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Algoma Steel Corp. v. Royal Bank

ALGOMA STEEL CORPORATION, LIMITED v. ROYAL BANK OF CANADA, MONTREAL TRUST COMPANY, et al.

Ontario Court of Justice (General Division)

Farley J.

Judgment: February 25, 1992
Docket: Doc. Toronto

Counsel: *Michael E. Royce* , for applicant.

J.L. McDougall, Q.C. , for respondents.

Subject: Corporate and Commercial; Insolvency

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

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

The role of the court on an application for the sanctioning of a plan is to determine whether the plan is fair and reasonable. The court must take into consideration the impact of the plan upon all interested parties. The whole scheme of *Companies' Creditors Arrangement Act* ("CCAA") proceedings is to see whether compromise or arrangement can be effected among the creditors and shareholders of a company with a view to see if the company can be made viable, assuming certain changes are made.

The holder of a guarantee from the company under CCAA protection is a creditor within the meaning of s. 12 of the CCAA.

Cases considered:

Film House Ltd., Re (1974), 19 C.B.R. (N.S.) 231 (Ont. S.C.) , varied (1974), 19 C.B.R. (N.S.) 231 at 234 (Ont. S.C.) — *referred to*

Froment, Re, 5 C.B.R. 765, [1925] 2 W.W.R. 415, [1925] 3 D.L.R. 377 (Alta. T.D.) — *referred to*

Hammond Organ Studios of Kelowna Ltd., Re (1981), 40 C.B.R. (N.S.) 293 (B.C. S.C.) — *referred to*

J. LeBar Seafoods Inc., Re (1981), 38 C.B.R. (N.S.) 64 (Ont. S.C.) — *referred to*

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

Quebec Steel Products (Industries) Ltd. v. James United Steel Ltd., [1969] 2 O.R. 349, 5 D.L.R. (3d) 374 (H.C.) — *referred to*

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

Standard Trust Co. v. Bodrug (1988), 71 C.B.R. (N.S.) 49, 63 Alta. L.R. (2d) 205, 90 A.R. 249, [1989] 2 W.W.R. 69 (Q.B.) — *referred to*

Standard Trust Co. v. Paragon Homes Ltd. (1987), 66 C.B.R. (N.S.) 224, 54 Alta. L.R. (2d) 48, 81 A.R. 187 (Q.B.) — *referred to*

Statutes considered:

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

Companies' Creditors Arrangement Act, R.S.C. 1952, c. 54 —

s. 11(1)(a)

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

s. 2 "company"

s. 12(1)

s. 12(2)

Courts of Justice Act, 1984, S.O. 1984, c. 11 [now R.S.O. 1990, c. C.43].

Motion for various declarations concerning the effect of the *Companies' Creditors Arrangement Act* on a guarantee.

Farley J. **(orally):**

1 This is the Bank of Montreal motion with respect to Algoma, related to the American subsidiary, Cannelton Iron Ore Co. Counsel were J.L. McDougall at that time for the Bank of Montreal, and Michael Royce for Algoma and Cannelton. It was heard February 14, 1992, with further written submissions up to and including February 24, 1992.

2 Algoma Steel Corp., Ltd. ("Algoma") is a corporation operating since February 18, 1991 under the provisions of the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36 ("C.C.A.A."); its American subsidiary, Cannelton Iron Ore Co. ("C.I.O.C."), is not (see definition of "company", s. 2 C.C.A.A.). The Bank of Montreal ("B. of M.")

loaned C.I.O.C. 15 million U.S. dollars pursuant to a credit arrangement dated as of February 18, 1989 to which C.I.O.C., Algoma and B. of M. are parties ("credit agreement"). The loan was made to allow C.I.O.C. to fund its share of mining equipment for a joint venture partnership operating the Tilden iron mines in Michigan.

3 Pursuant to the credit agreement, Algoma guaranteed the loan. C.I.O.C. has defaulted on the loan, including a principal repayment of $2,250,000 U.S. due August 19, 1991. B. of M. has neither exercised its right to demand and enforce payment of the C.I.O.C. debt by C.I.O.C., nor has it made any demand for payment under Algoma's guarantee. Aside from the guarantee, it does not appear that the loan was secured.

