TAB 1

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Rescue! The Companies' Creditors Arrangement Act

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of federal, provincial and territorial corporations statutes. Other mechanisms to deal with firm financial distress are receiverships under provincial courts of justice statutes, and remedies that arise out of secured transactions under provincial and territorial personal property security statutes.[11] There are also provincial and territorial statutes that deal with fraudulent conveyances, assignments and preferences, which can be accessed as a means to enforce creditor claims when a firm is in financial distress.[12] The discussion in this part confines itself only to the first four of these options.

The *Bankruptcy and Insolvency Act (BIA)* addresses both individuals and companies, and provides a mechanism for assigning or petitioning financially troubled debtors into bankruptcy and liquidating their assets, as well as providing a series of interim mechanisms such as appointment of receivers to take conservatory and other measures for the protection of creditors.[13]

When a corporation is insolvent, there are remedies available to creditors. The insolvency scheme provides that secured creditors can privately enforce their claims by meeting statutory and common law requirements of demand, reasonable notice and notice of intention to enforce security.[14] Once these are met, the creditor can privately appoint or seek a court appointment of a receiver to realize on the property securing its claims. A creditor falls within the scope of the *BIA* enforcement provisions if the debtor is "insolvent" within the meaning of the statute and the collateral being enforced against by the secured creditor constitutes all or substantially all of a category of the debtor's assets. The *BIA* defines an "insolvent person" as one who has debts exceeding $1,000, is unable to meet obligations or has ceased paying them in the ordinary course of business as they generally become due, or the aggregate of whose property is not, at fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process would not be sufficient to enable payment of all obligations due and accruing due.[15]

The *BIA* is aimed at bringing uniformity to the administration and liquidation of bankrupt estates in Canada. The underlying principle is that creditors should control administration of the assets of the corporation that has been placed into bankruptcy, because liquidation is for the almost exclusive benefit of the creditors and they are in the best position to determine what is in their interests. The *BIA* sets a hierarchy for the satisfaction of claims.[16]

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[11] See for example, Ontario *Courts of Justice Act*, R.S.O. 1990, c. C. 43, s. 101; Alberta *Personal Property Security Act*, R.S.A. 2000, c. P-7, s. 66; Nova Scotia *Personal Property Security Act*, S.N.S. 1995-96, c. 13, s. 66.

[12] For a helpful introduction to these other remedies on insolvency, see Kevin McElcheran, *Commercial Insolvency in Canada*, (Toronto: LexisNexis Canada Inc., 2005).

[13] *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (*BIA*).

[14] Section 244, *BIA*.

[15] Section 2(1), *BIA*.

[16] This hierarchy interacts with other statutes, such as the *Bank Act*, section 427; see also provincial statutes such as the *Personal Property Security Act*.

In addition to the mechanisms outlined in the *BIA* addressing the realization of property of a debtor and the distribution thereof to the creditors according to their relative rights, the *BIA* also provides a scheme for commercial "proposals", in order to allow an insolvent person or a bankrupt an opportunity to restructure its affairs and become financially viable.[17] As with the *CCAA* process, the proposal process allows a brief reprieve in which the *status quo* is maintained and creditors' realization rights are temporarily suspended. Proposal is defined in the *BIA* as including a proposal for a composition, where creditors agree to accept less than full repayment or an extension of time; and/or a scheme of arrangement in terms of alteration of debt and equity structure.[18] Corporate officers retain control of the corporation's assets and operations, and the trustee that assists with development of the proposal acts in a monitoring and advisory capacity, as opposed to taking over control of the company. The *BIA* proposal proceedings are used for individuals and for all sizes of business, from sole proprietorships to larger corporations. The greatest challenge for using the *BIA* as the tool to rescue a financially distressed company, however, is its "sunset clause"; specifically, failure to negotiate and receive creditor support for, and the sanction of the court of, a proposal within six months results in the company automatically becoming bankrupt. There is no judicial discretion to extend the stay past six months. This is discussed further below.

The second statute is the *Companies' Creditors Arrangement Act (CCAA)*, which allows corporations to negotiate a plan of arrangement or compromise with their creditors, as discussed in the introduction.[19] The *CCAA* is available to debtor corporations that are insolvent or bankrupt and have debts greater than $5 million.[20] Both the *BIA* proposal provisions and the *CCAA* allow for compromise of claims of both secured and unsecured creditors. Any reorganization of the equity of the corporation requires concurrent proceedings under corporations statutes.[21] Section

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[17] Section 50, *BIA*. The *BIA* provides that a proposal may be made by an insolvent person and a bankrupt, as well as by various persons on behalf of the insolvent person or bankrupt. For ease of reading, the remainder of this text refers only to a proposal being filed by an insolvent person, and the reader should understand that the provisions apply equally to the other situations, unless specifically stated otherwise. Refer also to section 2 of the *BIA* for the definitions of "person", "insolvent person" and "corporation". In effect, the *BIA* applies to a wide category of debtors, whether the debtor is an individual, partnership, corporation, cooperative society, association, etc., excluding banks, insurance companies, trust companies, loan companies and railway companies.

[18] Section 2(1), *BIA*. *Mutual Trust Co.* v. *Scott, Pichelli & Graci Ltd.* (1999), 11 C.B.R. (4th) 54 (Ont. Bktcy.), additional reasons at (1999), 11 C.B.R. (4th) 62 (Ont. Bktcy.).

[19] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (*CCAA*).

[20] Section 2, *CCAA*. The *CCAA* specifies that a debtor company may be a company that is insolvent or bankrupt. The distinction as relates to proceedings in respect of a bankrupt are found in section 11.6 of the *CCAA*. This section provides that a bankrupt can avail itself of the provisions of the *CCAA* only in the situation where the bankruptcy does not result from a failed restructuring proceeding under the *BIA*, and then only with the prior approval of inspectors appointed to the estate. The remainder of the text refers only to a plan of arrangement being filed in respect of an insolvent person, and the reader should understand that the comment applies equally to a bankrupt, unless specifically stated otherwise.

[21] Once Chapter 47 is proclaimed in force, this will no longer be a requirement. *An Act to Establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, Chapter 47, Royal Assent November 25, 2005, not yet proclaimed in force as of December 2006.

8 of the *CCAA* specifies that the *Act* has full force and effect notwithstanding anything to the contrary contained in a security interest; hence parties cannot contract out of the *CCAA* provisions.[22] Whereas the *BIA* is highly codified, the *CCAA* is a skeletal statute. The scope and contours of the *CCAA* have been set through the caselaw, with the court acting in a supervisory capacity during the period that parties negotiate a workout strategy and business plan.

