Union of Canada ("CEP") who arc entitled to benefits under the Global Communications Limited Retirement Plan for CH Employees (the "CH Employees Plan") but not otherwise. They are referred to as the CH Employees. Put differently, the proposed representatives do not plan to represent former unionized employees (or their surviving spouses) who were represented by CEP when they were active employees other than those who were entitled to benefits under the CH Employees Plan, namely the CH Employees. The CMI Entities also request an order appointing the law firm of Cavalluzzo Hayes Shilton McIntyre & Cornish LLP as representative counsel for the Retirees. It is proposed that the CMI Entities provide funding for this representation.

2 The CEP seeks an order appointing it and the law firm of CaleyWray to represent current and former members of the CEP who are employed or who were formerly employed by the CMI Entities[FN1] but not including the aforementioned CH Employees. It also requests funding by the CMI Entities and a charge over their property for this representation. It further requests that the claims bar date established in my order of October 14,2009 be extended from November 19, 2009.

Brief Outline of Facts

3 Since the date of the Initial Order, the CMI Entities have paid and intend to continue to pay:

(a) salaries, commissions, bonuses and outstanding employee expenses;

(b) current service and special payments with respect to the active defined benefit pension plans; and

(c) post-employment and post-retirement benefit payments to former employees who were represented by a union when they were employed by the CMI Entities.

4 That said, certain former employees are affected by the CMI Entities' discontinuance or proposed discontinuance of employee related obligations and it is intended that they be assisted by the granting of the order requested by the CMI Entities. Approximately 81 former non-unionized employees have been advised that the CMI Entities propose to cease making all post-employment and post-retirement benefit payments in relation to claims incurred after November 13,2009. There are also 2 out of IS beneficiaries of the Canwest Global Communications Corp. and Related Companies Retirement Compensation Arrangement Plan who will not have received the entire present value of

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their entitlement under that plan.

5 In addition, the CMI Entities purported to terminate the CH Employees Plan when they sold CHCH TV effective August 31, 2009. 120 former employees or spouses received a pension or were entitled to receive a deferred vested pension under this plan. OSFI has directed CMI to prepare without delay a valuation report for the CH Employees Plan effective as of December 31, 2008 to establish additional amounts to accrue from January 1, 2009 which may need to be funded through special payments. The CMI Entities anticipate that the valuation will identify an unfunded liability. Currently, special payments are not contemplated in the cash flow projections for that unfunded liability and a shortfall is anticipated to exist on the filing of the termination report for the plan.

6 Some former employees of CHCH TV have established a committee representing union and non-unionized former employees. Committee members include the proposed representatives. Rose Stricker is a non-unionized deferred vested member of the CH Plan. David Cremasco is a formerly unionized retiree with entitlement to post-retirement benefits and Lawrence Schnurr is a formerly salaried employee with entitlement to post-retirement benefits. If appointed, they will seek to form a broader committee with a member from each of the major population centres in which the Retirees reside and with at least one additional formerly unionized member.

7 Cavalluzzo LLP acts for about 100 retired participants in the CH Employees Plan, 30 to 40 of whom were not previously represented by a union and 60 to 70 of whom were. Other than those 100, most other Retirees are not represented by counsel in this CCAA proceeding.

8 The CMI Entities request that Cavalluzzo LLP be appointed as representative counsel to assist the Retirees.

9 CEP represents 1000 bargaining unit employees employed by the Applicants. It intends to facilitate and advance the claims of both its current members and its former members (but not including the CH Employees). CEP states that as a result of the current economic crisis, it has had to incur significant costs in representing its current and former members in CCAA proceedings. This is particularly so given the union's strong presence in the forestry and media industries and the degree to which they have been impacted by the state of the economy. CEP states mat the costs have been substantial and have adversely affected its financial position. CEP states that its ability to provide effective representation in these proceedings is dependent on receipt of funding. In the past 6 months, CEP has spent about $250,000 on legal costs in connection with different CCAA proceedings. Furthermore, former members do not pay union dues and their representation, although part of the union's internal mandate, creates costs that are outside CEP's cost structure. In addition, over the past 12 months, CEP has lost approximately 12,000 members due to economic conditions. This obviously has a negative impact on union revenues. Faced with these conditions, CEP seeks funding.

10 CEP requests that CaleyWray be appointed as representative counsel. It also requests a charge or security over the property of the CMI Entities to cover the costs of CEP and its counsel although it did not press this point on learning that no such charge is proposed for the Cavaluzzo representation order.

11 Lastly, CEP requests that the claims bar date be extended to provide it with additional time to identify, value and process claims.

Issues

12 The issues to consider are:

(a) Should the representatives and Cavalluzzo LLP be appointed to represent the interests of the Retirees and should Cavalluzzo LLP be provided with funding for such representation?

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(b) Should CEP and Caley Wray be appointed on behalf of CEP's current and former members (not including the CH Employees) and provided with funding and a charge over the property of the CMI Entities for such representation?

(c) Should the claims bar date be extended as requested by CEP?

Discussion

(a) Cavalluzzo LLP

13 No one opposes the motion of the CMI Entities. The Monitor and the Ad Hoc Committee of 8% Noteholders support the request and others are unopposed to the relief requested. CIT has agreed to a variation of the cash flow in this regard as well.

14 Dealing firstly with the representation component of the order, in my view, the order requested should be granted. I have jurisdiction under Rule 10 of the Rules of Civil Procedure and section 11 of the CCAA. The balance of convenience favours the granting of the order and it is in the interests of justice to do so. The Retirees are a particularly vulnerable group and without professional and legal resources, they are likely at risk of being unable to understand and protect their interests in the restructuring. Clearly there is a social benefit associated with them being represented. The appointment of a single representative counsel will facilitate the administration of the proceedings and provide for efficiency. Cavalluzzo LLP is experienced in this area, has a considerable reputation, and is fully qualified to act.

15 As for funding, the CMI Entities propose that, subject to fee arrangements agreed to by the CMI Entities and Cavalluzzo LLP, reasonable legal, actuarial and financial expert and advisory fees and other incidental fees and disbursements be paid by the CMI Entities on a monthly basis. Funding for such representation should be provided by the CMI Entities. I am satisfied that the moving parties have established that such an order is beneficial. I accept the evidence before me to the effect that most individual Retirees likely do not have the means to obtain actuarial and/or benefit experts and would benefit from the assistance offered by representative counsel and its pension expert. Absent such an order, there would likely be a multiplicity of lawyers acting for various Retirees, stress and inconvenience for those who could ill afford such representation, no representation for some, and the disorganization and inefficiency associated with multiple representation of substantially similar interests. A single counsel diminishes the likelihood of "overlawyering" and funding of such representation is a recognition of that desirable objective. It is fair and just to grant such an order.

(b) CEP and CaleyWray

16 CEP requests a separate representation order for all current and former CEP members other than the CH Employees and an order that CaleyWray be appointed as representative counsel funded by the CMI Entities.

17 Again, there is no issue that CaleyWray is experienced and well equipped to act for these individuals. Similarly, the union may appropriately represent its members and former members.

18 CEP intends to facilitate and advance the interests of both its members and former members. It is of the view mat it has no conflict of interest as all of the aforementioned may ultimately have unsecured claims. It clearly already represents its current members and plans to represent its former members. In that sense, they are not vulnerable. I do not see the need for a representation order particularly with respect to current members. To the extent, if any, that it is necessary to do so, and given that no one opposes the request, it and CaleyWray are authorized to represent CEP's current and former members (but not including the CH Employees).

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19 As for funding, as I indicated in the *Fraser Papers* case, it should only be provided for the benefit of those former employees who otherwise would have no legal representation. Here, CEP intends to represent its current and former members (except for the CH Employees). But for this desire and subject to the agreement of Cavalluzzo LLP to act, there is no principled reason for separate representation. It arises by choice not out of necessity. Furthermore, this is an insolvency. Absent a clear and compelling reason such as the existence of an obvious conflict of interest, the general rule should be that funding by applicant debtors should only be available for one representative counsel. Even if one disagrees with that proposition, in this case, the CMI Entities have paid and intend to continue to pay, amongst other things, salaries, current service and special payments with respect to the defined benefit pension plans and post-employment and post-retirement benefit payments. Based on the materials before me, there are approximately 9 CEP members who were recently terminated and who have been advised that they will no longer receive salary continuance. In essence, the evidentiary support that might merit a funding request is absent. As noted in the factum of the CMI Entities, if they should change their position with respect to employee related obligations, the need for funding could be addressed at that time. I am also not persuaded that funding should be granted to pay for CEP's costs for outstanding grievances. No one else including the Monitor supports the requested order and I do not believe that it should be granted.

20 As mentioned, no charge is being requested or granted with respect to the Cavalluzzo representation order and none should be given here. In addition, the Term Sheet as described in the materials restricts the granting of a charge absent the agreement of others including the Ad Hoc Committee.

(c) Claims Bar Extension

21 The last issue to consider is whether the claims bar date contained in my order of October 14, 2009, should be extended as requested by CEP. Based on the evidence before me, I am not persuaded that such an extension is necessary at this time.

Conclusion

22 In conclusion, the CMI Entities' motion is granted except that the third and last sentences of paragraph 2 are to be subject to any further or other order. The CEP motion is dismissed although authorization to represent current and former members (excluding the CH Employees) is granted.

***Pepall J.*:**

On a last unrelated issue, I would like counsel to give some thought to the following suggestion. For future time sensitive motions brought by the CMI Entities, it would be helpful in situations where interested parties do not have time to file a factum if, before the return date, those opposing filed with the court a 1 to 2 page memo *(maximum)* outlining their respective positions. Interested parties are not obliged to do so but the court would consider this to be of assistance.

FN1 In its materials, CEP uses the term "Applicants" but for consistency, I have used the term "CMI Entities".

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TAB 20

C

2008 CarswellOnt 6105, 48 C.B.R. (5th) 41, 44 E.T.R. (3d) 31, 171 A.C.W.S. (3d) 21

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re

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

IN THE MATTER OF A PLAN OF ARRANGEMENT OF THE CANADIAN RED CROSS SOCIETY/LA SOCIETE CANADIENNE DE LA CROIX ROUGE

THE CANADIAN RED CROSS SOCIETY/LA SOCIETE CANADIENNE DE LA CROIX ROUGE

Ontario Superior Court of Justice

Cullity J.

Heard: September 3, 2008
Judgment: September 29, 2008
Docket: 98-CL-002970

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Counsel: Risa Kirshblum for Trustee under the Plan of Arrangement

Harvey T. Strosberg QC, Heather Rumble Peterson, Dawna Ring Q.C., Peter I. Waldmann, Thomas Sheppard, Kenneth Arenson, John Plater for Claimants under the Plan of Arrangement

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

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

Jurisdiction — Pursuant to amended plan of compromise and agreement approved under Companies' Creditors Arrangement Act, trust was established for purpose of holding, administering and distributing fund in satisfaction of claims of persons infected with HIV virus who received blood products supplied by Canadian Red Cross Society prior to 1998 — No distributions from HIV trust were made — Trustee brought motion for advice and directions with respect to jurisdiction of court to relieve against late-filed or otherwise irregular applications for determination of damages by referee appointed in plan — Motion granted — Court has discretionary jurisdiction consistent with case law which is to be exercised sparingly in light of particular circumstances — Considerations that justified exercise of jurisdiction included structure of plan with its provisions of separate fund for HIV claimants and fact that no distributions from that fund were made — No prejudice would be suffered by society and other claimants, limitations issues created uncertainty, and circumstances of claimants distinguished them from commercial creditors — Adequate notice to claimants was essential for plan to be effective and application forms provided to claimants did not clearly indicate that they were required to identify each claimant in family group that included infected person

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— Selection of appropriate methods of disseminating notice of deadline for applications may have been affected and unduly limited by misapprehension about number of potential claimants — Approach that most appropriately engaged jurisdiction of court and powers of trustee was for trustee to receive and dispose of late and irregular applications in accordance with guidelines provided in appendix to reasons.

Cases considered by *Cullity J.*:

Algoma Steel Corp. v. Royal Bank (1992), 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303, 11 C.B.R. (3d) 11, 1992 CarswellOnt 163 (Ont. C.A.) — referred to

Blue Range Resource Corp., Re (2000), 2000 ABCA 285, 2000 CarswellAlta 1145, [2001] 2 W.W.R. 477, (sub nom. *Enron Canada Corp. v. National-Oilwell Canada Ltd.*) 193 D.L.R. (4th) 314, 271 A.R. 138, 234 W.A.C. 138, 87 Alta. L.R. (3d) 352 (Alta. C.A.) — followed

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (2005), 19 E.T.R. (3d) 189, 2005 CarswellOnt 4773 (Ont. S.C.J.) — referred to

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (2006), 2006 CarswellOnt 4004, 23 C.B.R. (5th) 143, 25 E.T.R. (3d) 128, [2007] 1 C.T.C. 27 (Ont. S.C.J.) — referred to

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (2008), 2008 CarswellOnt 3075, 40 E.T.R. (3d) 256 (Ont. S.C.J.) — referred to

Carlen Transport Inc. v. Juniper Lumber Co. (Monitor of) (2001), 21 C.B.R. (4th) 222, (sub nom. *Juniper Lumber Co., Re*) 233 N.B.R. (2d) 111, (sub nom. *Juniper Lumber Co., Re*) 601 A.P.R. 111, 2001 CarswellNB 21 (N.B. Q.B.) — referred to

Ivorylane Corp. v. Country Style Realty Ltd. (2004), 2004 CarswellOnt 2567 (Ont. S.C.J. [Commercial List]) — considered

McCarthy v. Canadian Red Cross Society (2001), 8 C.P.C. (5th) 350, 2001 CarswellOnt 2255, [2001] O.T.C. 470 (Ont. S.C.J.) — referred to

Noma Co., Re (2004), 2004 CarswellOnt 5033 (Ont. S.C.J. [Commercial List]) — considered

Ontario v. Canadian Airlines Corp. (2000), 2000 CarswellAlta 1336, (sub nom. *Canadian Airlines Corp., Re*) 276 A.R. 273 (Alta. Q.B.) — referred to

Pangeo Pharma inc., Re (2004), 2004 CarswellQue 292 (Que. S.C.) — referred to

Roman Catholic Episcopal Corp. of St. George's, Re (2007), 2007 CarswellNfld 198, 2007 NLTD 20, 801 A.P.R. 309, 264 Nfld. & P.E.I.R. 309, 32 C.B.R. (5th) 302 (N.L. T.D.) — referred to

West Bay SonShip Yachts Ltd., Re (2007), 37 C.B.R. (5th) 253, 2007 BCSC 1553, 2007 CarswellBC 2518 (B.C. S.C. [In Chambers]) — referred to

West Bay SonShip Yachts Ltd., Re (2007), 60 C.C.E.L. (3d) 21, 35 C.B.R. (5th) 104, 2007 CarswellBC 1868, 2007 BCCA 419 (B.C. C.A. [In Chambers]) — referred to

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Statutes considered:

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

Generally — referred to

Class Proceedings Act, 1992, S.O. 1992, c. 6

ss. 17-19 — referred to

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

Generally — referred to

Trustee Act, R.S.O. 1990, c. T.23

s. 60(2) — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 9.01 — referred to

R. 10 — referred to

MOTION by trustee for advice and directions with respect to jurisdiction of court to relieve against late-filed or otherwise irregular applications for determination of damages by referee.

***Cullity J.*:**

1 The issues in this motion for advice and directions were previously raised in a motion heard on May 22 and 23 of this year. In my reasons, and in an endorsement, released on May 28, 2008, consideration of the issues was deferred pending the delivery of further material by the parties.

2 The advice now requested relates to the jurisdiction of the court to relieve against late-filed, or otherwise irregular, applications for a determination of damages by the Referee appointed in the Amended Plan of Compromise and Arrangement (the "Plan") of the Canadian Red Cross Society (the "Society"). The Plan was approved by an order (the "Approval Order") of this court dated September 14, 2000 under the *Companies' Creditors Arrangement Act* (Canada) ("CCAA").

Background

3 Pursuant to the Plan, a Trust was established for the purpose of holding, administering and distributing a fund ("HIV Fund") in satisfaction of the claims of persons ("HIV Claimants") who were infected with the HIV virus from receiving blood, blood derivatives or blood products collected or supplied by the Society prior to September 28, 1998. Funds were also established to be administered by the Trustee for persons who contracted Creutzfeld-Jacob Disease and Hepatitis C. I will refer to the trusts attaching to the HIV Fund and the Hepatitis C Fund as the "HIV

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Trust" the "HCV Trust" respectively.

4 A Trust Agreement that sets out the powers and responsibilities of the Trustee was made as of September 24, 2001 with the Honourable Peter Cory as sole Trustee. On June 26, 2006, following Mr Cory's resignation, the Honourable John W. Morden was appointed by an order of Blair J. to replace him. Payments from the HIV Fund are to be made in accordance with damages assessments by a Referee — the Honourable Robert S. Montgomery, Q.C. — appointed pursuant to the provisions of the Plan.

5 The HIV Trust has been bedevilled by problems and litigation since its inception, with the result that no distributions from the Trust have been made in the eight years since the Plan was approved. Several motions have been decided by the court. The most substantial of these raised limitations issues that could have a significant effect on the size of the class of HIV Claimants. This has been a matter of concern not only to those whose claims might be barred, but also to other Claimants whose entitlement would be reduced if the total damages awarded exceed the amount of the HIV Fund — an amount that was originally approximately $14 million but will have since been eroded by administration expenses and the costs of the litigation. It will undoubtedly be depleted further if the disputes continue.

6 Independently of the limitations issues, it appears that the number of potential HIV Claimants was underestimated by at least some of the creditors involved in negotiating, and voting for, the relevant provisions of the Plan — including the amount of the HIV Fund. These creditors had filed Proofs of Claim within time limits imposed by the court. Those who did not do so were barred from voting on the Plan but their claims against the Society were not thereby extinguished. Pursuant to paragraph 5.13 (b) of the Plan, this occurred on the Plan Implementation Date (October 5, 2001), when the rights of such Claimants against the Society were, in effect, converted into, or replaced by, rights to receive damages from the HIV Fund.