4 The plan that Algoma has filed under the C.C.A.A. appears to propose that Algoma's liability to the B. of M. under the guarantee constitute for the purpose of the plan a *claim* by a *specified unsecured creditor* (as defined in the plan) to be valued and compromised through the issuance to the B. of M. of an undetermined number of *NA common shares* (emphasis indicating terms defined in the plan). *Trade creditors* are proposed to be treated more favourably. However, under the plan, Algoma proposes that its indebtedness to C.I.O.C. as to iron ore that it has purchased from C.I.O.C. not be treated as a trade debt for the purposes of the plan. Rather, Algoma proposes to reduce the $26,112,000 Algoma owes C.I.O.C. on an inter-company account basis to the nominal amount of one dollar as an amount owed to a fully owned subsidiary. An affidavit submitted by the B. of M. stated:

> The November 30, 1991 Balance Sheet confirms that the outstanding account receivable owed by Algoma to CIOC in the amount of $26,112,000, CIOC's interest in the Joint Venture and CIOC's iron ore inventory are the only assets of CIOC which appear to be available to satisfy the CIOC Debt. I have been advised by representatives of Algoma and I do believe that the realizable value of the assets of CIOC may not be sufficient to satisfy the CIOC Debt.

5 Before and after the February 18, 1991 C.C.A.A. order, Algoma has purchased iron ore from C.I.O.C. It is understood that the purchases were valued on a transfer pricing arrangement — i.e., one that is to be calculated on a "friendly arm's length basis" for the purposes of tax filings in Canada and the U.S.A. Apparently Algoma could (and did in fact from time to time) repatriate part of its equity investment in C.I.O.C. by redemptions and used the funds in a paper transaction to reduce the amount of debt it owed C.I.O.C. Such indebtedness would also be affected by the amount of cash calls that Algoma contributed to the joint venture on behalf of C.I.O.C. from time to time. Given the present view of C.I.O.C.'s assets versus its liabilities, it may be very questionable as to Algoma's present ability to accomplish such an "exchange".

6 One assumes that the B. of M. wishes to keep its options open before proceeding to enforce payment against physical assets — i.e., it would wish to see if it could benefit from C.I.O.C. being treated as a trade creditor, which would have minimal impact on the $26,112,000 receivable asset as opposed to the practical write-off of the receivable.

7 Algoma's position as to the B. of M. loan to C.I.O.C. was es sentially that the loan arrangement should be treated as one with Algoma directly and that the B. of M. should not (and was not) concerned with the dealings between C.I.O.C. and Algoma.

8 The motion was for an order

9 (a) declaring that the B. of M. is not, in its capacity as a holder of the Algoma guarantee, a creditor of Algoma within the meaning of the C.C.A.A. and that the guarantee is not an obligation or liability of Algoma subject to compromise or arrangement under that C.C.A.A.;

10 (b) in the alternative, if the B. of M. is held to be a creditor of Algoma, declaring that

(i) the rights of the B. of M. to claim against C.I.O.C. for the C.I.O.C. debt to it shall not be varied, affected or impaired as a consequence if the plan proposed by Algoma under the C.C.A.A.;

(ii) no valuation of Algoma's guarantee liability to the B. of M. for the purposes of the plan and no issuance of any *NA common shares* to the B. of M. in accordance with the plan shall have the effect of either reducing the C.I.O.C. debt or entitling Algoma to any rights of subrogation to the B. of M.'s position; and

(iii) any consideration provided the B. of M. pursuant to the plan in respect of the guarantee shall not constitute a payment by a guarantor on a guarantee but shall be deemed to constitute consideration paid to amend or vary a contract;

11 (c) declaring that any plan of compromise and arrangement by Algoma under the C.C.A.A. would not be fair and equitable if C.I.O.C.'s receivables from Algoma were not treated in a manner equivalent to the treatment afforded other trade creditors of Algoma.