The third insolvency statute is the *Winding-up and Restructuring Act (WURA)*, which covers financially distressed financial institutions and certain corporations and allows such persons to be liquidated or restructured.[23] Finally, there is the *Farm Debt Mediation Act*, enacted to help farmers in financial distress by allowing them to seek relief from secured and unsecured debt in particular circumstances.[24]

There are also private workouts that are undertaken without the benefit of any statutory mechanism. An insolvent corporation can restructure its affairs through a private arrangement with its creditors, which may be possible if there are few creditors or it is a closely held company where there is some ability to deal with equity and debt claims for only a few stakeholders. Use of a private workout does not necessarily signal to consumers or trade suppliers that the corporation is in difficulty and may facilitate the retention of key employees and distributors who might otherwise begin diversifying their risk by seeking employment or contracts elsewhere.[25] Generally, private workouts with a few creditors are cheaper and faster than court-supervised processes, in part, precisely because there are fewer creditors and thus fewer transaction costs and collective action problems in the negotiations for a workout.

However, private workouts are rarely a practical solution, except in special circumstances. The characteristics of an efficient restructuring tool include the ability to suspend recourse against the debtor while the discussions are progressing, and the ability to force a minority of creditors to be bound by an agreement acceptable to the majority. Under the *BIA* and the *CCAA*, the debtor need only win the support of a majority in number representing two thirds in value of claims in each class of creditors, present or represented at the meeting, in order to meet the statutory requirements for a proposal or plan; hence the debtor can deal with "holdout creditors", who will not agree to a plan or will agree only if they receive payment in full. This ability to deal with holdout creditors is not possible under a private workout. In other words, the stay under the *BIA* or *CCAA* creates the potential ability to compel creditors to act collectively rather than individually. In many cases of cor-

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[22] *Hongkong Bank of Canada* v. *Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.).

[23] *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11 (*WURA*). For example, by virtue of section 3(3) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as amended *(CBCA)*. The *WURA* does not apply to corporations incorporated under the *CBCA*.

[24] *Farm Debt Mediation Act*, S.C. 1997, c. 21. This Act is essentially a voluntary mediation act, but since it has no mechanism to bind creditors who do not agree with a proposed arrangement, its utility is limited.

[25] Janis Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003).

porate insolvency, there are hundreds and sometimes thousands of creditors, and thus a private workout is not possible. Given that creditors are not prevented from seeking to enforce their claims during negotiation for a private workout, debtor corporations often seek the protection of court-supervised processes.[26] For companies with a number of creditors or any complexity in the debt structure, the provisions under both the *BIA* and the *CCAA* that stay creditors' ability to realize on their claims for a period, provide a breathing space to corporations so that they can negotiate a workout plan with creditors.

A less commonly used means of restructuring than the *BIA* or *CCAA* is use of the arrangement provisions under the *Canada Business Corporations Act (CBCA)* and companion provincial and territorial corporations statutes, where at least one corporation in a group of affiliated companies that are trying to restructure is solvent, even if the principal company in the corporate group is itself insolvent.[27] The principal reason for using the *CBCA* or other corporations statutes is to preserve equity for shareholders. A precondition to use of the *BIA* or *CCAA* is that the corporation is insolvent and thus there is little or no equity remaining in the corporation.

In contrast, the arrangement provisions of the *CBCA* require the corporation to be solvent, and thus can be used to try to preserve shareholder equity as well as value for creditors.[28] For example, in *Dome Petroleum*, Dome was insolvent yet the proposed arrangement required amalgamations and debt exchanges, neither easily provided for under the *CCAA*, even if the application had been brought conjointly with a *CBCA* application.[29] Amoco Acquisitions, a solvent corporation, applied to the court under the *CCAA* and received a declaration from the Alberta Court of Queen's Bench that its proposed arrangement was an arrangement pursuant to the *CBCA* and that the court had jurisdiction. It then proceeded to secure the support of creditors and shareholders, and the endorsement of the court to amalgamate with Dome and several other subsidiaries. The Court thus facilitated the plan of arrangement by liberally interpreting the arrangement provisions of the *CBCA*, by finding at least one company solvent within a group of affiliated companies seeking to utilize the corporations statute to effect a restructuring.

As this book goes to press, it is important to note that legislative reform has been proposed. Chapter 47 of the Statutes of Canada, 2005, amending the *CCAA* and the *BIA* and creating a new national wage earner protection program, has been enacted

[26] *Ibid.*

[27] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as amended *(CBCA)*. For an example of provincial provisions, see Ontario *Business Corporations Act*, R.S.O. 1990, c. B. 16, section 186; and Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9, s. 192.

[28] See for example, the cases of *Dome Petroleum* and *Unitel Communications* in J. Ziegel and D. Baird, eds., *Case Studies in Recent Canadian Insolvency Reorganizations, In Honour of the Honourable Lloyd W. Houlden* (Toronto: Carswell, 1997).

[29] Simon Scott, "The Acquisition of Dome Petroleum Limited by Amoco Corporation" in Ziegel and Baird, *ibid.* at 300, citing unreported judgment, *Amoco Canada Petroleum Co.* v. *Dome Petroleum Ltd.* (January 28, 1988), Doc. Calgary 8701-20108 (Alta. Q.B.) at 311, 313.

but has not yet been proclaimed in force.[30] Subsequent to the legislation receiving Royal Assent in November 2005, there was a federal election in Canada and the Liberal government was replaced by a Conservative government. The new Government is expected to bring further amendments forward early in 2007 prior to proclaiming Chapter 47 in force.[31] There are references throughout this book to the proposed changes to the *CCAA* under Chapter 47.