7 The same concern about the number of HIV Claimants who may be entitled to share in the HIV Fund was reflected in the submissions of counsel in this motion. Each of them supported the existence of the jurisdiction to relieve against what were described as irregularities in applications, but they were not unanimous on the extent, if any, to which it extended beyond such cases. In Mr Strosberg's submission all of the other late-filed applications should be disallowed. It is tragic that a plan designed to provide compensation for innocent victims should be tied up in disputes over whether all, or only some of them, are to receive it — disputes that many and, perhaps, most of the eligible HIV Claimants must find mystifying, and disheartening. Much of the impetus for the litigation has stemmed from an initial misapprehension that the number of the potential Claimants was significantly less than has since appeared to be the case.

The issues

8 The Plan provides for the Referee to receive and dispose of applications by HIV Claimants for an assessment of their damages. Article 5.10 provides in part:

> HIV Claimants may apply to the Referee within 4 months following the Plan Implementation Date for a determination of damages with respect to their respective HIV Claim.

9 Although that language is, in form, permissive, it is provided later in the same article as follows:

> Any surplus remaining after disposition of all references filed within the four month period following Plan Implementation Date shall be paid to the HCV Fund.

10 Read literally — and without regard to the possibility that the court could grant relief to Claimants whose applications were filed outside the deadline — the Plan provides that any surplus would be computed without refer-

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ence to late applications. The disposition of surplus appears to be analogous to a gift over under a traditional testamentary trust, or trust *inter vivos*.

11 The four months' deadline referred to in article 5.10 expired on February 5, 2002. I am advised that timely applications were received in respect of the Claims — or derivative of the Claims — of 89 infected persons. I am now asked by the Trustee to advise whether the court has jurisdiction to extend the deadline or, otherwise to direct that additional late, or irregular, applications should be accepted. In paragraph 18 of his helpful affidavit, the Trustee's counsel, Mr Michael Royce, stated:

> As previously indicated, we do not yet have information from all "Late Claimants" explaining why their applications were made after the deadline. For the purposes of this motion, however, which is simply to determine without reference to any particular case, the question of whether the court has the power to extend or otherwise relieve against the effect of the deadline, the Trustee assumes that among the Claimants there exist at least some whose reasons for submitting their applications after the deadline are compelling and represent circumstances that were entirely beyond their control.

12 Having been advised that the existence of the jurisdiction would be disputed by other Claimants — I endorsed this two-stage approach.

13 In his affidavit, Mr Royce refers to a variety of explanations provided by HIV Claimants whose applications were irregular or out of time. The Trustee's records reveal that late applications have been received relating to the Claims of 38 persons who were either infected persons, or persons with derivative Claims as members of the families of infected persons. On the basis of communications from various haemophilia societies and other organisations, the Trustee believes that further late applications may be made in the future. In addition, there are a number of applications — described by the Trustee's counsel as "irregular" in which timely applications for damages assessments were made on behalf of some, but not all, HIV Claimants of the same family. It appears that at least some of the omissions were the result of inadvertence, or a misunderstanding of the language of the application forms provided.

14 Some of the Claimants whose applications were received after the deadline state that they did not receive notice of the HIV Fund before the deadline expired. This may have been due to inadequacies of the notice dissemination caused by what appears, with hindsight, to have been an initial erroneous assumption that there were no more than 35-40 infected Claimants and that these could be identified, and contacted, through various federal and provincial agencies. In addition, it is alleged that that one such agency did not send out notices it had agreed to provide. Other late-filed applications were made by, or on behalf of, individuals who state that they were unable to comply with the deadline as their HIV infection was discovered after the deadline had expired.

15 The notice that informed HIV Claimants of the deadline stated that persons who decided to make "a claim on the *HIV Fund*", must do so by February 5, 2002. One Claimant who had previously provided a Proof of Claim to the Monitor appointed under the CCAA has stated that he believed that nothing further was required from him.

16 In considering whether the court has jurisdiction to legitimise late and irregular applications, there are number of special features of the HIV Trust that distinguish it from trusts of a more traditional kind, and even the more closely analogous provisions of settlements of class proceedings under which — because of the inevitable imperfection of notice-dissemination programs — late-filed claims have been allowed from time to time.

17 Most fundamentally, the Trust was created pursuant to the CCAA and was part of a compromise of the claims of the HIV Claimants and the Society that was approved by the order of September 14, 2000. Paragraph 12 of the Approval Order contemplates a continuing role for the court while the Plan is being implemented.

> THIS COURT ORDERS that any interested party may apply to this court for directions or to seek relief in re-

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spect of any matter arising out of or incidental to the Plan or this Order, including, without limitation, the interpretation of this Order and the Plan, the implementation of the Plan, and for any further Order that may be required for implementation of the Plan, on notice to any party likely to be affected by the Order sought.

18 Although the Trust Agreement provides that its provisions are subject to those of the Plan to the extent of any inconsistency, the Plan does not purport to deal with the terms of the HIV Trust except to the extent that it provides for the distribution of the HIV Fund. Paragraph 1.01 states:

> "Trust Agreement" means that agreement among the Society, the Plan Participants and the Trustee, to be entered into on the Plan Implementation Date subject to the terms of this Plan, pursuant to which the Trust shall be established and governed.

19 The terms of the Trust Agreement were evidently to be settled between the parties without any other assistance from the provisions of the Plan and without any requirement in it for court approval. The Agreement was, however, approved, and incorporated in the order of this court made in *McCarthy v. Canadian Red Cross Society*, [2001] O.J. No. 2474 (Ont. S.C.J.) in a proceeding relating to the HCV Fund.

20 Having imposed what is, in effect, a four-month limitation period for applications for damages assessments, the Plan does not address whether, or how, notice of this was to be given to HIV Claimants. The question of notice is dealt with under paragraph 8 (f) of the Trust Agreement that empowers the Trustee:

> to authorize, prescribe, publish and distribute, at the cost of the Trust Fund, all forms and notices necessary for the administration of the Distribution Scheme including, without limitation, any advertising to potential beneficiaries as to the existence of the Trust Fund and the call for claims relating thereto.

21 Again, unlike the position under section 17-19 of the *Class Proceedings Act, 1992*, S.O. 1992, c.6, there is no requirement for the Trustee to obtain the approval of the court for notices informing HIV Claimants of their rights.

22 More generally, in addition to the detailed powers given to the Trustee for the purpose of administering the trust property, paragraph 8 of the Trust Agreement confers extensive powers and authority on the Trustee in connection with the administration of the "Distribution Scheme" in Article 5 of the Plan. These include power to decide all questions concerning the administration of the Distribution Scheme, to determine the persons who are to receive payments from HIV Trust, and to authorise such payments. In the exercise of these powers, the Trustee is, again, subject to the controlling jurisdiction of the court.

23 Finally, I note that, In his reasons disposing of another motion, Blair J. opined that, for the purpose of providing access to the HIV Fund, the Plan should be given a liberal interpretation: [2005] O.J. No. 4177 (Ont. S.C.J.), para 15. In a subsequent motion he emphasised that the Plan was intended to be effective: [2006] O.J. No. 2675 (Ont. S.C.J.), para 24. The learned judge has also referred to the fact that the circumstances of the HIV Claimants are very different to those of commercial creditors affected by CCAA proceedings. While, as a general rule, the latter can be presumed to be knowledgeable, and ready and willing to assert their claims, the same cannot be said of the HIV Claimants who did not personally retain lawyers and did not participate in the CCAA proceeding. This was, I believe, reflected in the bar order that disqualified them from voting but did not purport to bar their Claims. Some, and perhaps most of them, prepared applications without professional assistance.

Heads of jurisdiction

24 I do not believe there is any doubt that the court has jurisdiction to intervene to give relief in at least some of the cases described by Mr Royce. To the extent that the responsibility to determine how potential HIV Claimants are

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to be notified — and to supervise this process — is that of the Trustee, there is, *first*, the general jurisdiction of the court to exercise control over the administration of the trust and the exercise of a trustee's discretionary powers. If, as was suggested in the material filed on this motion, the application forms lacked clarity in material respects, or if the dissemination of notice was manifestly inadequate, the court would not be powerless to intervene.

25 The jurisdiction in such cases is extended by paragraph 12 of the Approval Order which reserved to the court the authority to make orders required for the purpose of implementing the plan. In reasons delivered on a previous motion, I held that "required" for this purpose meant "reasonably required" and I accepted Ms Ring's submission that the paragraph was intended to continue the overall supervision of the court over proceedings under the CCAA: [2008] O.J. No. 2102 (Ont. S.C.J.), at para 29.

26 Authorities under the CCAA support the existence of a third head of jurisdiction that is grounded in the supervisory role of the court under the statute. I do not think it matters whether the interpretation of paragraph 12 is considered to be informed by the existence of this more general jurisdiction, a reflection of it, or as supplemented by it.

27 The question whether the general jurisdiction under the CCAA can be applied to relieve against late-filed, or otherwise irregular, claims or applications made in the course of negotiating — or after — an arrangement under the CCAA is not novel. The existence of the jurisdiction has been accepted by this court, as well as in the courts of other provinces. It is a discretionary jurisdiction that is, I believe, appropriately described as an equitable jurisdiction as it involves an extension of familiar principles of equity to cases under the statute.

28 In *Blue Range Resource Corp., Re*, [2000] A.J. No. 1232 (Alta. C.A.) — the decision that has been most influential in the later cases — all counsel conceded that the jurisdiction existed notwithstanding that an arrangement under the CCAA had been approved by creditors who had filed Proofs of Claim, and an unqualified provision in a claims bar order that claims filed out of time would be "forever barred".

29 Although most of the discussion in the reasons for judgment was directed at the criteria to be applied in exercising the jurisdiction, I do not understand the discussion to be premised on counsel's agreement that it existed. The tenor of the reasons of the Court of Appeal suggests to me that it considered the concession to be correct. Having found assistance in authorities under the United States bankruptcy rules, the approach taken under the *Bankruptcy and Insolvency Act* (Canada), the application of procedural rules governing delays in the prosecution of actions, and the principles applied in dealing with applications for relief from forfeiture under insurance statutes, Wittmann J.A. concluded:

> These authorities arise in a clearly different context from that which I am dealing with in this case, but they demonstrate that there is a somewhat consistent approach in a variety of areas of the law when dealing with the impact of late notice for delays in particular processes.
>
> Therefore, the appropriate criteria to apply to the late Claimants is as follows:
>
> 1. Was the delay caused by inadvertence and if so, did the claimant act in good faith?
>
> 2. What it is the effect of permitting a claim in terms of the existence and impact of any relevant prejudice caused by the delay?
>
> 3. If relevant prejudice is found can it be alleviated by attaching appropriate conditions to an order permitting late filing?
>
> 4. If relevant prejudice is found which cannot be alleviated, are there any other considerations which may

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nonetheless warrant an order permitting late filing? (paras 26 and 41)

In the context of the criteria, "inadvertent" includes carelessness, negligence, accident, and is unintentional.

30 Leave to appeal to the Supreme Court of Canada from the decision of the Court of Appeal was denied.

31 I note that, in permitting a number of late-filed claims, the court in *Blue Range Resources* did not purport to amend the provisions of the bar order by imposing a new deadline. The jurisdiction supported was limited to determining whether, in individual cases, equitable relief should be given to those who for some reason had not filed in time.

32 *Blue Range Resources* was cited and the court's apparent recognition of the jurisdiction was expressly accepted by Cumming J. in *Ivorylane Corp. v. Country Style Realty Ltd.*, [2004] O.J. No. 2662 (Ont. S.C.J. [Commercial List]), at para 47 — where the jurisdiction was described as limited to "exceptional circumstances", and there is no suggestion that the point had been conceded by counsel. The analysis of Wittmann J.A. was applied — again without any such suggestion — by Cameron J. in *Noma Co., Re*, [2004] O.J. No. 4914 (Ont. S.C.J. [Commercial List]), in which a late-filed claim was rejected.

33 The jurisdiction was also discussed, and its exercise considered, in three unreported endorsements of Farley J. of September 20, 1999 in respect of a CCAA arrangement for Royal Oaks Inc. (relief granted); of December 1, 2000 on a motion in the liquidation of T. Eaton Company Limited (relief granted); and of July 22, 2003 in a CCAA application involving Algoma Steel Inc. (relief denied).

34 Other cases in which the reasoning in *Blue Range Resources* was accepted, or was cited with apparent approval, include *Ontario v. Canadian Airlines Corp.*, [2000] A.J. No. 1321 (Alta. Q.B.); *West Bay SonShip Yachts Ltd., Re*, [2007] B.C.J. No. 2287 (B.C. S.C. [In Chambers]), leave to appeal granted from the exercise of the discretion: [2007] B.C.J. No. 1813 (B.C. C.A. [In Chambers]); and *Carlen Transport Inc. v. Juniper Lumber Co. (Monitor of)*, [2001] N.B.J. No. 20 (N.B. Q.B.); see, also, *Roman Catholic Episcopal Corp. of St. George's, Re*, [2007] N.J. No. 32 (N.L. T.D.) (bankruptcy); and *Pangeo Pharma inc., Re*, [2004] J.Q. No. 706 (Que. S.C.). The earlier authorities are discussed in a helpful annotation by Mr Vern DaRe in 26 C.B.R. (4th) 142.

35 Contrary to the submission of Mr Strosberg, I do not consider that the reasoning of the Court of Appeal in *Algoma Steel Corp. v. Royal Bank*, [1992] O.J. No. 889 (Ont. C.A.) precludes an application of the analysis in *Blue Range Resources*, and the cases in which it has been accepted, to the facts of this case. In *Algoma Steel*, the court gave leave to a creditor to bring proceedings against the appellant notwithstanding unambiguous language in a plan of arrangement that extinguished the claims of the creditor as a known designated unsecured creditor of the appellant. In the course of its reasons, the court stated, at paras 6-7:

> The plan of arrangement is a matter of contract, it is argued, and the court's jurisdiction is limited to sanctioning or refusing to sanction the arrangement arrived at contractually. There is much merit in this argument but, in our view, it is not a complete answer.
>
> [The creditor] does not deny that if the language of the plan of arrangement quoted above, extinguishing the claims of designated unsecured creditors is unambiguous, as we believe it is, to grant the relief which it seeks would require an amendment by the court of the plan arrangement. We accept the submission that, generally speaking, the plan of arrangement is consensual and the result of agreement and that if it is fair and reasonable (an issue for the court to decide) it is not to be interfered with by the court unless (a) the Act authorises the court to affect the plan and (b) there are compelling reasons justifying the court's action. ...
>
> The CCAA must be the authority for the jurisdiction and the critical issue is whether there is any provision in

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the Act that fairly gives rise to a power in the court to amend. In our view there is such a provision and that provision, s.11 (c), depending on the language of the plan itself, may by necessary inference, in an appropriate case, enable the court to make an order, the technical effect of which is that the plan is amended.

36 In *Algoma Steel*, the creditor was seeking leave to proceed against a corporation that had been the subject of a plan of arrangement, and not simply seeking to enforce its rights under the plan. The extinguishment of claims against the corporation was an essential part of the plan that had been sanctioned by the court under the CCAA. The finding that the relief sought by the creditor would involve an amendment to the plan of arrangement which would require statutory authority does not, in my judgment, necessarily extend to late-filed applications to enforce the rights of claimants to share in a fund created pursuant to the provisions of a CCAA plan — the only scenario that I am concerned with. Any analogy between the two sets of fact is, I believe, tenuous. In the absence of any indication that the Court of Appeal intended to address issues such as those in this motion, I do not believe that I am obliged to conclude that the jurisdiction discussed in *Blue Range Resources* requires explicit statutory justification for its existence in the circumstances of this case.

37 The words of the Plan indicate that the "surplus" to be paid to the HCV Trust is to be computed without reference to claims that were out of time. I believe it is implicit in *Blue Range Resources* that such provisions of the Plan are not to be understood as ousting the equitable jurisdiction of the court to relieve against late, or irregular, applications but, rather, are to be read as subject to it. Immediately after his reference to counsel's concession, Wittmann J.A. stated, at para 10:

> It necessarily follows that a claims bar order and its schedule should not purport to "forever bar" a claim without a saving provision. That saving provision could be simply worded with a proviso such as "without leave of the court", which appears to be not only what was contemplated, but what in fact occurred here.

38 I emphasise, however, that, in the exercise of the jurisdiction, the provisions of a Plan that has been approved by the creditors and the court are to be respected. The jurisdiction is essentially a discretionary jurisdiction to grant relief from a strict application of those provisions. As Wittmann J.A. accepted, it involves an application of equitable principles analogous to those that — in other situations and subject to other limitations — enable the court to relieve against forfeiture.

39 To the extent that some of the irregularities, and omissions, in otherwise timely applications submitted in this case were caused by inadequacies in the application forms provided, I agree with counsel that these could be remedied by an exercise of the authority in paragraph 12 of the Approval Order to make orders implementing the Plan without reference to any wider jurisdiction. I do not, however, accept that paragraph 12 is to be read as limited to such cases, or that a narrow interpretation of the concept of "implementation" should be considered to exclude the court's inherent equitable jurisdiction imposed on the bare-bones legislative scheme under the CCAA. If no notice had been given — or if its dissemination and reach are now, with the benefit of hindsight, seen to have been inadequate — the court must, in my opinion, be able to intervene. If the Plan was, as I believe, intended to make damages available to all persons who would be able to establish that they were HIV Claimants within the four months period, adequate notice to such persons was essential. Independently of the jurisdiction under the CCAA, the requirement of adequate notice could be enforced in the exercise of the court's supervisory jurisdiction over trustees and the consequences of failing to give such notice would not, in my opinion, be outside the control of the court.