Is the B. of M. a "creditor" within the meaning of the C.C.A.A.?

12 The B. of M. relied heavily on the decision of Parker J. in *Quebec Steel Products (Industries) Ltd. v. James United Steel Ltd.*, [1969] 2 O.R. 349, 5 D.L.R. (3d) 374 (H.C.) for the proposition that it was not a creditor. This case was decided before the C.C.A.A. was amended. Under the previous legislation (R.S.C. 1952, c. 54), the relevant section reads as follows:

11. (1) For all purposes of this Act the amount represented by a claim of any secured creditor or unsecured creditor shall be determined as follows:

(*a*) 'claim' means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy Act*;

13 Under the current legislation, the relevant section reads as follows:

12. (1) For the purposes of this Act, 'claim' means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy Act*.

(2) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor shall be defined as follows: ...

14 Parker J. in *Quebec Steel* reached the conclusion, based on the former language of C.C.A.A. that since creditor was not per se defined, that one had to resort to the common law rules which dictated that one with an unliquidated claim could not be considered a creditor. After quoting s. 11, he said at p. 356 [O.R.]:

This section clearly refers only to amount. If a creditor has a claim under the *Companies' Creditors Arrangement Act* then the amount may be extended under this section. In the present case we are not concerned with the amount unless the plaintiff first qualifies as an unsecured creditor as of January 17, 1965.

He had previously stated at p. 353:

At common law, a claim for unliquidated damages does not constitute one a creditor. Jowitt's Dictionary of English Law (1959), defines 'creditor' at p. 535 as follows:

Creditor, a person to whom a debt is owing by another person, called the debtor ...

and 'debt' is defined at p. 581 in these words:

> A debt exists when a certain sum of money is owing from one person (the debtor) to another (the creditor).

15 Thackray J. in *Re Quintette Coal Ltd.* (1991), 7 C.B.R. (3d) 165, (sub nom. *Quintette Coal Ltd. v. Nippon Steel Corp.*) 56 B.C.L.R. (2d) 80 (S.C.) said, in referring to *Quebec Steel* [at p. 88 B.C.L.R.]:

> CdFI conceded that I am not bound by that decision, but said that it is persuasive authority. I am not convinced that if Mr. Justice Parker had the present placement (that is, in s. 12 instead of s. 11) in front of him, he would come to the same decision. He preferred to resort to a common law definition of 'claim' because he found that the definition in the C.C.A.A. was restricted to that section concerned with amount. The legislation has been amended and we must assume with purpose. The concepts of claim and amount are no longer tethered together. 'Claim' is visualized with a future prospect, i.e., 'would be a debt' and in my opinion clearly envisages giving potential creditors a role in the C.C.A.A. proceedings.

It should also be noted that *Quebec Steel* was dealing with a situation when "the plaintiff did not know of the plan of compromise or of the holding of a meeting to approve it" (at p. 351 [O.R.]), conditions which are not present in the subject case.

16 When one appreciates that debtor companies (such as Algoma) are entitled to a broad and liberal interpretation of the jurisdiction of the court under the C.C.A.A., see *Nova Metal Products Inc. v. Comiskey (Trustee of)*, 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey*) 41 O.A.C. 282, 1 O.R. (3d) 289 , where Doherty J.A. in dissent, but not apparently as to the following, quite explicitly described the importance of the policy and objectives underlining the C.C.A.A. stated at pp. 119-120 [C.B.R.]:

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy- or creditor-initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
>
> . . . . .
>
> The Act must be given a wide and liberal construction so as to enable it to effectively serve this remedial purpose: *Interpretation Act* , R.S.C. 1985, c. I-21; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* ...