2. Policy Objectives of the *CCAA*

The *CCAA* has a broad remedial purpose, permitting compromises or arrangements to be made between an insolvent company and its creditors. The courts have held that the *CCAA* allows the debtor company to avoid bankruptcy, to continue operating, and to find a business strategy that enables it to meet the demands of creditors.[32] The *CCAA* is to be given a large and liberal interpretation so as best to meet its policy objectives.[33]

Canadian courts have held that the *CCAA* is aimed at avoiding, where possible, the devastating social and economic consequences of the cessation of business operations, and at allowing the corporation to carry on business in a manner that causes the least possible harm to employees and the communities in which it operates. There is a public policy interest in allowing for a certain transition period to allow debtors to economically adjust in difficult markets in unsettled times; and the courts have held that co-operation is required if the debtor corporation is to emerge competitive, innovative, and able to withstand temporary adversity.[34] The costs of the process are outweighed by the benefits of potential success and the protection of multiple interests. The Alberta Court in *Fracmaster* held that the objective of the

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[30] *An Act to Establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, Chapter 47, Royal Assent November 25, 2005, not yet proclaimed in force as of December 2006 (Chapter 47). On December 8, 2006, the Government gave notice of further amendments under the *Notice of Ways and Means Motion to introduce an Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earners Protection Act and Chapter 47 of the Statutes of Canada, 2005,* (December 8, 2006, Library of Parliament), which are primarily in the nature of administrative amendments to Chapter 47 to clarify language or align the provisions of the *CCAA* more directly with the companion provisions of the *BIA*. However, the amendments have not yet been tabled as of December 31, 2006.

[31] Current projections are that Chapter 47 may come into force in 2007 (Industry Canada, Policy Branch).

[32] *Multidev Immobilia Inc.* v. *S.A. Just Invest,* (1988), 70 C.B.R. (N.S.) 91, [1988] R.J.Q. 1928 (Que. S.C.); *Meridian Development Inc.* v. *Toronto Dominion Bank* (1984), 52 C.B.R. (N.S.) 109, 32 Alta L.R. (2d) 150 (Alta. Q.B.).

[33] *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 (Ont. C.A.); *Citibank Canada* v. *Chase Manhattan Bank of Canada* (1991), 5 C.B.R. (3d) 165 (Ont. Gen. Div.).

[34] *Algoma Steel Inc., Re* (2001), 2001 CarswellOnt 4640, [2002] O.J. No. 66, 30 C.B.R. (4th) 1 (Ont. S.C.J. [Commercial List]), LeSage, C.J.S.C. at para. 8; *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]), at 173-4.

CCAA to facilitate restructuring should include consideration of interests beyond those of senior creditors.[35]

The *CCAA* was enacted in 1933, but was really only rediscovered as a valuable restructuring tool in the past 25 years. The *CCAA* has the simultaneous objectives of maximizing creditor recovery, preservation of going concern value where possible, preservation of jobs and communities affected by the firm's financial distress, rehabilitation of honest but unfortunate debtors, and enhancing the credit system generally.[36] These objectives can be measured by whether production has been maximized; whether there is a resultant generation of consumer surplus and overall welfare of the enterprise; whether the corporation has provided opportunities for workers to remain productive; whether a greater flow of profits to investors has been generated than would occur if they invested elsewhere; and whether the flow of benefits and size of return to suppliers and other creditors is such that this is optimal use of their capital and supplies, rather than directing their resources elsewhere.[37] A workout can be effective where these complex relationships interact in a cost effective, productive, and innovative manner.

One measure of a successful *CCAA* workout is the financial health of the corporation some years later. However, the nature of restructuring proceedings is shifting, such that the longer term financial health and wealth generating activity of the debtor may no longer be the only measure of a successful *CCAA* application. Although the public policy objectives of the statute remain the same, there are new actors entering the market and new efforts at controlling the process and outcome of a *CCAA* proceeding, such that these public policy goals may be at some risk. This is most evident in the discussion of DIP financing in chapter 4, but is highlighted throughout this text.

Notwithstanding the success of the *CCAA* in meeting its legislative objective of facilitating plans of arrangement and compromise with creditors, the statute is not without its critics. The skeletal nature of the statute means that the supervising judge is required to make numerous procedural and substantive decisions during the *CCAA* proceedings. There has been some criticism that this leaves judges with too much discretion and parties with too much uncertainty.[38] U.S. lenders, who often supply capital for a restructuring, are accustomed to a highly rules-based lending environment during insolvency and frequently are concerned about the lack of codification under the *CCAA*.

However, as will be discussed in chapter 3 on the role of the courts, examination of the caselaw reveals that the role of judges is twofold: supervising the proceedings

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[35] *Fracmaster Ltd., Re* (1999), 11 C.B.R. (4th) 204 (Alta. Q.B.), Paperny, J., affirmed *Royal Bank* v. *Fracmaster Ltd.* (1999), 11 C.B.R. (4th) 230, 1999 ABCA 178 (Alta. C.A.) at paras. 18-23.

[36] For a discussion, see Janis P. Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003).

[37] Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, DC: Brookings Institute, 1995) at 240.

[38] Andrew Kent, "Comment on Professor Yamauchi's Paper" (2004) 40 Canadian Business L.J. 295.

and weighing the prejudice to parties of particular decisions, and tempering the activities of the most aggressive and powerful parties in the restructuring process. The *CCAA* is a statute that facilitates bargaining. However, that bargaining occurs in light of radically different economic stakes in the financially distressed company, unequal bargaining power, and frequently, information asymmetries. While it is not realistic to expect a level playing field in a *CCAA* workout, the court's role in balancing interests and prejudice has become an extremely significant one.

As will be seen throughout this text, Parliament has addressed the uncertainty question in its proposed amendments to the *CCAA* in Chapter 47. A number of current practices of the court will be codified for the first time, enhancing the transparency of particular rights and remedies in such proceedings, and arguably creating greater certainty in some cases. At the same time, Parliament has chosen to leave a fair degree of discretion with the court in its exercise of jurisdiction under the *CCAA*.

3. Policy Instruments

The primary instrument under the *CCAA* is to grant a stay of proceedings against the debtor corporation so that it has breathing room to develop a going forward business and financial plan with its creditors. The *CCAA* maintains the *status quo* in terms of the debtor's financial relationships for the period of the stay, while the debtor corporation negotiates with creditors and seeks approval for a plan that will allow it to continue operating.[39] It provides a structured environment in which the debtor corporation can carry on business and retain control over assets during the negotiations.[40] The courts have also held that a public policy objective is to permit a broad balancing of stakeholder interests in the insolvent corporation.[41]

One of the objectives of an efficient insolvency system is that it discourages both premature liquidation and deferred liquidation. Premature liquidation arises because over-caution by directors and officers in respect of their own liability risk leads to filing of bankruptcy prematurely, or creditors move to enforce their claims on all or substantially all of the assets without a prior determination of whether there is going concern value in the enterprise. The *CCAA* provides debtors with a tool to act prior to this point as it provides a stay of proceedings without having to become bankrupt and the temporary stay allows for negotiations with creditors who might otherwise enforce their claims and prematurely insist that assets be liquidated.[42] Deferred liquidation is where directors and officers have not acted in a timely manner to deal with the firm's financial distress, specifically, to file under the *CCAA* or under the

[39] *Quintette Coal Ltd.* v. *Nippon Steel Corp.* (1990), 80 C.B.R. (N.S.) 98 (B.C. S.C.).

