Q.B.G. No. 1461 of 2009

C A N A D A)
PROVINCE OF SASKATCHEWAN)

IN THE QUEEN'S BENCH
JUDICIAL CENTRE OF SASKATOON

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36 (the "CCAA")

AND IN THE MATTER OF A PROPOSED PLAN OF ARRANGEMENT FOR THE CREDITORS OF BIG SKY FARMS INC., DRYCAST SYSTEMS INC. and BIG SKY MANAGEMENT CONSULTING CORP.

BRIEF OF LAW OF BIG SKY FARMS INC.
(Motion by Big Sky Finishers (No. 1) Inc. Under Section 32(2) of the CCAA)

FACTS

1. This Brief of Law of Big Sky Farms Inc. ("**Big Sky**") is filed in reply to a motion by Big Sky Finishers (No. 1) Inc. ("**Finishers**") for an Order under section 32(2) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**") providing that the following agreements between Big Sky and Finishers dated May 16, 2003 are not to be disclaimed or resiliated: a) Contract Finishing Agreement; b) Option Agreement; and c) Indemnity Agreement (collectively, the "**Subject Agreements**").

2. On Thursday, February 4, 2010, Big Sky served Finishers with a Notice by Debtor Company to Disclaim or Resiliate an Agreement (the "**Notice of Intention to Disclaim**") with respect to the Agreements, pursuant to section 32(1) of the CCAA.

3. By correspondence dated February 11, 2010, Finishers, by its counsel, made a formal request, pursuant to section 32(8) of the CCAA, that Big Sky identify the reasons for its repudiation of the Subject Agreements set out in the Notice of Intention to Disclaim.

4. By correspondence dated February 16, 2010, Big Sky, by its counsel, identified three reasons why Big Sky delivered to Finishers the Notice of Intention to Disclaim, namely:

i. The cost of hog contract spaces purchased by Big Sky from Finishers under the Subject Agreements was no longer economically competitive;

ii. The "Put Option" price contained in the Subject Agreements significantly exceeded the fair market value of the hog finishing facilities owned by Finishers; and

iii. Negotiations between Big Sky and Finishers regarding alternative arrangements had reached an impasse.

(*Seventh Supplementary Affidavit of Canute Tagseth* [the "*Tagseth Affidavit*"] at para. 48)

5. By means of a Notice of Motion dated February 18, 2010, Finishers commenced this application under section 32(2) of the CCAA.

ISSUES

6. Big Sky respectfully submits that this application by Finishers raises the following issues for consideration by this Honourable Court, namely:

i. In general, what are the criteria applicable to the repudiation or disclaimer of contracts under the CCAA?

ii. What are the specific factors which the Court is to consider in determining whether or not to prohibit the repudiation or disclaimer of contracts under section 32(2) of the CCAA?

iii. Applying these criteria and factors to the case, to what extent is it appropriate for this Honourable Court to intervene and prevent the disclaimer or repudiation of the Subject Agreements?

ARGUMENT

(I) The General Criteria Applicable to the Repudiation of Contracts Under the CCAA

The 2009 Amendments to Section 32 of the CCAA

7. Section 32 of the CCAA (as amended and proclaimed in force on September 18, 2009) provides that:

> **32(1) Disclaimer or resiliation of agreements**
>
> **32(6) Intellectual property** Subject to subsections (2) and (3), a debtor company may — on notice given in the prescribed form and manner to the other parties to the agreement and the monitor — disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer or resiliation.
>
> **32(2) Court may prohibit disclaimer or resiliation**
>
> Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.
>
> **32(3) Court-ordered disclaimer or resiliation**
>
> If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement be disclaimed or resiliated.
>
> **32(4) Factors to be considered**
>
> In deciding whether to make the order, the court is to consider, among other things,
>
> > (a) whether the monitor approved the proposed disclaimer or resiliation;
> >
> > (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
> >
> > (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

32(5) Date of disclaimer or resiliation

An agreement is disclaimed or resiliated

(a) if no application is made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1);

(b) if the court dismisses the application made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1) or on any later day fixed by the court; or

(c) if the court orders that the agreement is disclaimed or resiliated under subsection (3), on the day that is 30 days after the day on which the company gives notice or on any later day fixed by the court.