40 Cases where a Claimant was not diagnosed with HIV until after the deadline are more difficult. The jurisdiction to relieve against untimely applications is, in my opinion, limited to applications by persons who could have established their eligibility within the four months period. It would not apply to persons whose infection was not discovered before the expiration of the period. The intention to withhold damages from such persons is inherent in the imposition of the deadline and is not affected by deficiencies in, and the imperfection of, notice dissemination that, in a case such as this and in class proceedings, underlie the jurisdiction to relieve against untimely applications. The necessity for some cut-off date in respect of the time of a diagnosis is reinforced by the likelihood that the HIV

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Fund will prove to be inadequate to satisfy all of the qualified HIV Claimants, with the result that distributions might need to be deferred until the maximum number of Claimants was ascertained. In my judgment, it is one thing to grant relief to persons who might have — but, for some reason, did not — claim within the four months' period and something fundamentally different to extend the class to persons who would not have been able to establish a claim within the period. The exclusion of the latter should, in my opinion, be considered to be part of the compromise effected by the Plan, and to that extent its provisions are to be respected.

Prejudice

41 In *Blue Range Resources*, prejudice to other creditors was recognised as an important factor that would militate against an exercise of the court's discretionary jurisdiction under the CCAA. At paragraph 40 of his reasons for judgment, Wittmann J.A. stated:

> In a CCAA context, as in a BIA context, the fact that Enron and the other Creditors will receive less money if late and late-amended claims are allowed is not prejudice relevant to this criterion. Reorganisation under the CCAA involves compromise. Allowing all legitimate creditors to share in the available proceeds is an integral part of the process. A reduction in that share cannot be characterised as prejudice: ... Further, I am in agreement with the test for prejudice used by the British Columbia Court of Appeal .... It is: did the creditor(s) by reason of the late filings lose a realistic opportunity to do anything that they otherwise might have done? Enron and the other creditors were fully informed about the potential for late claims being permitted, and were specifically aware of the existence of the late Claimants as creditors. I find, therefore, that Enron and the Creditors will not suffer any relevant prejudice should the late claims be permitted.

42 In affidavits delivered for the purpose of this motion, Mr Strosberg's client relied on negotiations that preceded the acceptance of the plan by the HIV creditors voting as a separate class for that purpose. He stated that Mr Strosberg was instrumental in persuading other creditors represented by Mr Arenson to vote in support of the Plan and that without this it would have been defeated. He stated further that, at that time, he believed that there were no more than 34 eligible Claimants.

43 Paragraph 18 of the client's original affidavit and paragraph 6 of a supplementary affidavit read as follows:

> 18. Fundamental to my decision to support the plan of arrangement and to persuade Mr Arenson's clients to support the plan was the limited number of HIV Claimants who could come forward to claim and the short period of time these HIV Claimants had to apply under the plan of arrangement. Had I believed that there were more than 34 HIV claimants or that the period of time that potential HIV claimants had to pursue their claims by making application under the plan of arrangement would be extended, I would not have instructed Mr Strosberg to enter into negotiations with Mr Arenson and I too would have voted against the plan of arrangement thereby causing its rejection. It was for good reason that potential HIV claimants were required to apply under the plan of arrangement within four months.
>
> 6. If the plan was rejected, I would have been in a position to bargain for a greater share of the available monies to compensate for the risk of an extension of the four-month period and the risk that additional claimants who would dilute the HIV Fund might claim after the expiration of the four-month period.

44 I do not believe that the consequences of the client's mistake about the number of potential HIV Claimants should be regarded as the kind of prejudice that might weigh against an exercise of the court's jurisdiction. On the basis of the evidence — such as it is — and the findings made in earlier motions, I am prepared to accept that a number, and perhaps all, of the HIV Claimants who filed Proofs of Claim, and thereby were entitled to vote on the Plan, underestimated the number of persons with eligible HIV Claims. I am also prepared to accept that this may have influenced the decisions of the voting Claimants to approve the Plan, and the amount of the HIV Fund to be

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established according to its terms. Even if there was evidence that their misapprehension was reasonable, it would not affect the eligibility of HIV Claimants to share in the Fund. This being the case, I do not consider that it is a factor that should militate against a discretionary decision to allow late-filed applications for payment out of the Fund if, for example, they would otherwise be allowed on the ground that the notice of the deadline provided to Claimants was found to be materially inadequate. In short, in applying the test of prejudice accepted in *Blue Range Resources*, the loss of an opportunity to vote against the Plan by reason of an erroneous belief that there were only 34 eligible Claimants is not a loss that would occur "by reason of the late filings".

45 Similarly, while, as in *Blue Range Resources* (at para 40, quoted above), knowledge of the possibility that late claims might be permitted may militate against a finding of prejudice, I do not think ignorance of this, of and by itself, is sufficient to establish it in the present circumstances. The client's statement that — even on the assumption that there were only 34 eligible Claimants — he would have voted against the Plan if he had known of the possibility that late-filed applications would be permitted appears to be based on his expectation that the short deadline would have the practical effect of excluding a number of eligible HIV Claimants. This expectation contemplated that the underlying purpose of the Plan would be frustrated. As mentioned earlier in these reasons, the bar order that restricted voting rights to Claimants who filed Proofs of Claim did not purport to extinguish the HIV Claims of others — known or unknown. All HIV Claimants who had not released the Society, and whose Claims were not barred by limitations defences, were intended to be eligible to file applications for damages assessments under the provisions of the Plan. Thus, in a motion in these proceedings, Blair J. — who had previously supervised the CCAA application and made the Approval Order — stated:

> As I read the Plan, the reason for establishing the HIV Fund was not to provide recourse to a limited number of HIV Claimants. The reason was to make the HIV Fund available to *all* those who had an HIV Claim existing against the Society on July 20, 1998: [2005] O.J. No. 4177 (S.C.J.), at para 15 (*italics* in the original).

46 In my judgment, a creditor who hopes, and bargains on the basis of a belief, that a plan of arrangement and compromise under the CCAA will not achieve its intended effect does not suffer material prejudice for the purpose of the court's equitable jurisdiction when the belief turns out to have been unfounded.

47 In *Blue Range Resources*, the focus of the analysis was directed at prejudice to other creditors. Prejudice to the insolvent debtor corporation was not treated as in issue, and it is not in issue in this case in which the Society was released from all HIV Claims on the Plan Implementation Date. In another unreported case, prejudice to the debtor was emphasised by Blair J. where, in the course of a reconstructuring of T. Eaton Company Limited, a bar order had been made extinguishing the claims of creditors who did not file proofs of claim on or before a particular date. A creditor moved for leave to file a Proof of Claim after an arrangement had been approved by the court and implemented. She relied on her solicitor's failure to advise her of the bar order, and the fact that she filed a proof of claim as soon as she became aware of it and its effect. In an endorsement of May 5, 1999, Blair J. declined to grant an extension of time. The bar order specifically reserved to the court's jurisdiction to waive it, but it was held that to permit the creditor to have access to the debtor corporation's post-arrangement assets would be prejudicial to it, and — citing *Algoma Steel* — that the case was:

> ... not one for the "sparing" and "exceptional" jurisdiction to make such an order.

In contrast, the issue before me is confined to rights of claimants to share in the HIV Fund, and is not for recourse against the Society and its remaining assets.

48 Any prejudice that beneficiaries of the HCV Trust would suffer by the elimination, or reduction, of surplus in the Fund as a result of accepting late-filed applications appears now to be entirely theoretical.

Conclusion

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49 I am satisfied that the court has the discretionary jurisdiction discussed in *Blue Range Resources* and the cases that have followed the reasoning of the Alberta Court of Appeal. I accept also that it is a jurisdiction to be exercised sparingly in the light of the particular circumstances of each case. It is very much fact specific. The considerations that I consider will justify its exercise in this case can be summarised as follows:

(a) the structure of the Plan with its provision of a separate Fund for HIV Claimants;

(b) the fact that no distributions from the HIV Fund have yet been made;

(c) the absence of prejudice that would be suffered by the Society and other Claimants;

(d) the uncertainty created by the limitations issues;

(e) the circumstances of the Claimants that distinguish them from commercial creditors;

(f) the fact that adequate notice to them was essential if the Plan was to be effective;

(g) the application forms provided to Claimants did not clearly indicate that they were required to identify each Claimant in a family group that included an infected person. Similarly, I am of the opinion that it was not unreasonable for a Claimant who had filed a Proof of Claim to understand that this would be considered to be a claim against the HIV Fund to which the deadline was said to apply in the notice provided by the Trustee; and

(h). the selection of appropriate methods of disseminating notice of the deadline for applications may have been affected, and unduly limited, by the misapprehension as to the number of potential Claimants. It appears, also, that, as in the case of those in Nova Scotia, the chosen method may not have been completely successful in reaching Claimants whose identities were ascertainable.

50 I have considered whether my decision should be simply that the jurisdiction exists, and that the manner of its exercise is to be determined by the court on the facts relating to each late or irregular application. I am satisfied that in, providing advice and directions to the Trustee, it is unnecessary to adopt such a restricted approach. The process of dealing with late and irregular applications will involve a degree of fact finding that is within the powers of the Trustee under paragraph 8 of the Trust Agreement. Those powers can be exercised with less formality and more expedition than the practice and procedure of the court would permit. I believe that the approach that most appropriately engages the jurisdiction of the court and the powers of the Trustee is for the Trustee to receive and dispose of late and irregular applications in accordance with the guidelines I will provide in an Appendix to these reasons.

51 The guidelines do not address every possible situation and may be supplemented, or amended, by further orders of the court from time to time. If the Trustee is uncertain as to the application of the guidelines to particular cases — or if particular applications are, in the opinion of the trustee, not covered by the guidelines — they may be referred to the court in writing to be dealt with summarily. HIV Claimants whose applications are disallowed by the Trustee are to be informed of their right to have the decision reviewed by filing a motion record in the court for the purpose within 30 days, or such longer period as the court may order.

52 Any further procedural issues that may arise — including the question whether notice to HIV Claimants who have not filed applications is required — can be disposed of at a case conference to be arranged as soon as practicable.

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53 As has been the case on previous motions, not all of the potential HIV claimants were served with the motion record and the counsel who appeared did not represent all of them. On motions for directions by a trustee in a case like this, it is unnecessary to name all beneficiaries as parties unless the court orders otherwise. This is provided by rule 9.01 of the Rules of Civil Procedure and it is reinforced by paragraphs 1 (f) and 17 of the Trust Agreement that require notice of applications to the court to be given only to Ms Ring and Mr Arenson. Despite these provisions, the Trustee attempted to notify as many of the Claimants as was practicable, and the issues on the motion were comprehensively addressed by his counsel and the other counsel appearing. In these circumstances, I did not find it expedient to deplete the HIV Fund further by ordering service of the motion record on the unrepresented claimants, to add them as parties, or to make a representation order pursuant to Rule 10. By virtue of section 60 (2) of the *Trustee Act* (Ontario), the Trustee will be protected in acting on the directions I have given.

54 I appreciate the assistance that counsel have provided. The Trustee is to be fully indemnified out of the HIV Fund for his costs of the motion. Other parties represented at the hearing — including Mr Plater's client — are to have a substantial indemnity for their costs. Submissions in writing with respect to quantum may be made within 21 days of the release of these reasons.

— Appendix

Guidelines for Late and Irregular Applications

1. Applications made by one member of a family of an infected person are to be treated as applications by, and on behalf of, all members of the family who are HIV Claimants, and the personal representatives of deceased HIV Claimants.

2. Late applications by persons who had filed timely Proofs of Claim are to be allowed;

3. Applications by persons who did not receive notice of the deadline until after it had passed should be allowed if, in the opinion of the trustee, the applications were made within a reasonable time after notice was acquired;

4. Applications by HIV claimants whose failure to meet the deadline was due to matters that, in the opinion of the Trustee, should reasonably be considered to be beyond their control should be allowed;

5. Other late applications made by persons who had notice of the deadline before it expired should be disallowed unless, in the opinion of the Trustee, the timing of the receipt of such notice was inadequate for the purpose of making an application;

6. Late applications are to be allowed only if they are from, or in respect of, persons who, being aware of their infection during the four months period, could have established their eligibility as HIV Claimants before it expired; and

7. Any other late or irregular applications — and those where the Trustee is uncertain as to the appropriate application of the above guidelines — should be referred in writing to the court to be dealt with summarily.

Motion granted.

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TAB 21

Alberta Court of Queen's Bench
Canadian Airlines Corp. (Re)
Date: 2000-05-12

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

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

S. Dunphy, for Air Canada.

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

D. Nishimura, for Resurgence Asset Management LLC.

E. Halt, for Claims Officer.

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

(Calgary No. 0001-05071)

May 12, 2000.

2000 CanLII 28185 (AB QB)

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

[2] Resurgence applied for the following relief:

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

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

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

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

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

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

Standing

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

[5] Canadian has not raised this issue on any of the previous occasions on which Resurgence has been before the court in these proceedings. There has been a consent order involving Resurgence and Canadian.

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

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

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

Classification of Air Canada's Unsecured Claim

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[21] It was also submitted in *Norcen Energy Resources Ltd.* that since the purchaser under the plan had made financing arrangements with the Royal Bank, the bank had an interest not shared by the other secured creditors. Forsyth J., held that in the absence of any allegation that the Royal Bank was not acting bona fide in considering the benefit of the plan, the secured creditors could not be heard to criticize the presence of the Royal Bank in their class.

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

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

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

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

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

The commonality of interest test was addressed by the British, Columbia Supreme Court in *Re Woodward's Ltd.* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.). Tysoe J. rejected the identity of interest approach and held that it was permissible to include creditors with

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different legal rights in the same class, so long as their legal rights were not so dissimilar that it was still possible for them to vote with a common interest.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[35] Resurgence also asserted that a court should avoid placing creditors with a potential conflict of interest in the same class and relies on *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.), a case in which the court considered a potential conflict of interest between subcontractors and direct contractors. To the extent this case can be seen as decided on the basis of the distinct legal rights of the creditors, I agree with the result. To the extent that the case determined that a class could be separated based

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on a conflict of interest not based on legal right, I disagree. In my view, this would be the sort of issue the court should consider at the fairness hearing.

[36] Resurgence also relied on the decisions of the British Columbia Supreme Court in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.), a case decided prior to *Norcen Energy Resources Ltd.*. In that case the court held that a subsidiary wholly owned by Northland Bank was incorporated to purchase certain bonds from Northland in exchange for preferred shares and was not entitled to vote. The court found that would be tantamount to Northland Bank voting in its own reorganization and relied on *Re Wellington Building Corp.,* [1934] O.R. 653, 16 C.B.R. 48 (Ont. S.C.) In this regard. I would note that the passage relied upon at page 5 in that case, in *Wellington Building Corp* (Supra) dealt with whether the scheme, as proposed, was unfair.

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

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

[39] Permitting the classification to remain intact for voting purposes will not result in a confiscation of rights of or injustice to the unsecured note holders. Their treatment does not at this point depart from any other Affected Unsecured Creditors and recognizes the similarity of legal rights. Although based on different legal instruments, the legal rights of

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the unsecured note holders and Air Canada are essentially the same. Neither has security, nor specific entitlement to assets. Further, the ability of all of the Affected Unsecured Creditors to realize their claims against the debtor companies, depend in significant part, on the company's ability to continue as a going concern.

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

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

Separating the Claims Against CAC and CAIL

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

[43] There is insufficient evidence to suggest that the unsecured note holders are also creditors of CAIL. Counsel referred only to a statement made by Mr. Carty on cross-examination that there was an "unsecured guarantee". However, no documents have been brought to my attention that would support this statement and, in of itself, the statement is not determinative. In any case, I do not have sufficient evidence before me to conclude that there would be a meaningful difference in recoveries for unsecured creditors of CAC and CAIL in the event of bankruptcy. I, therefore, cannot conclude on this basis that rights are being confiscated, unlike Tysoe J.'s ability to do so in *Re Woodward's Ltd.* Simply looking to different assets or pools of assets will not alone fracture a class; some unique additional legal right of value in liquidation going unrecognized in a plan and not balanced by others losing rights as well is needed on the analysis of Tysoe J.

[44] I recognize the struggle between the unsecured note holders, represented by Resurgence on one side, and Air Canada and Canadian on the other. Resurgence fears the inclusion of Air Canada and the Affected Unsecured Creditors' class will swamp the vote. Air Canada and Canadian fear that exclusion of Air Canada will result in the voting down of a plan which, in their view, otherwise stands a realistic chance of approval. As

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unsecured creditors, they do share similar legal rights. As supporters or opponents of the plan, they may well have distinctly different financial or strategic interests. I believe that in the circumstances of this case, these other interests and their impact on the plan, are best addressed as matters of fairness at the June 5, 2000 hearing, and in this way, the concerns will be heard by the court without necessarily putting an end to the entire process.

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Voting

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

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

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

Section 6(2)(2) of the Plan

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

1. The debtor companies and its subsidiaries;

2. The directors, officers and employees;

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

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

[49] Section 5.1(3) of the C.C.A.A. provides that the court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

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

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

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

Application dismissed.

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TAB 22

1986 CarswellBC 131, 3 B.C.L.R. (2d) 145, 17 C.C.L.I. 194, [1986] 4 W.W.R. 504, 28 D.L.R. (4th) 414, [1986] I.L.R. 1-2100

Fredrikson v. Insurance Corp. of British Columbia

FREDRICKSON v. INSURANCE CORPORATION OF BRITISH COLUMBIA

British Columbia Court of Appeal

Seaton, Anderson and McLachlin JJ.A.

Judgment: May 15, 1986
Docket: Vancouver No. CA004438

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Counsel: *R. B. Harvey, Q.C.* for appellant.

J. E. Murphy, for respondent.

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

Choses in Action --- Assignability — Cause of action — In tort.

Choses in Action --- Assignability — Cause of action — In contract.

Insurance --- Claims — Settlement and release — General.

Insurance --- Actions on policies — Commencement of proceedings — Right of action — General.