[40] *Blue Range Resource Corp., Re* (2000), 192 D.L.R. (4th) 281, 20 C.B.R. (4th) 187 (Alta. C.A.).

[41] *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 (Ont. C.A.); *Air Canada, Re* (2004), 47 C.B.R. (4th) 189 (Ont. S.C.J. [Commercial List]). For a discussion, see Janis P. Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003).

[42] A restructuring by the debtor or a going concern sale by a creditor may provide economic efficiency.

TAB 2

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2000 CarswellAlta 1004, 2000 ABCA 239, [2000] A.W.L.D. 718, 192 D.L.R. (4th) 281, 20 C.B.R. (4th) 187, 266 A.R. 98, 228 W.A.C. 98, [2001] 2 W.W.R. 454, 87 Alta. L.R. (3d) 329, [2000] A.J. No. 1032

Blue Range Resource 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 Blue Range Resource Corporation; Enron Capital & Trade Resources Canada Corp. (Appellant/Applicant) and Blue Range Resource Corporation, Humble Petroleum Marketing Ltd., Pricewaterhousecoopers Inc., in its capacity as Monitor, Royal Bank of Canada, National Bank of Canada, and First National Bank of Chicago (Respondents/Respondents) and TransCanada Energy Ltd. and International Swaps and Derivatives Association, Inc. (Intervenors)

Duke Energy Marketing Limited Partnership (Appellant) and Blue Range Resource Corporation and Humble Petroleum Marketing Ltd. (Respondents)

Engage Energy Canada, L.P. (Appellant/Applicant) and Blue Range Resource Corporation and Humble Petroleum Marketing Ltd., Pricewaterhousecoopers Inc., in its capacity as Monitor, Royal Bank of Canada, National Bank of Canada, and First National Bank of Chicago (Respondents)

Alberta Court of Appeal

Hunt, Berger, Fruman JJ.A.

Heard: February 29, March 1, 2000
Judgment: August 31, 2000[FN*]
Docket: Calgary Appeal 99-18410, 99-18411, 99-18418

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Proceedings: reversed (1999), 1999 CarswellAlta 652, 72 Alta. L.R. (3d) 196, 245 A.R. 172, 12 C.B.R. (4th) 173, [1999] 12 W.W.R. 616 (Alta. Q.B.)

Counsel: *A.R. Anderson* and *S.J. Burrell*, for Enron Capital & Trade Resources Canada Corp.

H.A. Gorman, for Duke Energy Marketing Limited Partnership.

L.B. Robinson, for Engage Energy Canada, L.P.

No counsel present for Blue Range Resource Corporation and Humble Petroleum Marketing Ltd.

No counsel present for National Bank of Canada, Royal Bank of Canada and First National Bank of Chicago.

A.J. Jordan, Q.C., and *J.M. Eamon*, for PriceWaterhouseCoopers Inc.

S.E. Dunphy, for International Swaps and Derivatives Association, Inc.

J.G. Hanley, for TransCanada Energy Ltd.

Subject: Insolvency; Corporate and Commercial

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Effect of arrangement — Stay of proceedings

Natural gas producer B Corp. obtained protection under CCAA — Purchasers of gas pursuant to long-term gas supply agreements applied for declaration that their contracts were "eligible financial contracts" within meaning of s. 11.1(1) of Act — Application was dismissed — Purchasers appealed — Appeal allowed — Purchasers' contracts were "future commodity contracts" and therefore exempt from stay of proceedings under CCAA — Trial judge erred in approach to limiting scope of s. 11.1(1) by focussing on whether contract referred to financially- or physically-settled contracts — Appropriate approach was to determine whether subject-matter of derivative contract was "commodity" — "Commodity" is fungible and trades in volume in volatile trading market — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.1(1).

B Corp. obtained protection under the *Companies' Creditors Arrangement Act*. Several risk management and gas marketing companies ("the purchasers"), who had entered into long-term contracts to purchase natural gas from B Corp., applied for a declaration that their contracts qualified as "eligible financial contracts" within the meaning of s. 11.1(1) of the CCAA and were therefore exempt from the general stay of proceedings. The contracts were negotiated on an individual basis, pursuant to master agreements, and provided that the purchasers would purchase a specified quantity of gas at a certain or determinable price on a certain future date. The contracts contained termination and netting out or set-off provisions, which would permit the purchasers to terminate all the agreements upon a triggering event.

The chambers judge dismissed the application, concluding that the contracts were not "forward commodity contracts," and therefore did not qualify as "eligible financial contracts." The purchasers appealed.

Held: The appeal was allowed.

The distinction drawn by the chambers judge between "physical" and "financial" contracts was not an appropriate one by means of which to limit the scope of s. 11.1(1)(h) of the CCAA. The essence of a forward commodity contract is that it is a commercial hedging contract used to manage various types of risk. There is nothing in the language of s. 11.1(1) which indicates an intention to restrict the section to financially-settled commodity contracts. The applicability of the section is properly circumscribed by the meaning of the word "commodity," rather than the word "financial." Commodities, within the meaning of the Act, must be fungible and must trade in a volatile market, with a sufficient trading volume to ensure a competitive trading price. These qualities distinguish commodities contracts from contracts for commercial merchandise and manufactured goods. The purchasers' contracts for the purchase of natural gas clearly met the definition of "forward commodity contract."

This approach to interpreting "eligible financial contract" and "forward commodity contract" appropriately reflected both the intention of the legislature and the public interest in a viable derivatives market. Enforceable termination and netting out provisions, in both solvency and insolvency situations, were essential to the risk management strategy that underlied the structure of the derivatives market.