32(6) Intellectual property

If the company has granted a right to use intellectual property to a party to an agreement, the disclaimer or resiliation does not affect the party's right to use the intellectual property — including the party's right to enforce an exclusive use — during the term of the agreement, including any period for which the party extends the agreement as of right, as long as the party continues to perform its obligations under the agreement in relation to the use of the intellectual property.

32(7) Loss related to disclaimer or resiliation

If an agreement is disclaimed or resiliated, a party to the agreement who suffers a loss in relation to the disclaimer or resiliation is considered to have a provable claim.

32(8) Reasons for disclaimer or resiliation

A company shall, on request by a party to the agreement, provide in writing the reasons for the proposed disclaimer or resiliation within five days after the day on which the party requests them.

32(9) Exceptions

This section does not apply in respect of

(a) an eligible financial contract;

(b) a collective agreement;

(c) a financing agreement if the company is the borrower; or

(d) a lease of real property or of an immovable if the company is the lessor.

8. Under the 2009 amendments to the CCAA, a debtor company may, on notice to the other parties to an agreement and the monitor, disclaim or repudiate any agreement to which the company is a party at the commencement of the CCAA proceeding, pursuant to s. 32(1) of the CCAA. The counterparty to the contract in question has 15 days within which to make an application to the court opposing the disclaimer or resiliation under s. 32(2). If the monitor does not approve the proposed disclaimer or resiliation, the debtor company is required by s. 32(3) of the CCAA to make an application to the Court for an order that the agreement be disclaimed or resiliated.

(II) Specific Factors to Be Considered By the Court in Exercising Its Jurisdiction

9. The broad discretionary powers conferred upon the Court by the CCAA are required to be exercised in a fair and reasonable manner and guided by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company and its stakeholders. (*Re. Skeena Cellulose Inc.* 2003 BCCA 344 at para. 39; and *Re. Canadian Airlines Corp.* 2000 ABQB 442 at paras. 94-96)

10. The role of the supervising CCAA Court in hearing a section 32 CCAA application was aptly described by the Québec Court of Appeal in *Re. 9145-7978 Québec Inc.* 2007 QCCA 768 (at para. 11): "s'apparente plutôt à celle du capitaine dans la tempête qui doit décider s'il jette à la mer la cargaison problématique pour sauver le navire" [is like that of a captain in the throes of a storm who must decide whether to throw the problem cargo overboard in order to save the ship.]

11. With these general principles in mind, in making an order under section 32(4) of the CCAA, as amended, the Court is to consider, among other things: a) whether the monitor approved the proposed disclaimer or resiliation; b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement; and c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

(III) It Is Not Appropriate For the Court to Grant the Relief Requested By Finishers in This Case

12. There is no dispute as to the right of a debtor company to disclaim or repudiate its contracts under the CCAA. The parties disagree, however, about the application to this case of such a right of the debtor company.

13. The general principles to be applied by the Court when analyzing or adjudicating upon the exercise by a debtor company of its statutory right to repudiate or disclaim contracts were recently summarized by the Quebec Superior Court in *Re. AbitibiBowater Inc.* 2009 QCCS 2188 (at paras. 26-27):

> 26 The exercise of this statutory discretion, including the discretion which allow[s] repudiation of contracts, is subject to an analysis of the criteria of fairness and reasonableness essential to each decision made by a judge pursuant to the CCAA.
>
> 27 **This analysis is done in a collective manner, by taking all the stakeholders into account, not each one individually**. [Emphasis added]

14. Finishers' position is that the Court should not allow Big Sky to repudiate the Subject Agreements because the balance of fairness and reasonableness favours Finishers. Further, Finishers alleges that maintaining the Contract Finishing Agreement represents greater economic value for Big Sky than does repudiating or disclaiming it.

15. Based upon its need to compromise its debt and restructure its business and financial affairs pursuant to the Amended and Restated Plan of Compromise and Arrangement (the "**Plan**") sanctioned by Order of this Honourable Court on February 11, 2010, Big Sky has determined that it is necessary for it to repudiate and disclaim the Subject Agreements because they are financially onerous and harmful to its cash flow and prospects for reorganization.

16. Big Sky respectfully submits that the factors relevant to the exercise by the supervising CCAA Court of its jurisdiction under section 32(4) of the CCAA must be applied: (a) in a fair and reasonable manner; (b) on a collective, not an individual, basis; and

(c) with regard to the main purpose and objective of the CCAA—to enable an insolvent company to continue in business and return to solvency to the benefit of all its stakeholders.