Insurance — Automobile insurance — Actions — Plaintiff owner found 80 per cent liable for injuries suffered by intoxicated driver in automobile accident — Plaintiff insured by defendant up to $500,000 — Defendant settling with driver for $1.2 million — Plaintiff having no assets other than cause of action against defendant for failing to properly defend driver's claim — Plaintiff's cause of action properly assignable to driver.

Actions — Champerty and maintenance — Nature and scope — Plaintiff owner found 80 per cent liable for injuries suffered by intoxicated driver in automobile accident — Plaintiff insured by defendant up to $500,000 — Defendant settling with driver for $1.2 million — Plaintiff having no assets other than cause of action against defendant for failing to properly defend driver's claim — Plaintiff assigning cause of action to driver — Assignment not champertous since driver having pre-existing commercial interest in assignment.

N. was seriously injured while driving the plaintiff's automobile with the plaintiff's consent. A jury found the

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plaintiff 80 per cent liable for N.'s injuries. N. was insured up to $500,000 by the defendant I.C.B.C. Following the trial but prior to appeal, the plaintiff gave notice to I.C.B.C. that if it chose not to settle N.'s claim within the policy limits, then he expected I.C.B.C. to indemnify him fully. The court later approved a settlement as to quantum put forward by counsel for N., I.C.B.C. and the plaintiff at $1.2 million. The plaintiff's appeal on the liability issue was dismissed. Because the plaintiff had no assets of significance other than the cause of action against I.C.B.C. for failure to properly defend N.'s claim against him, the plaintiff assigned that right of action to N., whereupon N. agreed to take no execution proceedings against him. N., in the plaintiff's name, commenced an action against I.C.B.C. who applied to strike out the action as being champertous, against public policy and in breach of s. 6.33 of the regulations because the assignment interfered with I.C.B.C.'s ability to negotiate and settle the claim. The application was dismissed and I.C.B.C. appealed.

Held:

Appeal dismissed.

An assignment of a cause of action for a non-personal tort is generally valid if the assignee has a pre-existing interest in the litigation sufficient to negate any taint of champerty or maintenance. In determining that issue the court should look at the totality of the transaction to discover whether the assignee had a genuine, pre-existing, commercial interest in the assignment, i.e., a commercial interest in the sense of a financial interest. In this case N. had a very real financial interest in the assignment: it represented her only means of obtaining satisfaction of her judgment. There was no breach of s. 6.33 of the regulations or interference with I.C.B.C. in its negotiations or legal proceedings, since the action had been concluded before the assignment took place. The enforcement of I.C.B.C.'s contractual duty to its insured to use reasonable care to protect him from unnecessary loss is a right deserving protection. The assignee had a legitimate interest in the enforcement of that right and there was no maintenance, champerty or collusion against the insurer; hence no objection could be made on grounds of public policy.

Cases considered:

Bourne v. Colodense Ltd., [1985] I.C.R. 291 (C.A.) — *considered*

Brown v. Hall, [1957] O.W.N. 15, 6 D.L.R. (2d) 460 (C.A.) [reversed 12 D.L.R. (2d) 529 (S.C.C.)] — *referred to*

Cohn v. Webber (1911), 24 O.L.R. 171 (C.A.) — *referred to*

Compania Colombiana de Seguros v. Pac. Steam Navigation Co., [1965] 1 Q.B. 101, [1964] 2 W.L.R. 484, [1964] 1 All E.R. 216 — *referred to*

County Hotel & Wine Co. v. London & North West. Ry. Co., [1918] 2 K.B. 251 [affirmed [1921] 1 A.C. 85 (H.L.)] — *referred to*

Dawson v. Great Northern & City Ry. Co., [1905] 1 K.B. 260 (C.A.) — *distinguished*

Defries v. Milne, [1913] 1 Ch. 98 (C.A.) — *distinguished*

Di Guilo v. Boland, [1958] O.R. 384, 13 D.L.R. (2d) 510 (C.A.) — *referred to*

Ellis v. Torrington, [1920] 1 K.B. 399 (C.A.) — *referred to*

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Ellis-Don Ltd. v. Norton (1982), 5 C.L.R. 281 (Ont. H.C.) — *considered*

Fidelity & Casualty Co. v. Marchand, [1924] S.C.R. 86, [1924] 4 D.L.R. 157 [Que.] — *considered*

Fitzroy v. Cave, [1905] 2 K.B. 364 (C.A.) — *referred to*

453416 Ont. Inc. v. White (1984), 42 C.P.C. 209, leave to appeal to Ont. Div. Ct. granted 42 C.P.C. 215 — *considered*

Gedeon v. State Farm Mut. Auto. Ins. Co., 261 F. Supp. 122 (Pa. D.C., 1966) — *referred to*

Glegg v. Bromley, [1912] 3 K.B. 474 (C.A.) — *considered*

Groce v. Fidelity Gen. Ins. Co., 448 P. 2d 554 (Ore. S.C., 1968) — *considered*

Henfry & Co. v. Poplar Properties Ltd. (1986), 70 B.C.L.R. 23, 24 D.L.R. (4th) 313 — *referred to*

Kapoor Lumber Co. v. Can. North. Pac. Ry. Co., 45 B.C.R. 213, [1932] 2 W.W.R. 417, [1932] 3 D.L.R. 487 (C.A.) — *considered*

King v. Victoria Ins. Co., [1896] A.C. 250, 65 L.J.P.C. 38, 74 L.T. 206, 12 T.L.R. 285, 44 W.R. 592 (P.C.) — *referred to*

McNulty v. Nationwide Mut. Ins. Co., 221 So. 2d 208 (Fla. D.C.A., 1969) — *referred to*

Martell v. Consett Iron Co., [1955] Ch. 363, [1955] 2 W.L.R. 463, [1955] 1 All E.R. 481 (C.A.) — *considered*

Paterson Timber Co. v. Can. Pac. Lumber Co. (1909), 15 B.C.R. 225, 14 W.L.R. 598, affirmed 47 S.C.R. 398 — *referred to*

Performing Rights Soc. v. Thompson (1918), 34 T.L.R. 351 (K.B.) — *considered*

Peters v. Gen. Accident & Life Assur. Corp., [1938] 2 All E.R. 267 (C.A.) — *referred to*

Simpson v. Thomson (1877), 3 App. Cas. 279 (H.L.) — *distinguished*

Terrell v. Western Casualty & Surety Co., 427 S.W. 2d 825 (Ky. C.A., 1968) — *referred to*

Tolhurst v. Assoc. Portland Cement Mfr. (1900) Ltd., [1902] 2 K.B. 660 (C.A.) [affirmed [1903] A.C. 414 (H.L.)] — *referred to*

Trendtex Trading Corp. v. Crédit Suisse, [1980] Q.B. 629, [1980] 3 W.L.R. 367, [1980] 3 All E.R. 721, affirmed [1982] A.C. 679, [1981] 3 W.L.R. 766, [1981] 3 All E.R. 520 (H.L.) — *referred to*

Union Gas Co. v. Brown, [1968] 1 O.R. 524, 67 D.L.R. (2d) 44, reversed [1970] 1 O.R. 715, 9 D.L.R. (3d) 337 (C.A.) — *referred to*

Walter & Sullivan Ltd. v. J. Murphy & Sons Ltd., [1955] 2 Q.B. 584, [1955] 2 W.L.R. 919, [1955] 1 All E.R. 843 (C.A.) — *referred to*

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Statutes considered:

Builders' Lien Act, R.S.B.C. 1979, c. 40.

Supreme Court of Judicature Act, 1873 (36 & 37 Vict.), c. 66.

Regulations considered:

Insurance (Motor Vehicle) Act, R.S.B.C. 1979, c. 204, B.C. Reg. 428/73, s. 6.33(*a*), (*b*).

Authorities considered:

Chitty on Contracts, 25th ed. (1983), pp. 293, 709-15.Fleming, The Law of Torts, 6th ed. (1983), p. 593.Fridman, The Law of Contract in Canada (1976), pp. 442-45.Treitel, The Law of Contract, 5th ed. (1979), pp. 519-23.Waddams, Law of Contracts, 2nd ed. (1984), pp. 197-98.
Appeal by defendant from order of Locke J. 64 B.C.L.R. 301, [1985] 5 W.W.R. 342, 15 C.C.L.I. 249, [1986] I.L.R. 1-1991, dismissing application for order striking out action.

The judgment of the court was delivered by *McLachlin J.A.*:

1. Introduction

1 The issue argued on this appeal [from judgment reported at 64 B.C.L.R. 301, [1985] 5 W.W.R. 342, 15 C.C.L.I. 249, [1986] I.L.R. 1-1991] is whether an insured person may validly assign to the person claiming against him a cause of action against his insurer for failure to properly defend and negotiate settlement of the action on his behalf.

2 The facts may be summarized as follows.

3 On 28th May 1977 Linda Nielsen was seriously injured while driving Fredrickson's automobile with his consent. In 1982 a jury found Mr. Fredrickson 80 per cent liable for Nielsen's injuries. Mr. Fredrickson held a certificate of insurance from I.C.B.C. with a $500,000 limit for third party liability.

4 Following the trial but prior to appeal, Mr. Fredrickson gave I.C.B.C. notice that if I.C.B.C. chose not to settle the Nielsen claim within the limits of the policy, then Mr. Fredrickson expected I.C.B.C. to indemnify him fully. On 26th October 1982 Berger J. approved a settlement as to quantum put forward by counsel for Nielsen, counsel for I.C.B.C. and counsel for Mr. Fredrickson subject to a pending appeal on the issue of liability. The quantum approved was approximately $1.2 million. Mr. Fredrickson was personally responsible for all amounts in excess of $500,000. On 14th October 1983 Mr. Fredrickson's appeal was dismissed [[1984] B.C.W.L.D. 2088].

5 Mr. Fredrickson had no assets of significance other than cause of action against I.C.B.C. for failure to properly defend Miss Nielsen's action against him. At the suggestion of counsel for Miss Nielsen, an assignment agreement was executed between Mr. Fredrickson and the Public Trustee as committee of the estate of Miss Nielsen, purporting to assign to her this right of action. Pursuant to the assignment the Public Trustee commenced this action in the name of Fredrickson for a declaration that Mr. Fredrickson is entitled to indemnification for any money owed to Nielsen not payable under the policy, for an order that I.C.B.C. indemnify him for

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those moneys owed to Miss Nielsen and for a judgment in the amount owed to Miss Nielsen not payable under the policy, i.e., the difference between the amount of the judgment and Mr. Fredrickson's policy limits.

6 On 6th February 1984 I.C.B.C.'s counsel on behalf of Mr. Fredrickson applied for leave to appeal the personal injury action to the Supreme Court of Canada. That application was refused.

7 Mr. Fredrickson's action against I.C.B.C. is set down for trial in June 1986. It is being pursued by the Public Trustee on Miss Nielsen's behalf. I.C.B.C. in its pleadings (para. 8) stated that the action must fail because Mr. Fredrickson has suffered no loss as a result of I.C.B.C.'s conduct because he has assigned his interest in the action to Miss Nielsen. I.C.B.C. also said (para. 9) that the action is ill-founded because the assignment is invalid. Based on these two contentions and the admissions of Mr. Fredrickson, it sought an order striking out Mr. Fredrickson's claim. The chambers judge held that the assignment constituted a valid equitable assignment and that it did not contravene the regulations of the Insurance (Motor Vehicle) Act. I.C.B.C. now appeals that decision.

8 Notwithstanding that Miss Nielsen has not been joined as party, both parties have addressed the motion below and on this appeal on the basis that the real claimant is not Mr. Fredrickson, but Miss Nielsen. I am prepared to deal with the matter on that basis. I note, however, that it may be necessary to formally add Miss Nielsen as a plaintiff before the matter proceeds to trial. It appears that both the assignor and assignee of an equitable assignment of a legal chose in action must be made parties to the proceedings: Chitty on Contracts, 25th ed. (1983), p. 293, citing *Walter & Sullivan Ltd. v. J. Murphy & Sons Ltd.*, [1955] 2 Q.B. 584, [1955] 2 W.L.R. 919, [1955] 1 All E.R. 843 (C.A.). Were this to be done, then the first defence which I.C.B.C. cited in support of its motion — Mr. Fredrickson's lack of a person interest in the litigation — could properly be raised against him, while the other defence cited — the alleged invalidity of the assignment — could properly be raised against the assignee, Miss Nielsen.

9 With this reservation, I turn to the issue argued on appeal, the validity of the assignment. This issue raises two subsidiary questions:

1. Whether the assignment violates Regulations, s. 6.33(*a*) and (*b*), of the Insurance (Motor Vehicle) Act;

2. Whether the assignment was valid at law or equity.

I will consider each in turn.

II. Whether the Assignment Violates s. 6.33(a) and (b), of the Regulations

10 Section 6.33(*a*) and (*b*) provides:

> Where indemnity under this part is, or may be, claimed, the insured shall not:
>
> (a) voluntarily assume any liability or settle any claim, except at his own cost; or
>
> (b) interfere with the corporation in any negotiation, settlement, or in any legal proceedings; but whenever requested by the corporation, the insured shall: ...

11 This ground of appeal raises three issues: (1) whether Mr. Fredrickson's assignment constitutes a "settle-

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ment"; (2) if so, whether the settlement was at Mr. Fredrickson's "own cost" within s. 6.33(*a*); or, alternatively, (3) whether the assignment amounted to interference under s. 6.33(*b*). The chambers judge did not decide the first issue, having determined the second and third issues in Mr. Fredrickson's favour. I propose to approach the matter in the same way.

12 I turn first to s. 6.33(*a*) and the question of whether the assignment, if it constituted a settlement, was at Mr. Fredrickson's "own cost". I am of the view that the chambers judge was correct in concluding that it was.

13 It is conceded that, where doubt exists, the regulations should be interpreted in favour of the insured. This consideration leads me to conclude that the phrase "except at his own expense" was intended to permit the accused to settle claims, provided that the settlement does not involve cost to I.C.B.C. I do not think the section was intended to impose on the insured the obligation of showing that the settlement costs him something. That fact is irrelevant to I.C.B.C.'s concerns.

14 In this case, the assignment cannot prejudice I.C.B.C. in the sense that it would be required to pay more money because of the assignment. The only difference it might make to I.C.B.C. is that, instead of paying the money to Mr. Fredrickson, its assured, upon proof that he had satisfied Miss Nielsen's judgment, it would pay it to Miss Nielsen directly.

15 The next question is whether, assuming the assignment constituted a settlement, it amounts to an interference with I.C.B.C. in any negotiations, settlements or legal proceedings. I.C.B.C. does not allege specific interference but argues that to permit such assignments creates a disincentive to injured claimants to settle for less than the policy limits and removes the interest of the insured in having his defence succeed in whole or in part.

16 I do not accept the contention of I.C.B.C. that the assignment interfered with its ability to negotiate, settle and defend this action. The action had been concluded before the assignment took place, save for an unsuccessful application for leave to appeal to the Supreme Court of Canada. Moreover, it cannot be contended on the facts of this case that the assignment or the prospect of an assignment provided any disincentive to Miss Nielsen settling the action. The Public Trustee on her behalf made seven offers to settle the case. I.C.B.C. rejected them all and made no offers of its own, except for one offer made after the appeal was dismissed.

17 In support of its contention that the assignment violates s. 6.33(*a*) and (*b*) of the Regulations, I.C.B.C. conjures up the spectre of such assignments being given early in the litigation, allying the plaintiff and the defendant against the insurer in the litigation. In general, as Duff J. pointed out in *Fidelity & Casualty Co. v. Marchand*, [1924] S.C.R. 86, [1924] 4 D.L.R. 157 [Que.], the purpose of provisions such as s. 6.33(*a*) and (*b*) is to protect the insurer against the risk of collusion between the insured and the persons claiming damages for alleged torts. The assignment here in question does not violate this principle. Mr. Fredrickson cooperated fully with I.C.B.C. throughout the litigation. The agreement was entered into only after Miss Nielsen had made demands on him for payment of the balance of her judgment in excess of the policy limits and after the appeal had been dismissed and the litigation concluded for all practical purposes. In short, the assignment did not prejudice I.C.B.C.'s position and did not constitute collusion between the claimant and the assured.

18 For these reasons, I conclude that the chambers judge was correct in concluding that I.C.B.C. had failed to establish that the assignment violated s. 6.33 of the regulations. Having so decided, I need not consider the contention of Mr. Fredrickson that I.C.B.C. is estopped from objecting to the alleged breach of the regulations.

III. Whether the Assignment was Valid in Law or Equity

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19 By the agreement of assignment, Mr. Fredrickson conferred on Miss Nielsen "any and all rights of action or actions he possesse[d] arising out of the defence by I.C.B.C." of Miss Nielsen's suit against him, and appointed her his attorney "with full power and authority ... to sue for, recover and receive, the proceeds of the action or actions ... assigned. ..." In return, Miss Nielsen agreed not to take execution proceedings against Mr. Fredrickson. The assignment was an equitable assignment, I.C.B.C. not being party to it. It is not disputed that I.C.B.C. has received notice of the assignment.

20 The causes of actions purporting to be assigned are pleaded alternatively in contract and tort. Paragraph 55 of the statement of claim alleges that I.C.B.C. was in breach of the express and implied terms of its contract of insurance with Mr. Fredrickson in that it failed to act reasonably and properly in the adjustment and defence of Miss Nielsen's action against him. Paragraph 56 alleges that in the alternative I.C.B.C. was negligent in adjusting and defending the action and sets out detailed particulars of the negligence alleged. Since the plaintiff intends to proceed with both claims at trial, it is necessary to consider the assignability of both the cause of action in contract and the cause of action in tort.

A. Assignability of the Cause of Action in Tort

21 It is frequently said that a bare cause of action in tort is not assignable. This rule is based mainly on strictures of the common law against maintenance and champerty. Anglo-Canadian jurisprudence has never countenanced trafficking in litigation.