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2000 CarswellAlta 1004, 2000 ABCA 239, [2000] A.W.L.D. 718, 192 D.L.R. (4th) 281, 20 C.B.R. (4th) 187, 266 A.R. 98, 228 W.A.C. 98, [2001] 2 W.W.R. 454, 87 Alta. L.R. (3d) 329, [2000] A.J. No. 1032

Cases considered by *Fruman J.A.*:

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303, 14 C.P.C. (3d) 339 (Ont. Gen. Div.) — applied

Communities Economic Development Fund v. Canadian Pickles Corp. (1991), [1992] 1 W.W.R. 193, [1991] 3 S.C.R. 388, 85 D.L.R. (4th) 88, 76 Man. R. (2d) 1, 131 N.R. 81, 10 W.A.C. 1, 8 C.B.R. (3d) 121 (S.C.C.) — applied

Confederation Treasury Services Ltd. v. Hees International Bancorp Inc. (1997), 45 C.B.R. (3d) 204, (sub nom. *Confederation Treasury Services Ltd. (Bankrupt) v. Hees International Bancorp Inc.)* 22 O.T.C. 321 (Ont. Gen. Div. [Commercial List]) — applied

Howley v. Canada (Deputy Attorney General) (1976), [1977] 2 S.C.R. 45, 34 C.R.N.S. 302, 9 N.R. 421, 30 C.C.C. (2d) 106, 69 D.L.R. (3d) 689 (S.C.C.) — applied

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275 (Ont. Gen. Div. [Commercial List]) — applied

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.) — applied

National Trust Co. v. Mead, 12 R.P.R. (2d) 165, [1990] 2 S.C.R. 410, 71 D.L.R. (4th) 488, 112 N.R. 1, [1990] 5 W.W.R. 459, 87 Sask. R. 161 (S.C.C.) — applied

Northland Properties Ltd., Re (1988), 69 C.B.R. (N.S.) 266, 29 B.C.L.R. (2d) 257, 73 C.B.R. (N.S.) 146 (B.C. S.C.) — applied

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 51 B.C.L.R. (2d) 105, 2 C.B.R. (3d) 303 (B.C. C.A.) — applied

Smith Brothers Contracting Ltd., Re (1998), 53 B.C.L.R. (3d) 264, 13 P.P.S.A.C. (2d) 316 (B.C. S.C.) — applied

Smoky River Coal Ltd., Re, 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94 (Alta. C.A.) — applied

Smoky River Coal Ltd., Re (1999), 175 D.L.R. (4th) 703 at 727, 71 Alta. L.R. (3d) 46, 244 A.R. 196, 209 W.A.C. 196, 12 C.B.R. (4th) 126 (Alta. C.A.) — referred to

Cases considered by *Berger J.A.*:

Hutterian Brethren Church of Starland v. Starland (Municipal District No. 47) (1993), 9 Alta. L.R. (3d) 1, 14 Admin. L.R. (2d) 186, 135 A.R. 304, 33 W.A.C. 304 (Alta. C.A.) — referred to

R. v. Bonneteau (1994), 24 Alta. L.R. (3d) 153, 93 C.C.C. (3d) 385, 157 A.R. 138, 77 W.A.C. 138 (Alta. C.A.) — referred to

R. v. F. (D.M.) (1999), 139 C.C.C. (3d) 144, 244 A.R. 146, 209 W.A.C. 146, 179 D.L.R. (4th) 492, 73 Alta. L.R.

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(3d) 149, [2000] 1 W.W.R. 724, 68 C.R.R. (2d) 215 (Alta. C.A.) — considered

Statutes considered by *Fruman J.A.*:

Bankruptcy Code, 11 U.S.C. 1982

Generally — referred to

s. 101(25) — referred to

s. 101(26) — referred to

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

s. 65.1(8) [en. 1992, c. 27, s. 30] — considered

Canada Deposit Insurance Corporation Act, R.S.C. 1985, c. C-3

s. 39.15(7) [en. 1996, c. 6, s. 41] — considered

Commodity Futures Act, R.S.O. 1990, c. C.20

s. 1 "commodity" — considered

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

Generally — considered

s. 11 [rep. & sub. 1997, c. 12, s. 124] — considered

s. 11(3) [en. 1997, c. 12, s. 124] — considered

s. 11(4) [en. 1997, c. 12, s. 124] — considered

s. 11.1 [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (c) [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (d) [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (e) [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (g) [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (h) [en. 1997, c. 12, s. 124] — considered

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s. 11.1(1) "eligible financial contract" (j) [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (k) [en. 1997, c. 12, s. 124] — considered

s. 11.1(1) "eligible financial contract" (m) [en. 1997, c. 12, s. 124] — considered

s. 11.1(2) [en. 1997, c. 12, s. 124] — considered

s. 11.1(3) [en. 1997, c. 12, s. 124] — considered

Securities Act, S.A. 1981, c. S-6.1

s. 1(b.01) "commodity" (i) [en. 1999, c. 15, s. 2(b)] — considered

s. 1(b.01) "commodity" (ii) [en. 1999, c. 15, s. 2(b)] — considered

s. 1(b.01) "commodity" (iii) [en. 1999, c. 15, s. 2(b)] — considered

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11

s. 22.1(2) "eligible financial contract" [en. 1996, c. 6, s. 142] — considered

Words and phrases considered

commodity

The word "commodity" [as used in s. 11.1(1)(h) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36] must be examined in the context of the legislation to see whether Parliament intended a broad dictionary meaning — to include a forward contract to buy or sell practically anything of value — or something less expansive.

. . . . .

. . . [F]orward commodity contracts are financial hedges and risk management tools. Interpreting them in the context of the rest of the section requires that they share certain traits. The contracts listed in s. 11.1(1) deal with units that are the equivalent of any other unit. Therefore commodities must be interchangeable, and readily identifiable as fungible commodities capable of being traded on a futures exchange or as the underlying asset of an over-the-counter derivative transaction. Commodities must trade in a volatile market, with a sufficient trading volume to ensure a competitive trading price, in order that forward commodity contracts may be "marked to market" and their value determined. This removes from the ambit of s. 11.1(1)(h) contracts for commercial merchandise and manufactured goods which neither trade on a volatile market nor are completely interchangeable for each other.

eligible financial contracts

"Eligible financial contract" [as used in s. 11.1(1) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36] includes spot contracts at (h), spot foreign exchange contracts at (c), and repurchase or reverse repurchase contracts at (g). These contracts can only be settled by physical delivery, never by financial payment. If eligible financial contracts require cash settlement, these terms are robbed of any meaning. Therefore an across-the-board

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interpretation of eligible financial contracts that excludes physically-settled transactions cannot stand.

APPEAL by purchasers from judgment reported at (1999), 72 Alta. L.R. (3d) 196, 245 A.R. 172, 12 C.B.R. (4th) 173, [1999] 12 W.W.R. 616 (Alta. Q.B.), dismissing claim for exemption from stay order under *Companies' Creditors Arrangement Act*.