<u>The Factors to Be Considered Pursuant to Section 32(4) of the CCAA</u>

17. Section 32(4) provides that:

> **32(4) Factors to be considered**
>
> In deciding whether to make the order, the court is to consider, among other things,
>
>> (a) whether the monitor approved the proposed disclaimer or resiliation;
>>
>> (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>>
>> (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

18. Section 32 of the CCAA has been in force for only six months. As such, there is no mature body of case law to guide the court in its application. However, it is submitted that the Court may rely on the well-established general principles of interpretation regarding the CCAA to guide its application of the new section.

19. For example, it is well-established that a debtor company may terminate contracts to which it is a party and which are harmful under the terms of the CCAA (including, for example, leases). CCAA case authorities to this effect include:

- *AbitibiBowater, supra* at para. 29;
- *9145-7978 Québec, supra* at para. 28;
- *Re. Dylex Ltd.*, 1995 CarswellOnt 54 (Ont. Gen. Div.) at para. 8;
- *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.) at 625; and
- *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.) at 84.

The Monitor's Approval

20. The Monitor has fully approved of the proposed disclaimer of the Subject Agreements in this case in accordance with section 32(4)(a) of the CCAA.

Enhancement of the Prospects of a Viable Compromise or Arrangement

21. Finishers says that "the termination of the Agreements was not essential to the making of a viable Plan". (*Affidavit of John Beckton* at para. 34)

22. Finishers also argues that there is "no reasonable or rational economic reason for the termination of the Contract Finishing Agreement". (*Affidavit of John Beckton* at para. 21)

23. With respect, the legal test applicable to this application by Finishers is neither whether the disclaimer or repudiation of the Subject Agreements is essential to the Plan, nor whether it is supported by a "reasonable or rational economic reason". Indeed, CCAA caselaw instructs that the proposed repudiation or disclaimer of a contract need not be essential to the success of a plan of compromise or arrangement. (*AbitibiBowater*, *supra* at para. 29; and *9145-7978 Québec*, *supra* at para. 28)

24. Further, had Parliament thought it desirable to require that repudiation or disclaimer of an Agreement be **essential** to a debtor's restructuring plan, or proven on the basis of some reasonable or rational economic reason, Parliament would have expressly included such requirements in section 32(4) of the CCAA. Parliament has not done so.

25. At paragraph 20 of the Affidavit of John Beckton, Finishers says that the financial difficulties which ultimately led to Big Sky's restructuring under the CCAA were not due to the Subject Agreements with Finishers but, among other things, resulted from low hog prices, high feed costs, and the ramifications of the H1N1 flu virus being unfortunately referred to as "swine flu" in the media. While the Subject Agreements were not the principal cause of Big Sky's financial difficulty, the Subject Agreements very clearly represent a significant financial drag on the cash flow of Big Sky at a time when Big Sky can least afford it. (*Tagseth Affidavit* at para. 46)

26. The price paid by Big Sky to Finishers for hog finishing services under the Subject Agreements is far in excess of prices charged in comparable contracts that could be entered into by Big Sky today in Iowa or in Western Canada. (*Tagseth Affidavit* at para. 49)

27. The total monthly cost to Big Sky Farms Inc. to obtain hog finishing services from Finishers under the Subject Agreements is $112,550.00 per month or $1,350,600.00 annually. When this total annual cost of $1,350,600.00 is divided by the 24,000 hog finishing spaces supplied to Big Sky Farms Inc. under the Subject Agreements, the annual cost to Big Sky Farms Inc. of a hog finishing space provided to it by Finishers amounts to $56.28. After factoring in the annual manure removal costs, the cost per hog space under the Subject Agreements is $66.03. (*Tagseth Affidavit* at paras. 32-33)

28. While the termination of the Subject Agreements by Big Sky might not appear to Finishers to be crucial to the Plan or to the survival of Big Sky, the available evidence is that the Subject Agreements are very clearly a financial drain on the cash flow of Big Sky at a time when Big Sky's cash flow is severely under stress. The disclaimer of the Subject Agreements is projected to enhance the prospects of Big Sky implementing a viable Plan of Arrangement. (*Tagseth Affidavit* at paras. 27-28, 32-33, 42-43, 46, 49)

29. Farley J. rejected a similar argument in *Dylex*, *supra* (at para. 5), in which the landlord of certain shopping centres opposed the termination of three leases by the debtor company restructuring under the CCAA on the grounds that they would "materially affect each shopping centre":

> The subject stores have been a financial drain on Dylex, at a time when it is in a tight financial squeeze. Their closure is projected to bring about variable cost saving and an amelioration of some fixed costs.