22 The exact ambit of the rule is elusive. Some of the cases commonly cited as authority for the rule prove, on analysis, not to have dealt with it except in obiter, if at all: *Simpson v. Thomson* (1877), 3 App. Cas. 279 (H.L.) (where the issue was subrogation, not assignment); *Dawson v. Great Northern & City Ry. Co.*, [1905] 1 K.B. 260 (C.A.) (where the cause of action lay in contract or administrative law); *Defries v. Milne*, [1913] 1 Ch. 98 (C.A.) (where the cause of action lay in contract law). Other cases speak only of the non-assignability of personal torts, as opposed to torts involving property: *Glegg v. Bromley*, [1912] 3 K.B. 474 (C.A.); see also *Union Gas Co. v. Brown*, [1968] 1 O.R. 524, 67 D.L.R. (2d) 44 at 51 (H.C.), reversed on other grounds [1970] 1 O.R. 715, 9 D.L.R. (3d) 337 (C.A.). None of the authorities offer a comprehensive discussion of the ambit of the rule.

23 On the assumption that, as a general rule, causes of action in tort are not assignable, it is clear that that rule is subject to a number of exceptions. In dealing with those exceptions it must be borne in mind that the categories of exceptions are not closed. In each case the court must ask itself whether the assignment can fairly be seen as prompted by a desire to advance the cause of justice rather than as intermeddling for some collateral reason: Fleming, The Law of Torts, 6th ed. (1983), p. 593.

24 First, it is clear that the fruits of an action, as opposed to the action itself, are assignable. In *Glegg v. Bromley*, supra, the issue was the validity of an assignment by a wife to her husband of the damages of a slander action. The court accepted that an assignment of a tort action based on a "personal wrong" would be invalid. It held, however, that if there were words in the assignment which purported to convey the cause of action as opposed to the fruits of the action, those words would be inoperative, leaving intact the portion of the assignment conveying the right to the fruits of the action.

25 The assignment in the case at bar purports to convey both the cause of action and the fruits of the action. If Miss Nielsen's only interest were in obtaining any damages which Mr. Fredrickson might obtain as a result of the suit, then the matter could be disposed of on the basis of this exception. However, it appears that she is desirous of prosecuting the action as well, through her agent, the Public Trustee. Her right to do so cannot be re-

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solved on the basis of this exception.

26 A second exception concerns cases where the assignee has either a pre-existing property interest or a legitimate commercial interest in the enforcement of the claim. An assignment where the assignee possesses such an interest will be valid, provided the action in tort is not based on a personal wrong, such as assault, libel or personal injury. The reason for the latter stricture appears to be that in cases of personal torts, the assignee can have no legitimate property or commercial interest in recovery: *Trendtex Trading Corp. v. Crédit Suisse*, [1980] Q.B. 629 at 656-57, [1980] 3 W.L.R. 367, [1980] 3 All E.R. 721, per Denning M.R., affirmed [1982] A.C. 679, [1981] 3 W.L.R. 766, [1981] 3 All E.R. 520 at 530 (H.L.).

27 This raises the question of what constitutes a sufficient interest to support an assignment of a cause of action in tort. Certainly a property interest to which the cause of action is ancillary is sufficient: *Ellis v. Torrington*, [1920] 1 K.B. 399 (C.A.). However, a property interest is not essential. The nature of the interest required to support an assignment is perhaps best ascertained by considering some of the cases which have upheld assignments of actions in tort on the basis of the assignee's interest in pursuing the action.

28 Assignments of causes of action in tort by the owners of damaged property to their insurers have been upheld on this ground: *King v. Victoria Ins. Co.*, [1896] A.C. 250, 65 L.J.P.C. 38, 74 L.T. 206, 12 T.L.R. 285, 44 W.R. 592 (P.C.); *Compania Colombiana de Seguros v. Pac. Steam Navigation Co.*, [1965] 1 Q.B. 101, [1964] 2 W.L.R. 484, [1964] 1 All E.R. 216. In these cases the insurer may be viewed as possessing a right by way of subrogation, of which the assignment is an extension: per Lord Roskill in *Trendtex*, supra.

29 In *Kapoor Lumber Co. v. Can. Nor. Pac. Ry. Co.*, 45 B.C.R. 213, [1932] 2 W.W.R. 417, [1932] 3 D.L.R. 487, this court considered whether an assignment of a cause of action in tort by an insured to his insurer was valid, entitling the defendants to pre-trial remedies against the insurance companies as true plaintiffs. Macdonald C.J.B.C., at p. 489, and Macdonald J.A. held that the assignment must fail because it assigned only part of the cause of action. Macdonald C.J.B.C., following *King*, supra, was of the view that otherwise the action would have been assignable, notwithstanding that it was an action in tort. McPhillips J.A. expressed the contrary view, stating [at p. 500] that it was "utterly impossible ... to assign a [cause of] action [in] tort". Martin J.A. held the assignment assigned the whole cause of action and was valid. In the upshot, while the case was decided on other grounds, two of the four justices would have upheld the assignment of the tort action. In my opinion, this is the better view.

30 Other cases illustrate that a cause of action may be assigned even where the assignee has no ancillary property interest. Assignment of the right to sue for infringement of copyright to a society formed to protect the interests of its members was upheld in *Performing Rights Soc. v. Thompson* (1918), 34 T.L.R. 351 (K.B.). In an action for infringement, the defendants alleged the assignment violated the rules against champerty and maintenance and that the business of the society was that of "breedbates" and "trafficking in litigation" [p. 352]. Atkin J. rejected that contention. He found at p. 352 that the assignment constituted a "*bona fide* business arrangement" for "legitimate business reasons". The society and its members, he said, both had a "real and *bona fide* interest in the result of the litigation".

31 Similarly, in *Martell v. Consett Iron Co.*, [1955] Ch. 363, [1955] 2 W.L.R. 463, [1955] 1 All E.R. 481 (C.A.), Danckwerts J. followed a "genuine interest in the litigation" test, in upholding maintenance by an association for the prevention of pollution to rivers of an action brought by owners and occupiers of fisheries.

32 *Martell* was approved in the House of Lords in *Trendtex*, supra. In the latter case, Lord Wilberforce at p.

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524, held that, apart from subsequent dealings, an assignment of a cause of action would have been valid, because it did not offend the law of maintenance or champerty. This was so because the assignee had a "genuine and substantial interest" in the success of the litigation.

33 Lord Roskill expressed the view at p. 531 that the assignment would be valid "If the assignment is of a property right or interest and the cause of action is ancillary to that right or interest, or if the assignee had a genuine commercial interest in taking the assignment and enforcing it for his own benefit ..." The other law lords agreed with both Lord Wilberforce and Lord Roskill. (It is immaterial that the cause of action assigned in *Trendtex* was in contract since the law on this point is the same for tort and contract.)

34 Two Canadian cases subsequent to *Trendtex* must be considered. In *Ellis-Don Ltd. v. Norton* (1982), 5 C.L.R. 281 (Ont. H.C.), an assignment of lien claims by subcontractors to a general contractor was struck down on the ground that the contractor-assignee in taking the assignment was not protecting a legitimate commercial interest. It was noted that he had ample machinery under the Ontario Mechanics Lien Act to vacate the liens and protect his position apart from the assignment. (Liens may be assigned under the British Columbia Builders' Lien Act: *Henfrey & Co. v. Poplar Properties Ltd.*, No. CA002767 [now reported at 70 B.C.L.R. 23, 24 D.L.R. (4th) 313].

35 A case closer to the facts of this case is *453416 Ont. Inc. v. White* (1984), 42 C.P.C. 209 (Ont. H.C.), leave to appeal granted (1984), 42 C.P.C. 215, per Reid J., appeal dismissed 27th June 1985 (Ont. Div. Ct.), where the court upheld an assignment by an insured to a party who had recovered judgment against him on account of an accident for which the insured successfully denied coverage. The subject of the assignment was the insured's cause of action against its insurance agent for breach of fiduciary obligation and negligent misrepresentation in failing to obtain proper insurance. Smith J. concluded at p. 214 that the interest of the assignee was real, genuine and legitimate. He was also of the view that it constituted a commercial interest even though it did not arise from financing arrangements as in *Trendtex*.

36 Most recently, in *Bourne v. Colodense Ltd.*, [1985] I.C.R. 291, the English Court of Appeal upheld the assignability of a cause of action of a union member for indemnification from his union for court costs to a receiver by way of equitable execution. The court found that the successful party in the litigation that gave rise to the costs had a commercial interest sufficient to negate any taint of champerty and thus to support the assignment. Lawton L.J. emphasized the fact that the assignee was not seeking to profit by the assignment, but was rather seeking only to obtain what it was entitled to under its order for costs. While the cause of action assigned was contractual, *Bourne* supports the view taken in other cases of the nature of the interest required to support an assignment.

37 I would summarize the effect of these cases as follows. An assignment of a cause of action for non-personal tort is generally valid if the assignee has a sufficient pre-existing interest in the litigation to negate any taint of champerty or maintenance. In determining if this test is met, the court should look at the totality of the transaction: *Trendtex*, per Lord Roskill at p. 531. A property interest ancillary to the cause of action assigned is sufficient to support an assignment, but not essential. A genuine pre-existing commercial interest will suffice. The term "commercial interest" is used in the sense of financial interest; it need not arise from commercial dealings in the narrow sense. Assignment of a cause of action to a stranger will not be permitted, nor will the court uphold an assignment made for the purpose of obtaining more than what the assignee is legally entitled to. The conditions necessary to support the assignment of a cause of action in tort will be held to have been met where one party to litigation assigns to the other a cause of action arising out of the conduct of that litigation, with a

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view to enabling the assignee to recover the judgment which the court has previously pronounced in his favour.

38 The latter proposition flows from *453416 Ont. Inc. v. White* and finds support in *Bourne v. Colodense* both supra. Those cases, like the case at bar, involved assignments by a person liable on a court order of a cause of action against a third party related to indemnification by the third party. Neither case involved a personal tort. There is only one significant difference between these cases and the case at bar, insofar as they touch on the question of the assignability of a cause of action. In *453416 Ont. Inc. v. White*, if White had procured the proper insurance, the assignee would have benefited, for there would have been funds from the insurance to satisfy his judgment. Similarly, in *Bourne*, if the union had indemnified its employee, there would have been funds available to pay the applicant's costs. In the case at bar, however, if I.C.B.C. had acted as Mr. Fredrickson suggests it should have, the result would have been a settlement which would have given the assignee judgment for an amount substantially less than the judgment she now holds. In other words, there was no common interest between the assignee and assignor in the case at bar until shortly before the assignment, when it was clear that no compromise could be reached.

39 In my opinion, this difference between the case at bar and *453416 Ont. Inc.* and *Bourne* cases does not justify departing from the conclusion in those cases that the assignee possessed a sufficient interest in the action assigned to support the assignment. First, the fact the assignor's and assignee's interests were previously opposed does not make the assignment champertous. While the entire transaction must be looked to, the essential question to be considered in determining whether the assignment smacks of maintenance or champerty is whether the assignee possessed the requisite financial interest at the time of the assignment. In my view, the fact that at some earlier date the interests of the assignee and the assignor were opposed does not negate the fact that when the assignment here in question was made, Miss Nielsen had a very real financial interest in obtaining it. She had a judgment. The cause of action of which she took an assignment represented her only means of obtaining satisfaction of that judgment. Her interest in the cause of action assigned is not created by the assignment, in which case it might well be champertous, but antedated and existed independently of the assignment. The assignee, in pursuing the assigned cause of action, does not seek to make a profit but only to recover the amount of her judgment. Moreover, she is not a stranger to the action assigned. She was involved in the proceedings which give rise to it. She has a direct relationship under our legislation with I.C.B.C., as Mr. Fredrickson's insurer, in her own right. In these circumstances I cannot conclude that assignment of Mr. Fredrickson's cause of action against I.C.B.C. to Miss Nielsen renders her an officious intermeddler guilty of the improper maintenance of the litigation.

40 In my view, if the fact that Miss Nielsen's and Mr. Fredrickson's interests were once opposed has any relevance, it must be on the ground that to permit a defendant to assign a cause of action against his insurer to a plaintiff whose interests are opposed to his is to promote improper collusion between the plaintiff and the defendant to the detriment of the insurer. If this assignment had taken place while the interests of the parties were opposed, it might be attacked as invalid on the ground that it violates the duty of the assured to cooperate with his insurer. I need not decide whether such an attack would succeed, since those are not the circumstances in the case at bar. Here the assignee had a judgment and was entitled to pursue Mr. Fredrickson in execution proceedings and all realistic prospect of compromise had vanished. The insured's duty to cooperate with his insurer had effectively been discharged. His interest at that point lay not with his insurer, but rather with the assignee; it was in their common interest to secure satisfaction of the judgment which had been rendered by the court and confirmed on appeal.

41 In summary, I see no valid reason for declaring the assignment in the case at bar to be invalid on the

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ground that at one point in time, the interests of the assignor and the assignee were opposed.

42 I conclude that the assignee had a legitimate pre-existing financial interest in the cause of action in tort assigned to her, and that consequently the assignment is valid. I have not found it necessary to discuss the American authorities in arriving at this conclusion. It may be observed, however, that the preponderance of American authority permits the assignment of causes of action in circumstances such as those here under consideration: *Gedeon v. State Farm Mut. Auto. Ins. Co.*, 261 F. Supp. 122 (Pa. D.C., 1966); *Terrell v. Western Casualty & Surety Co.*, 427 S.W. 2d 825 (Ky. C.A., 1968); *Groce v. Fidelity Gen. Ins. Co.*, 448 Pac. 2d 554 (Ore. S.C., 1968); and *McNulty v. Nationwide Mut. Ins. Co.*, 221 So. 2d 208 (Fla. D.C.A., 1969). Some of these authorities go so far as to suggest that any judgment creditor of the person assigning the cause of an action has a sufficient interest to support the assignment of the cause of action to him. It is not necessary to decide that question on this appeal. As discussed above, the relationship of the assignee in the case at bar to both Mr. Fredrickson and I.C.B.C. and her interest in the action between them places her in a position markedly superior to an ordinary judgment creditor.

B. Assignability of the Cause of Action in Contract

43 The Courts of Common Law did not permit the assignment of choses in action generally speaking. Two reasons are usually given for this. The first is that contracts created obligations which were strictly personal, that is, intangible to the immediate parties, so their transfer was not understandable to the earlier Common Law lawyers. Once our law grew more sophisticated, the reason was attributed to a fear of maintenance and champerty: *Di Guilo v. Boland*, [1958] O.R. 384, 13 D.L.R. (2d) 510 at 513 (C.A.), per Morden J.A.

44 However, the Courts of Equity generally speaking did recognize and enforce such assignments. This recognition was adopted in 1873 in the Judicature Act and today our courts uphold assignments which the Court of Equity would have previously enforced. Today there are six categories of contracts which are considered to be unassignable. They are:

45 1. Contracts which expressly by their terms exclude assignment;

46 2. Mere rights of action (assignments savouring of maintenance and champerty);

47 3. Contracts which by their assignment throw uncontemplated burdens on the debtor;

48 4. Personal contracts;

49 5. Assignments void by public policy (public officers' wages or salary and alimony or maintenance agreements); and

50 6. Assignments prohibited by statutory provisions. (Chitty on Contracts, 25th ed. (1983), pp. 709-15; Treitel, The Law of Contract, 5th ed. (1979), at pp. 519-23; Fridman, The Law of Contract in Canada (1976), pp. 442-45; and Waddams, Law of Contracts, 2nd ed. (1984), pp. 197-98.)

51 For purposes of this case, I need concern myself with only two of these categories: No. 2 (mere rights of action), and No. 4 (personal contracts).

52 The rule precluding the assignment of mere rights of action in contract is based on the rule against maintenance and champerty. As in the case of causes of action in tort, where the assignee possesses a sufficient pre-

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existing interest in the cause of action assigned, the suggestion of maintenance is negated and the assignment is valid: *Trendtex Trading Co. v. Crédit Suisse*, supra. In considering the assignability of the cause of action in tort, I have concluded that the assignee in this case had a genuine pre-existing financial interest in the cause of action assigned and that the assignment did not savour of maintenance or champerty. The same conclusion applies to the cause of action in contract.

53 I turn then to the rule against the assignment of personal contracts. As a general rule contracts for personal services cannot be assigned. The right to assign contractual rights without consent is confined to those cases where it can make no difference to the person on whom the obligation lies to which of two persons he is to discharge it: *Tolhurst v. Assoc. Portland Cement Mfr. (1900) Ltd.*, [1902] 2 K.B. 660 (C.A.); *Paterson Timber Co. v. Can. Pac. Lumber Co.* (1909), 15 B.C.R. 225, 14 W.L.R. 598, affirmed (1910), 47 S.C.R. 398. Motor vehicle insurance policies are regarded as personal contracts and hence as non-assignable, because it makes a difference to the insurer who the insured is: *Peters v. Gen. Accident & Life Assur. Corp.*, [1938] 2 All E.R. 267 (C.A.). Thus, for example, had Mr. Fredrickson sold his car prior to the accident, he could not have assigned his policy of insurance to the purchaser.

54 A distinction may be drawn, however, between the assignment of a contract and the assignment of a cause of action for damages arising out of an executed contract. Some cases suggest that if a contract is not assignable, a cause of action arising out of it is similarly not assignable: *Cohen v. Webber* (1911), 24 O.L.R. 171 at 173 (C.A.); *Brown v. Hall*, [1957] O.W.N. 15, 6 D.L.R. (2d) 460 at 464 (C.A.). However, the rationale which supports the non-assignability of personal contracts does not apply to causes of action for damages, when all that remains is the payment of money, since the assignment of a cause of action does not confer on the assignee the right to have services performed by the party who contracted with the assignor. This suggests that the fact that a personal contract cannot be assigned should not preclude assignment of a cause of action for damages based on a breach of that contract.