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

1 With mounting debt and brewing litigation, a company may be headed down the steep slope towards insolvency. The *Companies' Creditors Arrangement Act* permits the court to slow the company's descent by staying all actions and proceedings pending against it, and prohibiting creditors from terminating contracts. This permits the company to continue to operate while it attempts to restructure its financial affairs. But not all contracts are protected from termination. Despite an insolvency, creditors are entitled to terminate "eligible financial contracts" and set-off obligations. The legal issue in this appeal is whether long term natural gas supply contracts, entered into by a now insolvent gas producer, are eligible financial contracts. The answer to this question requires a foray into the perplexing financial world of derivatives.

FACTS

2 Blue Range Resources Corporation and its wholly-owned subsidiary, Humble Petroleum Marketing Ltd.[FN1] produce natural gas. As part of their business they have, over time, entered into long term contracts to sell natural gas to the appellants, Enron North America Corp. and its wholly-owned subsidiary Enron Canada, Duke Energy Limited Partnership, and Engage Energy Canada, L.P.[FN2] The appellants are risk management and gas marketing companies and are not end-users of the natural gas they purchase.

3 In early 1999, Blue Range and Humble found themselves on the brink of insolvency. They hastily made an *ex parte* application under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, commonly known as the *CCAA*, asking the court to stay all proceedings pending against them.

4 As is now the custom, the *ex parte* application asked for sweeping relief. The order granted was not disappointing. It stayed not only actions, but contractual obligations, restraining creditors from "accelerating, terminating, suspending, modifying or cancelling any such agreement ... exercising any rights of distress, recission or set-off or consolidation of accounts in relation to any indebtedness or obligation": Order of LoVecchio J. granted March 2, 1999, para. 3(b) (AB I at 7). The order provided an exception for "eligible financial contracts", as defined in s. 11.1(1) of the *CCAA*. Because those contracts were not stayed, a creditor was not prohibited from "terminating, amending or claiming an accelerated payment ... and setting off the obligations between Blue Range and such other party in accordance with [the contract's] provisions": Order, para. 3(c) (AB I at 8).

5 On March 19, 1999, the appellants applied to have their long term gas supply agreements declared eligible financial contracts. If their application succeeded, the contracts would be exempt from the *CCAA* stay order, permitting the appellants to terminate them and exercise any set-off rights provided in the agreements. LoVecchio J. decided that the agreements were not eligible financial contracts and dismissed the applications. I conclude that the agreements are eligible financial contracts.

THE *COMPANIES' CREDITORS ARRANGEMENT ACT*

6 The *CCAA*, which has become increasingly popular in recent years, provides a structured environment in which large insolvent companies continue to carry on business and retain control over their assets while their creditors, shareholders and the court consider a plan or compromise. See *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.); *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Com-

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mercial List]); and *Re Smoky River Coal Ltd.* (1999), 175 D.L.R. (4th) 703 (Alta. C.A.); leave to reargue refused(1999), 175 D.L.R. (4th) 703 at 727 (Alta. C.A.). The process of compromise is overseen by a judge who has discretion to do what is necessary, within the confines of the legislation, to maintain the status quo while the negotiations, creditor approvals and reorganization take place. This "will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors": *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 146 (B.C. S.C.) at 154 citing *Meridian Development Inc. v. Toronto Dominion Bank* (1984), 32 Alta. L.R. (2d) 150 (Alta. Q.B.) at 155.[FN3]

7 To invoke the *CCAA*, a "debtor company", which has claims against it exceeding five million dollars, may apply to the court on an *ex parte* basis seeking the suspension of actions and contractual rights of creditors. The court may then order a comprehensive stay of proceedings under s. 11. Section 11(3) permits a court, on an initial application, to stay proceedings taken, restrain further proceedings, and prohibit the commencement of any actions against the debtor company for a period of 30 days. Typically, the initial order is later extended for a period deemed necessary by the court (s. 11(4)). The court's discretionary powers under s. 11 have been interpreted to restrain any conduct "the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period": *Campeau v. Olympia & York Developments Ltd.* (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) at 309 citing *Quintette Coal Ltd. v. Nippon Steel Corp.*, *supra*, at 312. Accordingly, a court-ordered stay will usually prohibit creditors from terminating contracts with the debtor company.

8 Until 1997, the court had a broad discretion under the *CCAA* to order stays which interfered with a creditor's exercise of its contractual rights. That year the eligible financial contract provisions, which had been added in 1992 to s. 65.1(8) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (S.C. 1992, c. 27, s. 30), were imported into s. 11.1 of the *CCAA* (S.C. 1997, c. 12, s. 124) in order to harmonize the two insolvency statutes.[FN4] In its report to Parliament in 1991, the Standing Committee on Consumer and Corporate Affairs referred to termination and netting out provisions that had been exempted under United States bankruptcy law, and noted that "competitive considerations might require similar provisions here". The Committee went on to recommend the eligible financial contract exemption "that would allow certain financial swap and hedging agreements to be terminated where a notice of intention or a proposal has been filed" (Canada, Standing Committee on Consumer and Corporate Affairs and Government Operations "First Report on Bill C-22", October 7, 1991, at 15:13-15:14).

9 As a result of the addition of the eligible financial contract provisions, "no order may be made under [the *CCAA*] staying or restraining the exercise of any right to terminate, amend or claim any accelerated payment under an eligible financial contract" (s. 11.1(2)). This entitles a non-defaulting party to terminate an eligible financial contract and exercise rights of netting out or set-off, despite the *CCAA* proceedings. While the amendment permits a creditor to enforce the terms of the contract previously negotiated with the debtor company, it does not confer any extra powers; specifically s. 11.1(3) says "the setting off of obligations between the company and the other parties to the eligible financial contract, in accordance with its provisions, is permitted". The non-defaulting creditor who, on a net basis, is owed money, is deemed to be a creditor of the debtor company (s. 11.1(3)), and would participate in the *CCAA* proceedings on the same footing as other creditors. Presumably it would vote on the restructuring and ultimately receive whatever pro-rated payment other creditors receive.