17 It strikes me that the double recitation in s. 12(1) and (2) of "[f]or the purposes of this Act" and the segregation of these subsections was intended to allow "claim" to be determined as any "indebtedness, liability or obligation of any kind" by reference to whether it "could be a debt provable in bankruptcy within the meaning of the *Bankruptcy Act* ". The determination of the amount of that claim is to be determined under another provision, also "[f]or the purposes of this Act". Under the structure and context of the C.C.A.A. could there be a claim (unsecured debt provable as such under the *Bankruptcy Act*) without there being a creditor as the holder of that claim. I think not. I therefore conclude that the B. of M. is creditor of Algoma vis-à-vis the guarantee (see *Re Film House Ltd.* (1974), 19 C.B.R. (N.S.) 231 (Ont. S.C.) , varied (1974), 19 C.B.R. (N.S.) 231 at 234 (Ont. S.C.) ; *Re Froment*, 5 C.B.R. 765, [1925] 2 W.W.R. 415, [1925] 3 D.L.R. 377 (Alta. T.D.) , which indicate that the contingent liability of a guarantor who has not been called upon to pay or who has not in fact paid should be considered a debt provable in bankruptcy pursuant to the *Bankruptcy Act*).

18 In *Re J. LeBar Seafoods Inc.* (1981), 38 C.B.R. (N.S.) 64 (Ont. S.C.) , Henry J. stated at p. 68:

As I apprehend the law, the right of the principal creditor, Ocean Garden, to claim against the estate of the guarantor LeBar, is governed by *Re Blakely; Ex parte Aachener Disconto Gesellschaft* (1892), 9 Morr. 173 (D.C.). The principle established in that decision is that upon the bankruptcy of its debtor, the creditor is entitled to claim against the estate of the bankrupt guarantor for the full amount of the debt. The claim is to be reduced only by any amount paid to the creditor by the debtor or by the debtor's estate and by the amount of any dividend declared in favour of the creditor prior to proof of the creditor's claim in the estate of the guarantor.

Does the plan affect the right of the bank against C.I.O.C.?

19 It is quite clear the C.I.O.C. is not a company within the definition of that term in the C.C.A.A. It is a U.S. corporation. Apparently, no proceedings have been taken which directly affect it.

20 There appears to be consensus between the B. of M. and Algoma that if the B. of M. exercised its rights against C.I.O.C., there would be a shortfall even if the C.I.O.C. receivable from Algoma were left at $26,112,000. I do not see the operations of the C.C.A.A. proceedings as affecting the B. of M.'s rights to proceed against C.I.O.C. C.C.A.A. is a shield, not a sword, as it affects proceedings. It is as well not a sword as to the compromise of obligations with the requisite votes are taken and the plan sanctioned by the court. In other words, I do not see that Algoma at the present time can force the B. of M. to take *any common shares* — not for all or any part of its guarantee obligation. The B. of M. has sat on the fence as to which way it wishes to proceed. It seems to me that the time is ripe (possibly even overripe) for a decision to be made in fairness to Algoma (and all other interested parties) getting on with its proposed C.C.A.A. restructuring. Given that, the practical approach would be to determine what the B. of M. could obtain from C.I.O.C. It may be that this would have to be determined by a valuation. Most certainly, it will necessitate a determination of what is to be the appropriate valuation of the C.I.O.C. receivable from Algoma — i.e., should it be (i) valued at one dollar, as proposed by the plan, or (ii) treated as per a trade receivable, or (iii) determined in some other fashion.

21 A guarantee and the principal debt it guarantees are separate and distinct obligations. A guarantor ceased to be liable only when the principal debt has been repaid in full (unless otherwise released from liability). Where, by operation of law, the principal debt is completely discharged by partial payment, the amount owing under the guarantee is reduced, but the guarantee is not discharged; see *Standard Trust Co. v. Paragon Homes Ltd.* (1987), 66 C.B.R. (N.S.) 224, 54 Alta. L.R. (2d) 48, 81 A.R. 187 (Q.B.) and *Standard Trust Co. v. Bodrug* (1988), 71 C.B.R. (N.S.) 49 , 63 Alta L.R. (2d) 205, 90 A.R. 249, [1989] 2 W.W.R. 69 (Q.B.) .