30. In the words of Mayrand J.C.S. in *Re. AbitibiBowater Inc.*, *supra* (at para. 20): "[f]rom the perspective of the CCAA, there are no winners, but a single hope, that the debtor company will emerge successfully from its restructuring, for its benefit and that of the stakeholders".

31. Big Sky respectfully submits that its decision to disclaim or repudiate the Subject Agreements enhances the prospects of Big Sky implementing a viable compromise or Plan of

Arrangement. The support throughout the CCAA proceedings of Big Sky's unsecured creditors (who voted overwhelmingly in favour of the Plan) and the other stakeholders, including the Senior Secured Lenders, employees, suppliers, secured creditors and shareholders, must not be undermined by treating Finishers in a more favourable manner than the rest of the stakeholders of Big Sky.

Significant Financial Hardship

32. In accordance with the objective of the CCAA, Canadian CCAA Courts have adopted a "standard of liberal construction" that serves the interests of a "broad constituency of investors, creditors and employees", or stakeholders, and reflects "diverse societal interests". (*Re. Smoky River Coal Ltd.*, (1999), 175 D.L.R. (4th) 703 (Alta. C.A.) at 721-2; and *Re. Skeena Cellulose Inc.*, *supra* at para. 35)

33. Finishers is undeniably a member of the "broad constituency" of the stakeholders of Big Sky, as are Finishers' six full-time barn technicians, its local suppliers, its suppliers of electricity and natural gas, and its shareholders. (*Affidavit of John Beckton* at paras. 12-13, 15)

34. However, with the greatest of respect to Finishers, it appears that Finishers is asking the CCAA Court to narrow the focus of its section 32 CCAA analysis regarding what is fair and reasonable **to the stakeholders of Finishers** rather than what is fair and **reasonable to the stakeholders of Big Sky**. Finishers is, in effect, asking "why us?"

35. The answer to the remonstrative "why me?" question that often arises in CCAA proceedings was addressed in *Skeena*, where the Court stated that widespread losses are "a frequent and unfortunate fact of life in CCAA cases, where the only 'upside' is the possibility that bankruptcy and even greater losses will be averted". (*Skeena*, *supra* at para. 60)

36. Under the CCAA, Big Sky seeks to compromise its debt and to restructure its business and financial affairs. In its present financial circumstances, Big Sky has determined that it is necessary for it to repudiate the Subject Agreements, which were too costly and harmful to its cash flow.

37. When a major industry player such as Big Sky wavers, it will inevitably have far-ranging effect on its stakeholders. (*AbitibiBowater*, *supra* at para. 50)

38. Finishers argues that the repudiation of the Subject Agreements, if permitted, would have a "devastating economic effect upon Finishers". (*Affidavit of John Beckton* at para. 19) While the financial position of Finishers is not exactly robust, it is nonetheless stronger than that of Big Sky. Finishers, after all, is solvent.

39. As the CCAA Court pointed out in a similar context in *AbitibiBowater*, *supra* (at para. 57), the Court is charged with guiding and supervising the restructuring of Big Sky Farms Inc., not that of Finishers. As the CCAA Court noted at para. 61 of its decision in *AbitibiBowater*, *supra* on the facts of that case, it is not the case that the profitability gap is a "drop in the bucket" for Big Sky.

40. Finishers' position appears to be that this CCAA Court's analysis of the "significant financial hardship" factor ought to be carried out in accordance with a "balance of convenience" analysis. With respect, such an approach does not find support in the language of section 32 of the CCAA and is directly contrary to the overarching purpose and objective of the statute itself, which is to facilitate the reorganization of a debtor company for the benefit of the company and its stakeholders.

41. What is at stake in the CCAA proceedings relating to Big Sky is not limited to Finishers, but extends to the long list of Big Sky's other stakeholders.