10 Section 11.1(1) provides a comprehensive and intimidating list of the types of transactions that are eligible financial contracts:

11.1(1) in this section,

"eligible financial contract" means

(a) a currency or interest rate swap agreement,

(b) a basis swap agreement,

(c) a spot, future, forward or other foreign exchange agreement,

(d) a cap, collar or floor transaction,

(e) a commodity swap,

(f) a forward rate agreement,

(g) a repurchase or reverse repurchase agreement,

(h) a spot, future, forward or other commodity contract,

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i),

(k) any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j),

(l) any master agreement in respect of a master agreement referred to in paragraph (k),

(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l), or

(n) any agreement of a kind prescribed;

[Emphasis added.]

11 Here the key issue is whether the longer term gas supply contracts are forward commodity contracts under s. 11.1(1)(h).

THE AGREEMENTS

12 The agreements being considered in this appeal provide for long term natural gas sales by Blue Range or Humble to the appellants. They consist of:

a) Master Firm Gas Purchase/Sale Agreement dated June 13, 1994, as amended, between Enron and Humble (AB IV 406);

b) Master Firm Gas Purchase/Sale Agreement dated May 19, 1998, as amended, between Enron and Blue Range (AB VII at 921);

c) Gas Purchase Agreement dated June 25, 1996, between Duke and Humble (AB VI at 731-771);

d) Guarantee by Blue Range of Humble's obligations to Duke dated June 25, 1996 (AB VI at 772);

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e) Gas Purchase Contracts dated July 1, 1991 and a Gas Purchase Letter Agreement dated December 1, 1992, between Humble and Engage (AB IV at 300 and 359);

f) Gas Transaction Agreement dated May 20, 1994, between Engage and Humble (AB IV at 390);

g) Guaranty Agreement by Blue Range of Humble's obligations to Engage dated July 1, 1994 (AB V at 581).

13 The contracts between Blue Range, Humble and Enron are master agreements which contemplate that the parties will enter into gas purchase and sale agreements from time to time (AB IV at 406; AB VII at 921). These subsequent agreements, which are in the form of confirmation letters, set out the terms and conditions of specific natural gas purchase and sale transactions (AB VI at 831; AB VII at 983 and 997). The master agreements contain termination provisions which are triggered by various events of default including "the failure by a party to make when due, any payment required under this Agreement ... an assignment for the benefit of creditors, a petition or proceeding under Bankruptcy law including the CCAA" (Clause 10.3, AB VII at 921). Both the Duke and Engage agreements are natural gas purchase and sale contracts with Humble, whose obligations are guaranteed by Blue Range. While the termination provisions in the Duke and Engage contracts do not mirror the Enron provisions, they too provide for termination in certain circumstances. All the agreements contain netting out or set-off provisions.

14 The agreements therefore fit within one of three categories: they are either individual gas purchase and sale contracts, master agreements which provide for gas purchase and sale contracts, or guarantees of gas purchase and sale contracts. The appellants contend that the individual gas purchase and sale contracts are forward commodity contracts, qualifying as eligible financial contracts under s. 11.1(1)(h) of the *CCAA*. It is conceded that if that is the case, each master agreement would be "a master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j)", qualifying under s. 11.1(1)(k). Similarly each guarantee would be "a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l)", qualifying under s. 11.1(1)(m). The key issue in this appeal, then, is whether the long term gas purchase and sale contracts are forward commodity contracts. If so, all the agreements are exempt from the *CCAA* stay provisions and may be terminated by the appellants.

THE CHAMBERS JUDGE'S DECISION

15 The chambers judge decided that the agreements were not forward commodity contracts within the meaning of s. 11.1(1)(h). Noting that the term "forward commodity contract" is not defined in the *CCAA,* he considered many different definitions provided by the parties and concluded "[b]ased on these sources one could define these items as almost anything or conclude that almost any contract fits" (AB I at 256). He expressed concern that a broad definition would defeat the object of the stay imposed in *CCAA* proceedings (AB I at 266).

16 The chambers judge observed that s. 11.1 is entitled "eligible financial contracts", not "eligible contracts" and considered the word "financial" in the title to be "very significant" and to be the "guiding principle" in giving a "purposeful meaning to the section in light of the statute as a whole" (AB I at 259-60). He decided that a distinction should be drawn between contracts whose purpose is to lead to the actual delivery of a commodity, which he called physical contracts, and contracts whose purpose is only financial and is not intended to lead to actual delivery of a commodity, which he called financial contracts. In his view, only the latter could be considered eligible financial contracts and "[t]he question whether contracts are one or the other is to be resolved by the intention of the parties" (AB I 260). Because the preamble to the Enron Master Firm Agreement referred to delivery and receipt of natural gas, he concluded that "the parties were intending this to be a contract which was 'physical' in nature as opposed to 'financial'" (AB I 266) and the agreement was not an eligible financial contract. He reached the same conclusion with respect to the Duke and Engage agreements (AB I 267).

FORWARD COMMODITY CONTRACTS

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2000 CarswellAlta 1004, 2000 ABCA 239, [2000] A.W.L.D. 718, 192 D.L.R. (4th) 281, 20 C.B.R. (4th) 187, 266 A.R. 98, 228 W.A.C. 98, [2001] 2 W.W.R. 454, 87 Alta. L.R. (3d) 329, [2000] A.J. No. 1032

Hedges and Netting Out

17 Although "forward commodity contracts" are not defined in the *CCAA*, according to text writers they are merely "contract[s] to buy or sell an asset at a certain price on a future date": M. J. Bienenstock and P.M. Basta, "The Treatment of Derivatives under the Bankruptcy Code" in *Real Estate Workouts and Bankruptcies 1994*, (Practising Law Institute, 1994) 231 at 239. The long term natural gas supply contracts in this appeal fit within this general description. Put simply, they are negotiated contracts between private parties to buy and sell a specified quantity of gas at a certain or determinable price on a certain future date. According to the contracts, on the delivery dates Blue Range or Humble will deliver the gas to the purchaser at a specified delivery point, in exchange for the purchase price. The contracts therefore contemplate eventual physical settlement by the delivery of natural gas.

18 The agreements also serve an important financial purpose which is unrelated to physical or financial settlement; they are risk management tools, commonly known as "hedges". Blue Range or Humble agree to sell the gas at a predetermined price on a future date and assume the "short position". The buyer agrees to purchase the gas and assumes the "long position". The seller is looking for price certainty and limited downside exposure: Blue Range or Humble, who are guaranteed a particular purchase price, predict that the market price for gas will decline, and on the delivery date they will sell the gas at a price which is above market value.[FN5] The buyer assumes the risk of price fluctuations and predicts precisely the opposite: Enron, Duke and Engage gamble that the market price for gas will rise, and on the delivery date they will purchase the gas at a price that is below market value. See Bienenstock and Basta, *supra*, at 241-42.