55 This view has been taken in the United States. In Groce v. Fidelity Gen. Ins. Co., supra, Goodwin J. held at p. 559, in a case quite similar to this:

> The policy contained a provision that "[a]ssignment of interest under this policy shall not bind the company until its consent is endorsed hereon ..." But the contention that such a clause prohibits the insured from assigning his *cause of action* need not detain us. It is well settled that such a provision *does not preclude the assignment of a cause of action for damages for breach of a contract.* [The italics are mine.]

56 The authorities in England and Canada offer little assistance on the question of whether a cause of action for damages for breach of contract can be assigned. Clearly a cause of action in debt can be assigned, even though the debtor denies liability: *Fitzroy v. Cave*, [1905] 2 K.B. 364 (C.A.); *County Hotel & Wine Co. v. London & North West. Ry. Co.*, [1918] 2 K.B. 251 at 258. However, the assignability of unliquidated claims admits of more doubt. Treitel, The Law of Contracts, 5th ed., after noting the different views on the question, concludes at p. 523 that "The best approach is to avoid generalisation and to ask in each case whether *this* assignment savours of maintenance".

57 Adopting that approach, it is my conclusion for the reasons stated earlier that the assignment of the cause of action for breach of contract here at issue does not savour of maintenance. Nor, as already noted, can it make any difference to I.C.B.C., to whom it pays damages awarded in any judgment which may be entered against it.

58 In these circumstances, I conclude that Mr. Fredrickson's cause of action in contract is assignable.

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C. Public Policy

59 I.C.B.C.'s final submission is that the issue of the assignability of a cause of action in the circumstances of this case is one of public policy. It contends that assignments are contrary to the good faith required of the assured by his insurance contract. I cannot accept that contention. The enforcement of I.C.B.C.'s contractual duties to its insured to use reasonable care to protect him from unnecessary loss is an important right which deserves protection. The assignee has a legitimate interest in the enforcement of that right in the circumstances of this case. The assignment to her of Mr. Fredrickson's causes of action against I.C.B.C. does not smack of maintenance or champerty, and does not constitute collusion against the insurer. Accordingly, there can be no objection to the assignment on grounds of public policy.

IV. Conclusion

60 The appeal is dismissed.

Appeal dismissed.

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TAB 23

1984 CarswellOnt 671, 7 C.C.L.I. 231, 47 O.R. (2d) 472, 11 D.L.R. (4th) 516, [1984] I.L.R. 1-1800, 4 O.A.C. 209, 47 O.R.(2d) 472

Perry v. General Security Insurance Co. of Canada

PERRY et al. v. GENERAL SECURITY INSURANCE CO. OF CANADA et al.

Ontario Supreme Court, Court of Appeal

MacKinnon A.C.J.O., Arnup and Houlden JJ.A.

Heard: May 17, 1984
Judgment: July 25, 1984

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Counsel: *Peter Webb, Q.C.* , and Steven Reisler, for appellants.

Brendan O'Brien, Q.C. , for respondents.

Subject: Insurance; Civil Practice and Procedure; Torts

Barristers and Solicitors --- Negligence — In real estate transactions — Mortgages — Providing ineffective mortgage security.

Insurance --- Claims — Notice and proof of loss — Relief against forfeiture.

Insurance --- Actions on policies — Third party proceedings — Recovery by third party from insurer.

Claim for relief from forfeiture dismissed.

The plaintiffs obtained a default judgment against an insured lawyer for the loss they suffered as a result of the lawyer's failure to investigate properly the title to land. When execution on this judgment was returned unsatisfied, the plaintiffs brought an action under s. 109 of the Insurance Act (Ontario) against the lawyer's insurer. The insurers successfully defended this action on the grounds that the lawyer did not incur liability "for injury or damage to the person or property" of the plaintiffs within the meaning of s. 109 of the Insurance Act; that the lawyer had forfeited his right to be indemnified by breach of the conditions of the policy, and that the plaintiffs were not entitled to claim relief from forfeiture under s. 106 of the Insurance Act. The plaintiffs appealed.

Held:

The appeal was dismissed.

Per MacKinnon A.C.J.O. (Arnup J.A. concurring)

The words of s. 109 of the Act could not be interpreted to mean economic loss unrelated to physical damage to property. It would be a distortion of the language, and the legislative and judicial history of s. 109 and of the definition of the word "property" found in the Act to allow claimants in the position of the plaintiffs to recover against the insurer without any procedural protection or rights afforded to the insurer.

There was nothing in the agreed facts that would justify relief from forfeiture to the lawyer. This was a flagrant case of the flouting of the conditions of the policy by the lawyer. The plaintiffs "stood in the shoes" of the insured lawyer and their action was "subject to the same equities" as the insurer would have against the insured if the judgment had been satisfied by the insured and a claim then made under the policy against the insured.

Per Houlden J.A. (concurring in part)

The word "property" had no fixed legal meaning. The intention of the Legislature would be best achieved by giving the word a wide interpretation. The prime purpose of obtaining insurance coverage for all lawyers practising in Ontario, was to protect members of the public who suffer damage by acts or omissions of lawyers in the performance of their professional duties. If s. 109(1) of the Act did not extend to lawyers, liability insurance, then part of that protection would be lost. However, this was not a proper case to grant relief from forfeiture.

Cases considered:

Continental Casualty Co. v. Yorke, [1930] S.C.R. 180 , [1930] 1 D.L.R. 609 — *considered*

Crone v. Orion Ins. Co., [1965] 2 O.R. 431, 51 D.L.R. (2d) 27 (H.C.) , affirmed [1966] 1 O.R. 221, 53 D.L.R. (2d) 98 (C.A.) , affirmed [1967] S.C.R. 157, 60 D.L.R. (2d) 630, [1967] I.L.R. 1-179 — *considered*

Findlay v. Madill, 28 O.R. (2d) 673, 111 D.L.R. (3d) 180, [1980] I.L.R. 1-1181 (H.C.) [varied 32 O.R. (2d) 413, 123 D.L.R. (3d) 765n, [1981] I.L.R. 1-1466 (C.A.)] — *distinguished*

Frederick v. Aviation & Gen. Ins. Co., [1966] 2 O.R. 356 (C.A.) — *considered*

Fun Seekers Int. Ltd. v. Can. Indemnity Co., [1976] I.L.R. 1-799 (Alta. Q.B.) — *distinguished*

Hildon Hotel (1963) Ltd. v. Dom. Ins. Corp., 66 W.W.R. 289, 1 D.L.R. (3d) 214, [1969] I.L.R. 1-256 (B.C. S.C.) — *considered*

Jordan House Ltd. v. Menow, [1974] S.C.R. 239, 38 D.L.R. (3d) 105 —*followed*

Kallos v. Sask. Govt. Ins., [1984] 2 W.W.R. 183, 30 Sask. R. 185 (sub nom. Junet v. Sask. Govt. Ins.), 3 C.C.L.I. 65, 4 D.L.R. (4th) 34, [1984] I.L.R. 1-1740 (Q.B.) — *not followed*

Lunness, Re (1919), 46 O.L.R. 320, 51 D.L.R. 114 (C.A.) — *considered*

Markus v. West. Union Ins. Co. (1964), 48 W.W.R. 428, 46 D.L.R. (2d) 193 (Alta. C.A.) — *applied*

Meretzky v. Can. Surety Co. (1932), 41 O.W.N. 156 (C.A.) — *considered*

Vandepitte v. Preferred Accident Ins. Corp. of New York, [1932] S.C.R. 22, [1932] 3 W.W.R. 573, [1933]

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1 D.L.R. 289 , affirmed [1933] A.C. 70 (P.C.) *considered*

Statutes considered:

(Automobile) Insurance Act, S.O. 1932, c. 25, ss. 183(a), (h).

Insurance Act, S.O. 1924, c. 50, s. 80.

Insurance Act, S.O. 1931, c. 49, s. 7.

Insurance Act, S.O. 1934, c. 22, s. 2.

Insurance Act, S.O. 1937, c. 256, s. 205.

Insurance Act, R.S.O. 1960, c. 190, s. 95(1).

Insurance Act, R.S.O. 1970, c. 224, s. 103.

Insurance Act, R.S.O. 1980, c. 218, ss. 1(54), (55), 99, 106, 109, 209, 226.

Interpretation Act, R.S.O. 1980, c. 219, s. 10.

Liquor Licence Act, R.S.O. 1960, c. 218, s. 67.

Liquor Licence Act, R.S.O. 1980, c. 244, s. 53.

Authorities considered:

Crossley Vaines on Personal Property (5th ed., 1973), p. 3.Griffiths, W.D., "Automobile Insurance — Part III", [1962] Special Lectures L.S.U.C., p. 57 at 72-75.MacGillivray & Parkington on Insurance Law (6th ed., 1975), pp. 934-35, paras. 2246-48.Mitchell, George L., Q.C., "Rights of Unnamed Insureds and Third Parties", [1962] Special Lectures L.S.U.C., p. 331 at 336-38.
APPEAL from a judgment, reported at 1 C.C.L.I. 227, 42 O.R. (2d) 514, 149 D.L.R. (3d) 272, [1983] I.L.R. 1-1669 (H.C.) , dismissing judgment creditors' direct recourse action under s. 109 of the Insurance Act (Ontario) against a liability insurer.

***MacKinnon A.C.J.O. (Arnup J.A.* concurring):**

1 The issue before Mr. Justice R.E. Holland, sitting in Motions Court, and before this Court is whether, as clients and judgment creditors of a negligent solicitor, the appellants (plaintiffs) have a cause of action under s. 109 of the Insurance Act, R.S.O. 1980, c. 218, against the negligent solicitor's insurers (defendants/respondents). The learned Motions Court Judge, with obvious reluctance, came to the conclusion on an Agreed Statement of Facts that s. 109 conferred no cause of action upon the clients who had suffered loss as a result of the negligence of the solicitor and had successfully sued the solicitor for breach of contract. It is with equal reluctance that I have come to the same conclusion.

2 As did the Motions Court Judge, I use the current section numbers of the Insurance Act. Although they were differently numbered at the time of the institution of the present action, the wording of the relevant sec-

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tions is identical.

3 The parties presented the Agreed Statement of Facts to the Motions Court, as well as a Statement of Issues which outlined the questions of law which the Court was requested to answer. The agreed facts are as follows:

1. The Plaintiff, William Perry, resides in the City of Cambridge, in the Regional Municipality of Waterloo and Province of Ontario. The Plaintiff, Peter Stevens, resides in the Town of Collingwood, in the County of Simcoe and Province of Ontario.

2. The Defendants, with the exception of F.C. Maltman & Co. Ltd., are the insurers of solicitors practising law in the province of Ontario, through a policy of insurance entered into between the said Defendants and The Law Society of Upper Canada.

3. In or about the month of January, 1978, the Plaintiffs retained a solicitor, one James Kopinak, hereinafter referred to as 'Kopinak' to place a second mortgage in their favour against certain property located in the Regional Municipality of Waterloo. The Plaintiffs jointly advanced to the solicitor Kopinak, the sum of $40,000.00 in order to obtain the said mortgage. At all material times, Kopinak was a solicitor duly licensed to carry on the practice of law within the Province of Ontario. Kopinak acted in a solicitor-client relationship toward the Plaintiffs and, in writing, certified to the Plaintiffs that he had registered a good and valid second charge against the lands described in the mortgage. In fact, Kopinak failed to register a second charge in favour of the Plaintiffs, there being three mortgages and an agreement of purchase and sale registered against the title to the property in question prior to the mortgage in favour of the Plaintiffs.

4. As a result of power of sale proceedings taken by the first mortgagee, the sum of $19,858.84 was paid into Court, pursuant to the Order of His Honour Judge Salhany dated September 18, 1979. Subsequently, pursuant to the Order of Her Honour Judge Elizabeth Robson dated November 6, 1979, this sum of money was paid out to the second and third mortgagees, there being nothing available for distribution to the Plaintiffs as a fourth mortgagee apart from a small amount for costs of the application before Her Honour Judge Robson. In Affidavits filed for the purpose of the application before Her Honour Judge Robson, the intervening mortgagees claimed that they had not received payment for their mortgages.

5. On November 9, 1978, the solicitor for the Plaintiffs, being Steven Reisler, notified Kopinak in writing of the problem with respect to the second mortgage and requested that he notify F.C. Maltman & Co. Ltd. forthwith. On March 10, 1979, the said solicitor for the Plaintiffs telephoned F.C. Maltman & Co. Ltd. to notify them of the problem, and to ask if Kopinak had reported same. On April 23, 1979, the said solicitor for the Plaintiffs notified F.C. Maltman & Co. Ltd. in writing. This letter notified F.C. Maltman & Co. Ltd. that the plaintiffs had a claim against Kopinak, and requested Maltman's intervention.

6. On May 11, 1979, the said solicitor for the Plaintiffs notified Kopinak, in writing, that the Plaintiffs' solicitor had notified Maltman's of the claim. On May 7, 1979, an employee of F.C. Maltman & Co. Ltd. met with Kopinak to discuss another claim, at which time the said employee briefly discussed the subject matter of this action, and the employee undertook to let Kopinak have a copy of the Plaintiffs' solicitor [sic] letter. Kopinak was advised to consider the matter, and decide what he wanted to do. This meeting was followed up by a letter from the said employee of F.C. Maltman & Co. Ltd. to Kopinak dated May 9, 1979, inviting him to report the claim.

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7. On September 5, 1979, the said Plaintiffs' solicitor notified F.C. Maltman & Co. Ltd. that the property had been sold by the first mortgagee, and that the sum of $19,858.84 was available for distribution to the subsequent encumbrancers. F.C. Maltman & Co. Ltd. were advised in the said letter that a Motion permitting the first mortgagee's solicitor to make the payment in would take place on September 18, 1979, in Kitchener.

8. On September 27, 1979, the Plaintiffs issued a Writ against Kopinak in the Supreme Court of Ontario. On the same date, the Plaintiffs' solicitor notified F.C. Maltman & Co. Ltd. that a Writ had been issued and, together with a Statement of Claim, was out for service on Kopinak. A copy of each of the said documents was forwarded to F.C. Maltman & Co. Ltd. under cover of a letter dated September 27, 1979.

9. On October 16, 1979, F.C. Maltman & Co. Ltd. was notified that the Defendant had not appeared nor filed a Statement of Defence, and the said F.C. Maltman & Co. Ltd. was invited to indicate its intention to defend the matter.

10. On October 30, 1979, F.C. Maltman & Co. Ltd. wrote to the Plaintiffs' solicitor, advising him that unless Kopinak reported the claim in accordance with condition 5 of the policy, F.C. Maltman & Co. Ltd. was unable to intervene. The letter also mentioned condition 7 of the policy. F.C. Maltman & Co. Ltd. reiterated its position, as above stated, in a letter dated January 15, 1980, to the Plaintiffs' solicitor.

11. On March 12, 1980, the Plaintiffs obtained a Default Judgment in the Supreme Court of Ontario against Kopinak in the amount of $40,000.00, together with interest thereon at the rate of 15-1/2 percent per annum, from October 16, 1978 to the date of Judgment, such interest being $9,249.09, for a total Judgment of $49,249.09. The Judgment further provided for post-judgment interest on the above amount at the rate of 15-1/2 percent per annum, and costs.

12. On March 31, 1980, the original Judgment, Certificate of Taxation, and copy of Writ of Execution were sent to the F.C. Maltman & Co. Ltd. together with a request for payment of same.

13. On April 2, 1980, F.C. Maltman & Co. Ltd. wrote to the Plaintiffs' solicitor advising that Kopinak had still not reported, and that until such time as Kopinak did so, there was nothing F.C. Maltman & Co. Ltd. could do about the matter.

14. On April 11, 1980, the Plaintiffs' solicitor advised Kopinak by telephone of the existence of the above-mentioned Judgment and further that F.C. Maltman & Co. Ltd. had received no report of the claim from him. During the course of this conversation, Kopinak advised the Plaintiffs' solicitor that he would report the claim immediately to F.C. Maltman & Co. Ltd.

15. On July 23, 1980, Kopinak telephoned F.C. Maltman & Co. Ltd. and discussed the matter with an employee of F.C. Maltman. Kopinak remarked that a claim was being made against him because of the priority of mortgages problem. Kopinak denied that the mortgage in question was not a valid second mortgage, and added that he would compose a full report. Subsequent to this conversation, F.C. Maltman & Co. Ltd. wrote to Kopinak enclosing, for his signature, a Non-Waiver Agreement. The said Non-Waiver Agreement was never signed nor returned to F.C. Maltman & Co. Ltd.

16. On July 22, 1980, a Writ of Nulla Bona was returned from the Sheriff of the Judicial District of Waterloo.

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17. It is not alleged that the policy was invalid by reason of non-payment of premiums.

18. On October 23, 1980, F.C. Maltman & Co. Ltd. reported in writing to Gestas Corporation, the manager for the insurers under the policy.

19. The general procedure of F.C. Maltman & Co. Ltd. when a lawyer reports a claim to it, is as follows: (a) a file is opened up,

(b) an investigation is commenced,

(c) a report is made to Gestas Corporation.

This is a procedure, generally speaking, where there are no coverage problems. If it appears that the report is late, or for some other reason the claim may not be covered, it is routine to obtain a signed Non-Waiver Agreement before proceeding further. The investigation would normally consist of interviewing the insured lawyer, reviewing his file and, if necessary, engaging counsel to advise on questions of law. On occasion, the claimant's solicitor is spoken to.

20. Apart from the meeting on May 7, 1979, the telephone conversation of July 23, 1980 was the only verbal communication which took place between F.C. Maltman & Co. Ltd. and Kopinak regarding this matter. F.C. Maltman & Co. Ltd. opened up a file on the matter and, as above stated, reported to Gestas Corporation.

21. Kopinak did not respond to letters from F.C. Maltman & Co. Ltd. nor did he return their phone calls to provide the information which he said he would provide in a telephone conversation of July 23, 1980.