42. Faced with a similar position, the Court in *AbitibiBowater* decided the matter this way (at paragraph 65):

> 65 It bears repeating that what is at stake here is not limited to SFK, the ABI group, and ACI, but extends to the stakeholders dependent on its survival, including 10,000 employees in Canada, 1,700 forestry workers, 2,300 self-employed workers, 950 local and regional suppliers, 500 forestry operations specialists, and the list goes on.
>
> 66 According to ACI and the Monitor, the repudiation of the contract is advantageous, beneficial and necessary for the reorganization of the company. The evidence supports this observation. In this context, bearing in mind the

> interests of all the stakeholders, the Court considers that there is no need to become involved.

43. If its application to block the disclaimer of the Subject Agreements is dismissed, Finishers does not go uncompensated. To the contrary, Finishers retains the right to file a proof of claim as an unsecured creditor for the damages suffered by it as a result of the termination of the Subject Agreements.

44. The court in *AbitibiBowater*, *supra* went on to cite the following paragraphs from *Skeena Cellulose Inc. Re.* 2002 BCSC 1280 [*Skeena Cellulose*] (at paras. 43-44) as authority for the proposition that one whose contract has been repudiated must be treated in the same way as all the other creditors of a debtor:

> 43 The applicants state that "SCI is a large, multi-million dollar business enterprise." While that is true, SCI has also been struggling for many years to become profitable. There are many people in addition to the applicants who depend on SCI's viability. **While the applicants will no doubt be adversely affected by the terminations, they are in no different position in this regard than many other unsecured creditors of SCI who must prove their claims under the Plan and who stand to recoup only a small fraction of their claims**. It is to be noted that while the sale price of SCI was $8 million, the applicants have filed proofs of claim in excess of $5 million.
>
> 44 It is the unfortunate and generally unavoidable result of an insolvency restructuring that some individuals or entities will suffer hardship. In this case as part of its restructuring, SCI had to terminate numerous employees. They no doubt suffered hardship. [Emphasis added.]

45. In *Skeena Cellulose*, *supra*, (at paras. 46-47) certain logging contractors brought an application for a declaration that terminations by Skeena, pursuant to the CCAA, of their long-term contracts were invalid. In dismissing the application, the court held as follows:

> 46 In effect what the applicants are seeking here is an order for specific performance. Specific performance can be particularly inappropriate in an insolvency, because its effect generally will be to create a preference over other unsecured creditors.
>
> 47 SCI is insolvent. The fact of that insolvency precludes SCI from performing many other contracts. Indeed, SCI is by definition insolvent because it cannot perform all its contracts.
>
> ...

> 49 The intention of the CCAA … is for all creditors to be treated equally.
>
> 50 While I recognize that the applicants in the case at bar do enjoy the benefit of certain statutory privileges that differentiates them from other unsecured creditors, they are nevertheless seeking to be put in a position superior to SCI's other creditors. In my view those statutory privileges are not sufficient to justify the creation or recognition of such a preference.
>
> …
>
> 53 In my view the applicants are creditors of SCI and they have claims under the Plan. The definition of claim includes any present or future right to claim against the Skeena Companies. The applicants had full knowledge prior to the creditors meetings that they would have claims under the Plan if their contracts were to be terminated which SCI has carried out. In my view the applicants have shown no reason as to why they ought to be exempted from the operation of the CCAA and why they ought to, in effect, be placed in a better position than other creditors.
>
> (*Skeena Cellulose* at paras. 49-50, 53.)

46. In the respectful submission of Big Sky, a review of the available evidence compels the conclusion that the Subject Agreements are uneconomic, above market rates and represent a drag on the cash flow of Big Sky which impairs the prospects for the successful reorganization of its business and financial affairs. In the words of the CCAA Court in *AbitibiBowater*, *supra* (at para. 69), "that is enough in the circumstances" to dismiss the application to prohibit the repudiation of the Subject Agreements.

CONCLUSION AND RELIEF REQUESTED

47. For all of the foregoing reasons, Big Sky respectfully requests that this Honourable Court dismiss the application of Finishers with costs payable to Big Sky.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 9 day of March, 2010.

MacPHERSON LESLIE & TYERMAN LLP

Per: ______________________

Jeffrey M. Lee,
Counsel for Big Sky Farms Inc.

This Brief of Law was delivered by:

MacPHERSON LESLIE & TYERMAN LLP
Lawyers
1500 – 410 22nd Street East
Saskatoon, Saskatchewan
S7K 5T6
whose address for service is: Same as above.
Lawyer in charge of file: Jeffrey M. Lee
Telephone Number: (306) 975-7100
Fax Number: (306) 975-7145

INDEX OF AUTHORITIES