22 It was agreed in this case that if a guarantor (Algoma) made payment on a guarantee, the guarantor is then subrogated to the rights of the guaranteed party (B. of M.) against the primary debtor (C.I.O.C.). Given my view that the B. of M. should be allowed to proceed in the manner which in its view might produce the maximum recovery for the B. of M., I do not see this as a case where the B. of M. should be faced with Algoma potentially saying that the guarantee to the full extent of the C.I.O.C. debt to the B. of M. should be valued and satisfied by the proposed issuance of *NA common shares* pursuant to the plan. If, contrary to my view, this were to prevail, then it appears that Algoma could claim that the B. of M. should not press C.I.O.C. for payment since this would involve a duplication of the payment arrangement (see *Re Hammond Organ Studios of Kelowna Ltd.* (1981), 40 C.B.R. (N.S.) 293 (B.C. S.C.)).

How should the C.I.O.C. receivable from Algoma be treated?

23 The credit agreement provides, among other things, that:

24 (a) B. of M. loan C.I.O.C. 15 million U.S. dollars;

25 (b) C.I.O.C. represented and warranted to the B. of M. that its December 31, 1988 financials were prepared in accordance with generally accepted accounting principles and that they fairly represented the financial position of

C.I.O.C.;

26 (c) C.I.O.C. agreed to provide the B. of M. with future financials which met the requirements of (b) above; and

27 (d) as to each advance requested, C.I.O.C. was taken to have certified that the representations and warranties were true in all material respects.

28 Given these terms of the credit agreement and including the reference to Algoma as an entity distinct from C.I.O.C., it does not seem to me that Algoma should be able to say that the loan to the C.I.O.C. was made entirely without regard to transactions between Algoma and C.I.O.C. Furthermore, it appears that Algoma's position that the loan was made on the strength of Algoma's covenant under its guarantee was unsupported speculation.

29 I am of the view that the B. of M. is entitled to treat the C.I.O.C. receivable from Algoma as a receivable. It was represented (and continued to be represented) to the B. of M. that the receivable was "good". It is true that there was no contractual restriction against Algoma, reducing its equity and using the redemption proceeds to pay down the inter-company account. However, it did not do so in the last several years.

30 The B. of M. then submits that it would not be fair and reasonable to permit Algoma to prefer Algoma's creditors and shareholders over the creditors of C.I.O.C. by causing C.I.O.C. to vote in favour of the plan or to otherwise agree to or acquiesce in the reduction of its $26,112,000 receivable from Algoma to one dollar. I think that it is premature to rule on this instant situation. Clearly, the role of the court in a C.C.A.A. situation in this regard is to determine, on the application for sanctioning a plan, whether that plan is fair and reasonable. It is not, in my mind, something that can be answered in the vacuum of the instant case as only Algoma, C.I.O.C. and the B. of M. are being looked at in isolation. Whether a plan is fair and reasonable must take into consideration the impact of same upon all interested parties (in this situation all creditors and shareholders). 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, particularly in light of the wholly owned subsidiary scenario. The whole scheme of C.C.A.A. proceedings is to see whether a compromise or arrangement can be effected among the creditors and shareholders of a company with a view to see if the company can be made viable, assuming certain changes are made. See Doherty J.A.'s comments, supra, in *Nova Metal Products Inc.*

31 In the result I have determined:

32 (a) the B. of M. as holder of a guarantee from Algoma is a creditor of Algoma within the meaning of C.C.A.A.;

33 (b) the B. of M. is entitled to enforce its rights against C.I.O.C. without being then affected by the proposed plan, but that if there is determined to be a deficiency thereby, Algoma may satisfy such deficiency pursuant to its obligations under the guarantee and that such satisfaction may involve the issuance of *NA common shares* ;

34 (c) it would be premature and inappropriate to rule on whether the write-down of the C.I.O.C. receivable to one dollar was fair and reasonable; such should be determined in the context of considering the sanction of the plan as it affects all interested parties.

35 I have endorsed the motion record accordingly.

36 On consent, no order as to costs.

Order accordingly.

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