4 The questions of law which the parties outlined and asked the Court to determine are:

1. Upon the facts disclosed in the Agreed Statement of Facts, did Kopinak incur a liability for injury or damage to the person or property of the Plaintiffs within the meaning of Section 106(1) of the Insurance Act, R.S.O. 1970, Chapter 224 and amendments (now Section 109(1) R.S.O., 1980, Chapter 218) so as to make the said provision of the Insurance Act apply to the Judgment obtained by the Plaintiffs against Kopinak?

2. If the answer to the above question is in the affirmative, has Kopinak, by breach of the conditions of the insurance policy forfeited his right to be indemnified with respect to the said Judgment?

3. If Kopinak has forfeited his right to indemnity, can the Plaintiffs avail themselves of the right to claim relief from forfeiture under Section 103 of the Insurance Act, R.S.O. 1970, Chapter 224 and amendments (now Section 106, R.S.O. 1980, Chapter 218)?

5 As stated, the Motions Court Judge held that s. 109(1) did not apply to the judgment obtained by the appellants against their solicitor and he answered the first question in the negative. In view of his answer to question one, it was not necessary for him to answer questions two and three. However, in case the matter went further, the Motions Court Judge felt that he should state his views on questions two and three. He concluded that he was bound by Frederick v. Aviation & Gen. Ins. Co., [1966] 2 O.R. 356 (C.A.) , and that, on the equities, the appellants could not be granted relief from forfeiture under s. 106 of the Insurance Act (then s. 103). Question

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two was answered in the affirmative and question three in the negative. I should state that the appellants now agree that the solicitor had, by his breach of the conditions of the insurance policy, forfeited his right to be indemnified with respect to the appellants' judgment and that question two is properly answered in the affirmative. They argue, however, that that forfeiture does not, on the agreed facts, prevent the appellants from successfully claiming relief from forfeiture under s. 106. I shall deal with that argument later.

Section 109 of the Insurance Act

6 Section 109 reads:

> 109.-(1) Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against him in respect of his liability, and an execution against him in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.
>
> (2) This section does not apply to motor vehicle liability policies.

7 From the Agreed Statement of Facts, it is clear that the solicitor, in breach of his instructions, failed to place the requested second mortgage as security for the $40,000 advanced by the appellants to him for that purpose. The mortgage he did register was a fourth mortgage, subsequent as well to an agreement of purchase and sale. As a result of the exercise of its power of sale by the first mortgagee, there was no money available for distribution to the appellants.

8 It appears that if the appellants' security had been a second mortgage as required, there still would have been a considerable shortfall in the moneys available to pay it off after the sale by the first mortgagee. However, Mr. O'Brien for the respondents agreed that in view of the subsequent judgment secured against the solicitor by the appellants for the full amount of $40,000, the insurers, if liable under s. 109, would be liable for the total amount of the judgment.

9 As the Motions Court Judge pointed out, the policy here is styled "Lawyers' professional liability policy", commonly called an "errors and omissions" policy. The named insured is "The Law Society of Upper Canada" and the insured are described as "eligible members of the Law Society of Upper Canada, including Partnerships. ..." The individual coverage is set out as follows:

> To pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of any act or omission of the Insured, or of any other person for whose acts or omissions the insured is legally responsible, and arising out of the performance or intended performance of professional services for others, or failure to perform such services as ought to have been performed, in the Insured's capacity as a lawyer except that, if the Insured is a member of any partnership, this coverage (A) shall not apply if one or more claims arising out of the same professional service are made (1) jointly or severally against two or more members of the partnership or against any member of the partnership and the partnership, (2) against the partnership or (3) against the Insured solely because he is a member of the partnership.

10 The appellants' position, simply stated, is that the solicitor's failure to follow their instructions caused them to lose $40,000. That loss was "injury or damage" to their "property" within the meaning of those words in s. 109. It is argued that the words "injury or damage to person or property" is the most comprehensive language

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that could have been used by the Legislature and was intended to cover "all types" of monetary liability. Section 99 of the Insurance Act states that, except where otherwise provided, the part of the Act under which s. 109 falls applies to every contract of insurance made in Ontario other than contracts of accident and sickness insurance, life insurance, and marine insurance. Accordingly, the appellants submit, s. 109 applies to errors and omissions insurance and to the factual situation in the instant case.

11 "Property" is defined in the definition section [s. 1(54)] of the Insurance Act as follows:

> 'property' includes profits, earnings and other pecuniary interests, and expenditure for rents, interest, taxes and other outgoings and charges and in respect of inability to occupy the insured premises, but only to the extent of express provision in the contract;

12 The appellants argue that they have lost a "pecuniary interest" and therefore there was injury or damage to their property. However, it appears to me that the definition section militates against the position of the appellants. That section refers to "inability to occupy the insured premises", and it states further that it is only covered "to the extent of express provision in the contract". The section refers to "*the* " insured premises, not to insured property, and it is difficult to see how there could be injury or damage *to* rents and taxes. The section must be read as a whole and there is nothing in the cover of the Law Society contract of insurance which remotely fits this description. Counsel for the appellants, in arguing for a fair, large and liberal interpretation of s. 109, referred the Court to the definition of "property" used by Mr. Justice Riddell in Re Lunness (1919), 46 O.L.R. 320 at 332, 51 D.L.R. 114 (C.A.) . The Court there was determining the intention of a testator when he spoke of "property situated in the Province of Ontario". Mr. Justice Riddell stated in this connection:

> No doubt 'property' is the most comprehensive of all the terms which can be used, inasmuch as it is indicative and descriptive of every possible interest which the party can have: Langdale, M.R., in Jones v. Skinner (1835), 5 L.J.N.S. Ch. 87, 90 — and no doubt in a proper case the word will be so interpreted.

13 Counsel for the appellants pointed out that an Alberta trial Court had relied on this definition of "property" in Fun Seekers Int. Ltd. v. Can. Indemnity Co., [1976] I.L.R. 1-799, [1976] W.W.D. 153 (Alta. Q.B.) . However, it is to be noted that, in that case, the insurance coverage was for loss *of* money, securities and other property, not liability for injury or damage *to* property.

14 In looking at the scope of s. 109, I do not think the words of the section can be interpreted to mean economic loss unrelated to physical damage to property. As the Motions Court Judge pointed out, that view is supported by the interpretation placed on similar words found in the Liquor Licence Act by Laskin J., speaking for the majority of the Supreme Court of Canada in Jordan House Ltd. v. Menow, [1974] S.C.R. 239 at 246-47, 38 D.L.R. (3d) 105 .

15 The plaintiff Menow became intoxicated at the defendant hotel's (Jordan House) beverage room. He was ejected by an employee of the hotel and, while wandering home on foot, was struck near the centre line of the highway by a vehicle driven by Honsberger. Menow was awarded damages against the hotel and Honsberger under an equal apportionment of fault among all three parties.

16 Section 67 of the Liquor Licence Act, R.S.O. 1960, c. 218 (now s. 53 of the Liquor Licence Act, R.S.O. 1980, c. 244) which was considered by the Court read:

> s. 67 Where any person or his servant or agent sells liquor to or for a person whose condition is such that the

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> consumption of liquor would apparently intoxicate him or increase his intoxication so that he would be in danger of causing injury to his person or injury or damage to the person or property of others, if the person to or for whom the liquor is sold while so intoxicated,
>
> (a) commits suicide or meets death by accident, an action under The Fatal Accidents Act lies against the person who or whose servant or agent sold the liquor; or
>
> (b) causes injury or damage to the person or property of another person, such other person is entitled to recover an amount to compensate him for his injury or damage from the person who or whose servant or agent sold the liquor.

17 On the appeal, counsel for Honsberger argued, as did counsel for the appellants in the instant case, that the word "property" found in s. 67(b) can have an extremely broad meaning and submitted that it could mean monetary loss of the kind claimed here. Laskin J., in dealing with this argument, said at pp. 246-47:

> Before dealing in more detail with this central question, I wish to refer to an issue raised by counsel for Honsberger in reliance on s. 67(b) of The Liquor Licence Act. If the judgments below stand so far as the hotel's liability is concerned, Honsberger would have the benefit of the Ontario Negligence Act in respect of any claim over against the hotel for the damages assessed against both defendants. But on the assumption that the hotel is exonerated here, the submission on behalf of Honsberger is that the unappealed affirmation of the judgment against him amounts to 'injury or damage to the ... property' of Honsberger, within s. 67(b), and thus entitles him to recover from the hotel the amount for which he has been held liable to Menow. The Court did not require counsel for the hotel to respond to this submission. It was of the opinion that s. 67(b) cannot be so interpreted. That provision does not entitle a blameworthy defendant to cast himself in the role of a plaintiff claiming not for damage suffered by it but rather for that suffered by the intoxicated person and for which it is in part responsible. *This is entirely apart from the attempt to read the word 'property' in a sense which is entirely foreign to its ordinary meaning as well as to the context in which it is used in s. 67(b).*

(emphasis added.)

18 Although the facts in the instant case are much more sympathetic to the appellants than the facts upon which Honsberger sought to rely in seeking to establish a claim under the then s. 67(b) of the Liquor Licence Act, to interpret the word "property" in s. 109 of the Insurance Act to cover the present claim would be, in the words of Laskin J., "an attempt to read the word 'property' in a sense which is entirely foreign to its ordinary meaning as well as to the context in which it is used. ..."

19 Originally, s. 109 applied to all types of insurance. As a result of a series of cases in the 1920s and early 1930s, its deficiencies with respect to automobile accident victims became apparent. As a result, the Insurance Act was amended in 1932 and 1935 (found in the 1937 Consolidation: c. 256, s. 205) to make special provision for third-party rights in such cases by permitting a person not a party to the contract of insurance who had a claim against the insured, by virtue of an accident caused by one driving the insured's automobile with his permission, to claim against the insurer. This is now embodied in detail in ss. 209 and 226 of the Insurance Act which also allows for an insurer who denies liability to be made a third party to any action in which a claim is made against the insured (ss. 226(14) and (15)).

20 The only authority to which we were referred that appears to have some resemblance to the case under

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review is Kallos v. Sask. Govt. Ins., [1984] 2 W.W.R. 183, 30 Sask. R. 185 (sub nom. Junet v. Sask. Govt. Ins.), 3 C.C.L.I. 65, 4 D.L.R. (4th) 34, [1984] I.L.R. 1-1740 , a recent judgment of the Saskatchewan Queen's Bench. In that case, a solicitor negligently failed to commence a motor-vehicle accident claim within the limitation period. The plaintiffs (clients) obtained a judgment against the solicitor. The learned trial Judge concluded that there was no reason for excluding claimants against an insurer pursuant to a solicitor's professional liability policy from the operation of s. 122 of the Saskatchewan [Insurance] Act, R.S.S. 1978, c. S-266, which is similar to s. 109 of our Insurance Act. He was of the view that, because s. 101 of the Saskatchewan Insurance Act (which is identical in its relevant parts to s. 99 of the Ontario Act) makes s. 122 applicable to every contract of insurance made in Saskatchewan, it therefore applied to solicitors' professional liability insurance. In considering the trial decision in the instant case, he felt that this argument had not been made before Holland J. and he refused to follow it, being of the view that there was no necessity for the clients to establish a causal connection between the act or omission of the solicitor and the damage or injury to persons or property.

21 We were advised that the successful argument made in Kallos was indeed made to the trial Judge in the instant case. In my view, no matter how sympathetic one may be to the appellants' position, it would be a distortion of the language, and the legislative and judicial history of s. 109, and of the definition of the word "property" found in the Act, to allow claimants in the position of the appellants to recover against the insurer without any procedural protection or rights afforded to the insurer. As previously stated, this problem was recognized and addressed with regard to third-party claims of motor-vehicle accident victims in the circumstances recited, and the Act was amended accordingly. Section 109, in its present form, does not allow the appellants to succeed in their claim against the insurer, and the first question must be answered in the negative.

Section 106 of the Insurance Act

22 Having come to the same conclusion as the Motions Court Judge on the first question, it is not necessary to deal with the second and third questions posed. However, like the Motions Court Judge, I think it would be helpful to the parties and the profession to express my views on those questions, particularly on question three.

23 As stated, counsel for the appellant conceded that question two had to be answered in the affirmative. He agreed that the solicitor, by his breach of the policy conditions, had forfeited his right to be indemnified with respect to the judgment against him. However, Mr. Webb, on behalf of the appellants, argued that this forfeiture by the solicitor did not bar the appellants' right to claim relief from forfeiture under s. 103 (now s. 106) of the Insurance Act. Section 106 reads:

> 106. Where there has been imperfect compliance with a statutory condition as to the proof of loss to be given by the insured or other matter or thing required to be done or omitted by the insured with respect to the loss and a consequent forfeiture or avoidance of the insurance in whole or in part and the court considers it inequitable that the insurance should be forfeited or avoided on that ground, the court may relieve against the forfeiture or avoidance on such terms as it considers just.

24 Section 109 makes any action against the insurer by a third party "subject to the same equities as the insurer would have if the judgment had been satisfied".

25 From the Agreed Statement of Facts, the appellants did their best to make the insurers aware of the potential claim against their insured. The appellants' position is that, had the insurers chosen to do so, they could have intervened and had themselves added as third parties. But there is, at present, no rule or Act that permits the insurer in such situations to be added as of right. Mr. Webb did not argue that in all cases the conduct of the

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lawyer in breach of the policy conditions would not prejudice the insurer, but submitted that there had to be, in each case, an assessment of the prejudice without laying down a general rule. In this connection, he pointed out that the Motions Court Judge had stated:

> The insurer knew all about this claim and there is really little, if any, prejudice to the insurer by reason of not being advised of the claim by the insured and by the failure of the insured to cooperate.

26 However, it is uncontested that this was a flagrant case of the flouting of the conditions of the policy by the solicitor. His ignoring of the claim and his failure to advise his insurers of the claim and to cooperate with them was, apparently, deliberate. There is nothing in the agreed facts that would justify granting relief from forfeiture to the solicitor. In Kallos, supra, the trial Judge held that the solicitor had not been in breach of any condition of the policy. He had given notice of the claim against him and offered to cooperate with the defendant insurer.

27 I agree with the Motions Court Judge that the claimants here "stand in the shoes" of the insured solicitor and s. 109 makes their action "subject to the same equities" as the insurer would have against the insured if the judgment had been satisfied by the insured and a claim then made under the policy by the insured. The appellants sought to rely on Markus v. West. Union Ins. Co. (1964), 48 W.W.R. 428, 46 D.L.R. (2d) 193 at 201 (Alta. C.A.) . But Smith C.J.A., speaking for the Court, made the position plain:

> It was contended by the appellant that (a) there is not power in the Court to relieve from forfeiture in favour of a third party and (b) that in respect of the two alleged breaches of statutory condition by Nagy there was no compliance by him, that it is only in case of 'imperfect compliance' that relief can be granted, and that consequently there is no power in the Court to grant the respondent relief under s. 287.
>
> The answer to the first of these two arguments, in my view, consists of statements of Kerwin, C.J.C., and Tritschler, J.A., in the Erickson case already quoted by me. In my view it is quite clear from that decision that the power to relieve from the forfeiture in favour of the third party is co-extensive with the power to relieve in favour of the insured. *In the case at bar I am satisfied that the power to relieve could and would be exercised in favour of the insured if he were a party to this action* .

(emphasis added.)

28 Nor do I find Findlay v. Madill, 28 O.R. (2d) 673, 111 D.L.R. (3d) 180, [1980] I.L.R. 1-1181 (H.C.) [varied 32 O.R. (2d) 413, [1981] I.L.R. 1-1466, 123 D.L.R. (3d) 765n (C.A.)], referred to by counsel for the appellants, helpful in the context of this case. That was a claim under what is now s. 226 of the Insurance Act and different considerations applied. Under the Act, the insurer had the right to defend, but exercised its option not to and the Court held it had not suffered prejudice. The Insurance Act makes it clear that in motor-vehicle accident claims the third party is not prejudiced in his claim to the insurance money by any act or default of the insured (s. 226(4)(b)).

29 Mr. Webb concedes that the onus is on the appellants to persuade the Court, if he is first able to persuade us that his clients are in a better position under s. 106 than is the solicitor, that there was no prejudice to the insurer. But, even accepting that the appellants are in a better position than the insured under s. 106, I am not persuaded that it can be said that there was no prejudice caused the insurer by the solicitor's failure to defend and to cooperate with the insurer. For one thing, on the face of the agreed facts, it appears that the judgment might, if defended, have been limited to some $19,000, the money available after satisfying the claims of the first mort-

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gagee, rather than the $40,000 awarded.

30 In holding that the appellants stepped "into the shoes" of the insured solicitor, the Motions Court Judge was of the view, as noted earlier, that he was bound by the following statement of principle made by Schroeder J.A. in Frederick v. Aviation & Gen. Ins., supra, at p. 359:

> The effect of the section quoted is to place the plaintiffs in the shoes of the insured Ottawa Aero Services Ltd., and it operates as a statutory assignment of the benefits of the insurance policy in their favour. They have no higher rights under the policy than the insured would have, and their right of recovery is subject to all the equities existing between the insurer and the insured. The defendant denies liability to the plaintiffs upon the ground that Ottawa Aero Services Ltd. committed breaches of the policy conditions which disentitled it to indemnity thereunder.

31 Counsel for the appellants, in their Statement (although not in their oral submissions), argued that the Court in Frederick might have stated the law differently had the present s. 106 then been in force. However, when that case was decided, there was a provision for relief from forfeiture in the Act substantially the same as the present s. 106 and it cannot be distinguished on that basis.

32 To grant relief from forfeiture to a person not a party to the contract, when the insured could not be granted such relief, is, in effect, to remove any consideration of the equities between insured and insurer in the issue. Under such an interpretation and application of s. 106, the words "but subject to the same equities as the insurer would have" found in s. 109 can have no effect or meaning. I can see no reason to differ from Schroeder J.A.'s statement of principle, supra, and the third question must be answered in the negative.

33 On the facts of this case, the result is an unhappy one. It seems also to run counter to one of the purposes for the insistence by the Law Society of Upper Canada that its members assume this insurance as a condition of being licensed to practise. Surely one of the main reasons for such a condition was to ensure that members of the public, in the situation of the appellants, would be protected from loss caused by the negligent action or inaction of their solicitors. As noted during the course of the argument by my brother Arnup, it seems that the more negligent the solicitor is in carrying out his obligations to the insurer under the insurance contract (which could be, as in the instant case, merely an extension of the negligent manner in which he carries out his professional obligations generally), the less possibility there is for the client to recover moneys payable under the insurance contract.

34 To deal with such situations as the present, it might be possible for the Law Society to be named in the policy, for the purpose of such claims, a partner of each practising solicitor. Its liability being limited to the amount of the cover in this way, it could be sued directly, with the solicitor, could advise the insurer of the claim, ensure the co-operation of the solicitor and, at the same time, ensure the fulfillment of one of the purposes of the compulsory insurance. Alternatively, the Legislature could amend the legislation, as it did for automobile accident victims, so that third parties will be enabled to claim against insurers regardless of the acts or defaults of the insured, subject to protection to the insurer similar to that afforded by the present s. 226 to motor vehicle liability insurers.

35 The situation revealed by this claim cannot be unique, and it is to be hoped that a prompt solution is provided by legislation or otherwise.

36 Mr. O'Brien advised the Court that his client would not be asking for costs, and the appeal is dismissed

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without costs.

***Houlden J.A.* (concurring in part):**

37 I agree with MacKinnon A.C.J.O.'s interpretation of s. 106 of the Insurance Act, R.S.O. 1980, c. 218, and with his conclusion that this is not a proper case to grant relief from forfeiture. I do not, however, agree with his interpretation of s. 109(1) of the Insurance Act. Although the appeal must be dismissed, I would like to state briefly my views on the interpretation of the section.

38 At common law, an injured party had no cause of action against an insurer for damages awarded to him against an insured. The right of the insured to be indemnified by his insurer was personal to the insured, and there was no privity between the injured person and the insurer: MacGillivray & Parkington on Insurance Law, (6th ed., 1975), pp. 934-35, paras. 2246-48.

39 In 1924 a section was added to the Ontario Insurance Act to remedy this situation. Section 80 of the Insurance Act, S.O. 1924, c. 50 provided:

> 80. In any case in which a person insured against liability for injury or damage to persons or property of others has failed to satisfy a judgment obtained by a claimant for such injury or damage and an execution against the insured in respect thereof is returned unsatisfied, such execution creditor shall have a right of action against the insurer to recover an amount not exceeding the face amount of the policy or the amount of the judgment in the same manner and subject to the same equities as the insured would have if the said judgment had been satisfied.

To take advantage of the remedy provided by s. 80, the injured party had to obtain judgment against the insured, issue execution and obtain a nulla bona return before he could take proceedings directly against the insurer.

40 Section 80 and its successor sections applied to motor vehicle accident cases: see, for example, Continental Casualty Co. v. Yorke, [1930] S.C.R. 180 , [1930] 1 D.L.R. 609 , and Meretzky v. Can. Surety Co. (1932), 41 O.W.N. 156 (C.A.) . In 1931, the section was amended to its present wording, and subs. (2), which provides that the section does not apply to motor vehicle liability policies, was added to the section: see the Insurance Act, S.O. 1931, c. 49, s. 7.

41 The deletion of motor vehicle liability policies from the section resulted from the decision of the Privy Council in Vandepitte v. Preferred Accident Ins. Corp. of New York, [1933] A.C. 70 . In that case, the Court was concerned with s. 24 of the Insurance Act, S.B.C. 1925, c. 20 which was identical in wording with s. 109(1) of the Insurance Act. The Privy Council held, affirming the judgment of the Supreme Court of Canada, [1932] S.C.R. 22, [1932] 3 W.W.R. 573, [1933] 1 D.L.R. 289 , that s. 24 afforded no remedy to a person injured by an automobile driven by someone other than the insured, even though the driver was operating the vehicle with the permission of the insured. By ss. 183(a) and (h) of the (Automobile) Insurance Act, S.O. 1932, c. 25, this defect in the law was remedied: see article by W.D. Griffiths, "Automobile Insurance — Part III," in [1962] Special Lectures L.S.U.C. 57, Claims Under Insurance Policies. In 1935, the Insurance Amendment Act, S.O. 1935, c. 29, s. 35, permitted an insurer which denied liability under a motor vehicle policy to have itself added as a third party so that it could protect its interests when the main action was being tried: see article by Griffiths, op. cit., pp. 72-75. The present sections of the Insurance Act dealing with motor vehicle liability policies are ss. 209, 226, and 227. (For the differences between a claim under s. 109(1) and a claim under s. 226, see article by

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George L. Mitchell, Q.C., "Rights of Unnamed Insureds and Third Parties", in [1962] Special Lectures L.S.U.C. 331 at 336-38.) Section 109 of the Insurance Act reads as follows:

> 109. — (1) Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against him in respect of his liability, and an execution against him in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.
>
> (2) This section does not apply to motor vehicle liability policies.

42 The issue is: Did Kopinak incur a liability for damage to the property of the plaintiffs within the meaning of s. 109(1) when he failed to register the second mortgage for them against the property in Waterloo?

43 The plaintiffs suffered a substantial pecuniary loss as a result of Kopinak's negligence. In support of his contention that "property" in s. 109(1) includes such a loss, Mr. Reisler, who argued this portion of the appeal, relied on the definition of property in s. 1(54) of the Insurance Act, which is to this effect:

> 'property' includes profits, earnings and other pecuniary interests, and expenditure for rents, interest, taxes and other outgoings and charges and in respect of inability to occupy the insured premises, but only to the extent of express provision in the contract;

This definition was added to the Act by the Insurance Act, S.O. 1934, c. 22, s. 2. If the definition of "property" applies to "property" in s. 109(1), then the damage sustained by the plaintiffs comes within the section, since s. 1(54) states that "property" includes "other pecuniary interests".

44 Mr. O'Brien submitted, however, that s. 1(54) is only intended to apply to "property damage insurance" which is defined by s. 1(55) as follows:

> 'property damage insurance' means insurance against loss of or damage to property that is not included in or incidental to some other class of insurance defined by or under this Act;

While the Act is not as clear as it might be, I agree with MacKinnon A.C.J.O.'s analysis of s. 1(54) and with his conclusion that the subsection has no application to a policy of professional liability insurance.

45 There appear to be only two cases in which Courts have interpreted the word "property" in s. 109(1) or equivalent sections: one in Ontario and one in Saskatchewan. The Ontario case is Crone v. Orion Ins. Co., [1965] 2 O.R. 431, 51 D.L.R. (2d) 27 (H.C.) . In that case two individual plaintiffs and a corporate plaintiff sustained damage in an airplane crash. The three plaintiffs sued the owner of the airplane. When the owner did not defend the action, the plaintiffs obtained judgment and issued execution. The execution was returned unsatisfied. The three plaintiffs then took proceedings against the owner's insurer pursuant to what is now s. 109(1) of the Insurance Act (then s. 95(1) of the Insurance Act, R.S.O. 1960, c. 190).

46 The claims of the individual plaintiffs were for bodily injuries, and they were allowed recovery from the insurer. The claim of the corporate plaintiff was, however, for loss of profits, and Stewart J., the trial Judge, held

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that the claim did not fall within the section. At p. 433 [O.R.] of his judgment, the learned Judge disposed of the claim of the corporate plaintiff in these words:

> Section 95 of the Insurance Act, R.S.O. 1960, c. 190, reads as follows:
>
> > 95(1) Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against him in respect of his liability, and an execution against him in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.
>
> I am invited to read the section so as to mean 'liability for injury to another or damage to the person or property of another' so that the loss of business of the company might come under the head of 'injury to another' but I do not feel that this is the true sense of the section, believing that the liability must be injury to the person or property of another or damage to the person or property of another. No claim for damage to the property, such as cameras etc., of the company was made in the original action and it is obvious that there was no damage to the person of the corporation.

It is clear that Stewart J. was of the opinion that "damage to property" in the section meant "damage to physical property".

47 An appeal was taken by the insurer in the Crone case to the Court of Appeal and to the Supreme Court of Canada, but as both these Courts were careful to point out, there was no cross-appeal by the corporate plaintiff: see Crone v. Orion Ins. Co., [1966] 1 O.R. 221 at 222, 53 D.L.R. (2d) 98 (C.A.) and Orion Ins. Co. v. Crone, [1967] S.C.R. 157 at 160, 60 D.L.R. (2d) 630, [1967] I.L.R. 1-179 ; Stewart J.'s interpretation of s. 109 was thus not considered by the Appellate Courts.

48 The Saskatchewan case is Kallos v. Sask. Govt. Ins., [1984] 2 W.W.R. 183, 30 Sask. R. 185 (sub nom. Junet v. Sask. Govt. Ins.), 3 C.C.L.I. 65, 4 D.L.R. (4th) 34, [1984] I.L.R. 1-1740 (Q.B.) . This involved s. 122(1) of the Saskatchewan Insurance Act, R.S.S. 1978, c. S-266, a section similar in wording to s. 80 of the Insurance Act, 1924. The plaintiffs had been injured in an automobile accident. They retained a solicitor to bring an action on their behalf against the party who caused their injuries. The solicitor failed to commence the action within the prescribed limitation period so that the plaintiffs' cause of action became statute barred. The plaintiffs sued the solicitor for negligence and recovered judgment. When they were unable to obtain payment from him, they brought action against the defendant's liability insurer. Maurice J. held that s. 122(1) of the Saskatchewan Act was wide enough to include the claim. Although I do not agree entirely with Maurice J.'s reasons for arriving at this conclusion, I do agree with his conclusion.

49 Mr. O'Brien sought to distinguish the Kallos case on the ground that in that case, unlike the present one, there had been actual injury or damage to the person and property of the plaintiffs. With respect, I do not think that this distinction is a valid one. The solicitor was not responsible for the property damage and bodily injuries sustained by the plaintiffs; rather, he was responsible for the pecuniary loss suffered by the plaintiffs by reason of his failure to bring the action in the limitation period.

50 In support of his contention that "property" in s. 109(1) means physical property and does not include pecuniary loss, Mr. O'Brien relied on the decision of Laskin J. in Jordan House Ltd. v. Menow, [1974] S.C.R. 239,

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38 D.L.R. (3d) 105 . In that case, the plaintiff Menow, on the evening in question, drank to excess in the hotel of the defendant Jordan House Ltd. At about 10 p.m., the plaintiff was ejected from the hotel by the defendant's employees who knew that the plaintiff was unable to take care of himself by reason of intoxication and that he would have to go home, probably by foot, by way of a main highway. On the way home, Menow was struck by the motor vehicle of the defendant Honsberger. The trial Judge apportioned liability equally between the plaintiff and the two defendants. The defendant Honsberger did not appeal the finding of negligence or the apportionment of one-third of the fault against him. The defendant hotel did appeal the finding of negligence against it.

51 Section 67(b) of the Liquor Licence Act, R.S.O. 1960, c. 218 (now s. 53 of the Liquor Licence Act, R.S.O. 1980, c. 244) provides:

> s. 67 Where any person or his servant or agent sells liquor to or for a person whose condition is such that the consumption of liquor would apparently intoxicate him or increase his intoxication so that he would be in danger of causing injury to his person or injury or damage to the person or property of others, if the person to or for whom the liquor is sold while so intoxicated,
>
> .....
>
> (b) causes injury or damage to the person or property of another person, such other person is entitled to recover an amount to compensate him for his injury or damage from the person who or whose servant or agent sold the liquor.

In the Supreme Court of Canada, the defendant Honsberger argued that if the defendant hotel was exonerated of liability by the Court, then the judgment against him constituted injury or damage to his property within s. 67(b), and this entitled him to recover from the defendant hotel the amount for which he had been held liable to the plaintiff.

52 Laskin J. in holding that s. 67(b) could not be so interpreted said, at pp. 246-47:

> That provision does not entitle a blameworthy defendant to cast himself in the role of a plaintiff claiming not for damage suffered by it but rather for that suffered by the intoxicated person and for which it is in part responsible. This is entirely apart from the attempt to read the word 'property' in a sense which is entirely foreign to its ordinary meaning as well as to the context in which it is used in s. 67(b).

53 Notwithstanding the similarity of wording in the two statutes, I do not regard the above statement as a binding authority on the meaning of "property" in s. 109(1) of the Insurance Act. The context in which the words are used in the two statutes is quite different. Furthermore, s. 67(b) of the Liquor Licence Act applies to the situation where an intoxicated person "*causes* injury or damage to the ... property of another person" whereas s. 109(1) applies where a person "*incurs a liability* for injury or damage to the ... property of another". (The emphasis is mine.) In any event, Laskin J. did not purport to give a comprehensive definition of the word "property".

54 In Ontario, the Law Society has taken an active role with respect to professional liability insurance. It has entered into a policy with the defendant insurers which provides coverage for all lawyers practising in Ontario. The prime purpose of obtaining this coverage was, I believe, to protect members of the public who suf-

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fer damage by acts or omissions of members of the Society in the performance of their professional duties. If s. 109(1) does not extend to solicitors' liability insurance, then part of that protection is, of course, lost.

55 "Property" has no fixed legal meaning. As Crossley Vaines' Personal Property (5th ed., 1973) points out at p. 3:

> 'Property' is a word of different meanings. It may mean a thing owned (my watch or my house is 'my property'); it may mean ownership itself as when I speak of my 'property' in my watch which may pass to the person to whom I sell the watch before I actually hand the watch over (the rules as to the 'passing of the property' in this sense are set out in the Sale of Goods Act, 1893 (a)); or it may even mean an interest in a thing less than ownership but nevertheless conferring certain rights, as when we speak of the 'property' or 'special property' of a bailee in the thing bailed. Bailment is explained in Chapter 6 and these different senses in which the word 'property' is used should emerge as our discussion proceeds. In English law, therefore, 'property' comprehends tangibles and intangibles, movables and immovables; it means a tangible thing (land or a chattel) itself, or rights in respect of that thing, or rights, such as a debt, in relation to which no tangible thing exists.

I would refer also to Hildon Hotel (1963) Ltd. v. Dom. Ins. Corp., 66 W.W.R. 289, 1 D.L.R. (3d) 214, [1969] I.L.R. 1-256 (B.C.S.C.) , and Fun Seekers Int. Ltd. v. Can. Indemnity Co., [1976] I.L.R. 1-799, [1976] W.W.D. 153 (Alta. Q.B.) on the meaning of "property". If damage to property in s. 109(1) is restricted to damage to physical property, then a claim against an insurer pursuant to a solicitors' professional liability insurance policy would not be covered. If the draftsman uses an abstract word, such as "property", without defining it, I believe that the Court should give the word the meaning which best carries out the purpose and intent of the statute: s. 10 of the Interpretation Act, R.S.O. 1980, c. 219. Section 109(1), as I have pointed out, was intended to overcome the defect in the common law which prevented an injured party from taking action directly against an insurer for damage caused by an insured. The intention of the Legislature is, I believe, best achieved by giving a wide interpretation to the word "property".

56 I would not, therefore, restrict damage to property in s. 109(1) to damage to the physical property of a third party. Rather I would interpret it as being wide enough to include damage to the pecuniary interests of a third party. If property in s. 109(1) is given this interpretation, then the section is wide enough to include within its operation the claim of a client against a solicitor pursuant to a professional liability insurance policy.

***Arnup J.A.* (concurring):**

57 I have read the reasons prepared by MacKinnon A.C.J.O. and by Houlden J.A. I agree with them that this appeal must be dismissed.

58 I agree with the conclusion of MacKinnon A.C.J.O., concurred in by Houlden J.A., that the appellants can be in no better position than the insured solicitor with respect to forfeiture for breach of conditions of the policy, and that as the Insurance Act, R.S.O. 1980, c. 218 now stands, the appellants are not entitled to relief from forfeiture because the solicitor himself would not have been so entitled.

59 This is an unjust result. It makes no sense that the clients of a remorseful solicitor, who co-operated with the insurer and the new solicitors of his former clients, might in an appropriate case get relief from forfeiture,

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whereas the clients of a callous solicitor, who first botched his clients' affairs and then refused to lend them the slightest assistance in their efforts to recoup some of their loss, should find themselves helpless to secure relief from the forfeiture of his insurance, caused by him.

60 My brothers are in disagreement as to the answer to the first question formulated by the parties. In concise form that issue is: where a client has lost the $40,000 he gave his solicitor to put into a second mortgage, is that loss "injury or damage to ... [the client's] property" within the meaning of subs. 109(1) of the Insurance Act? It would be very satisfying to be able to answer that question: "Yes". One might support the answer, superficially, by saying: "Of course the loss is 'damage to property'. The client's assets have decreased by $40,000, and that loss was caused by the solicitor."

61 This can only be the correct answer if it is founded on subs. 109(1) of the Act. I am persuaded by the reasons of MacKinnon A.C.J.O. that the interpretation of "property" in that subsection, reading the subsection as a whole and in context, cannot be extended to cover the plaintiffs' loss. With great respect to my brother Houlden, he has agreed with MacKinnon A.C.J.O. that the definition of "property" in clause 1(54) of the Act (so as to include "other pecuniary interests") does not apply to a policy of professional liability insurance, but has then gone on to hold that "property" includes "pecuniary interests" even *without* the definition clause. I do not agree, because I think the conclusion is not consonant with a reading of subs. 109(1) as a whole.

62 Finally, I heartily endorse the view of MacKinnon A.C.J.O. that immediate action should be taken by the Law Society or the Legislature, or both, so that the present unfairness to innocent clients of insured solicitors can be ended.

Appeal dismissed.

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

**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c.C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION**

ONTARIO
**SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

PROCEEDING COMMENCED AT
TORONTO

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