19 Generally, no premium is paid when a long term gas purchase and sale contract is entered into, and on that day the contract has a zero value. But the price of gas fluctuates constantly, which in turn affects the value of the contract. Because gas is a commodity that trades on the New York Mercantile Exchange, its price and the value of an agreement providing for a future sale of gas are readily ascertainable at any given time. From the perspective of the purchaser, the contract will be "in the money" when the market value of gas exceeds the purchase price specified in the contract. It will be "out of the money" when the market value is less than the purchase price. The contract is therefore "marked to market" and may take on a positive or negative value, depending on the price of gas.

20 In order to further hedge their risk, many gas producers enter into a series of agreements with the same gas marketing and risk management companies, providing for the sale of gas at different prices, on different dates and at different points of delivery. Each of these contracts has its own calculable value. At any point in time, some of these will be "in the money", others "out of the money". Termination and netting out or set-off provisions permit the purchaser to terminate all the agreements upon a triggering event. The purchaser may then "calculate the value of all the transactions as of the termination date and ... net the positive and negative values to determine a lump sum termination amount payable by one party to the other": M.E. Grottenhaler and P.J. Henderson, *The Law of Financial Derivatives in Canada* (Toronto: Carswell, 1999) at 5.1.

The Derivatives Market

21 Contracts to sell things at some future date are not a new creation. Historians suggest forward commodity contracts have been around for some 800 years, since they first appeared at medieval trade fairs in the 12th century. See Richard J. Tweles and Frank J. Jones, *The Futures Game: Who Wins? Who Loses? Why?* (New York: McGraw Hill, 1987). One might wonder then why such basic contracts have taken on new prominence. The answer lies not in the nature of forward commodity contracts, but in the nature of the assets that are the subject of such contracts. It is necessary to consider these assets in the context of this case by reviewing the types of transactions commonly used in the natural gas industry, the manner in which they are actually traded and settled, and the consequences if a non-defaulting party cannot terminate contracts and net out obligations in the event of an insolvency. This analysis assists in understanding the purpose of the eligible financial contract provisions, and interpreting the words used in s. 11.1(1)(h).

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22 Natural gas contracts trade through an exchange or board of trade in what is known as an exchange transaction, or between two negotiating parties in an off-exchange or over-the-counter transaction. There are, in turn, two main types of over-the-counter gas transactions: those which are physically settled by the delivery of gas, and those which are financially settled by cash payment.[FN6]

23 These instruments are all part of the global derivatives market. "Derivative products are investment tools whose value depends on, or is derived from, the performance of some underlying asset such as stocks, bonds, commodities, currencies or indices": G. Luinenburg and F. Soda, "The Enforceability of Over-the-Counter Derivative Contracts Under Canadian Insolvency Regimes" (1996) 12 B.&F.L.R. 41 at 43 [footnote omitted]. Forward commodity contracts and other derivatives have a financial value that can readily be calculated; they are commercial hedging contracts that can be used to manage various types of risk, including changes in commodity prices, exchange rates, interest rates and market risks.

24 Risk management companies, like the appellants, offer a wide range of cash-settled and physically-settled commodity products to customers, who may be producers, end-users or other financial intermediaries in the natural gas market. Natural gas market participants who do not ultimately consume the gas place little emphasis on the distinction between physically- and financially-settled transactions. Just as investors who dabble in the futures market do not anticipate waking up one morning to find a freight-car load of pork bellies on their front lawn, investors who deal in forward gas contracts do not intend to take physical possession of the gas.

25 Many of the trades among producers, gas marketers, risk managers and end-users involve buying and selling the right to take physical delivery of natural gas on a future date. Given the liquidity of the natural gas market, purchasers can readily offload their obligation to take delivery of gas under a physical contract by entering into a contract to make delivery of the same quantity of gas at the same point of delivery. These offsetting arrangements can be made with the original seller or a new party. The market operates like an exchange, as parties agree to make or take delivery, but settle their obligations by entering into offsetting contracts: Affidavit of David W. Richardson, sworn November 10, 1999 (Supp. AB II 18).

26 Although some end-user will eventually claim the gas, trades along the way are not settled by physical delivery. Instead, they are normally settled by "title transfers", using such systems as the NOVA Inventory Transfer System, which plays a role similar to a securities depository and transfer agent in the securities industry: Richardson Affidavit, *supra*, at 16. Participants transfer a nominated volume of gas from their Nova account to another participant's account. The transfer is done by book entry, without actual possession or physical delivery of gas. Like the active trading that takes place in other financial markets, the volume of gas traded on a daily basis far exceeds the amount of natural gas that actually flows through the system.

27 The appellants argue that an effective and fully functional termination, netting and set-off scheme that applies to all derivative instruments, including forward commodity contracts, is critical to the vitality of the derivatives market. A similar observation was made by Farley J. in *Confederation Treasury Services Ltd. v. Hees International Bancorp Inc.* (1997), 45 C.B.R. (3d) 204 (Ont. Gen. Div. [Commercial List]). He recognized that derivative contracts are a legitimate method of managing risk and as a matter of public policy should not be dealt with in a manner that affects their efficiency either in non-insolvency or insolvency situations. "If the right to terminate contemplated in the agreement ... is not enforceable, the whole structure of risk management for the swaps and other transactions is weakened or may fall apart": at 231 [citation omitted]. The effect of non-enforceability on the derivatives market is worth exploring.

28 The *CCAA* stay provisions create disparities among market participants. While the non-defaulting party is subject to the stay order and may not terminate its contracts, the debtor company suffers from no similar disability. Subject to the court's supervision, it may terminate and breach contracts with impunity, forcing the non-defaulting

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party to claim damages as an unsecured creditor in the *CCAA* proceedings. The ability to selectively repudiate contracts is disdainfully known as "cherry picking". The debtor company could, for example, retain "out of the money" transactions, speculating that they might improve in value, but knowing full well that it would not be able to pay if the market moved in the other direction. At the same time it might terminate "in the money" transactions, triggering a cash payment by the non-defaulting party. See Luinenburg and Soda, *supra*, at 65; Brenda Gonzalez-Hermosillo, "The Microstructure of Financial Derivatives Markets: Exchange-Traded versus Over-the-Counter", Technical Report No. 68 (Bank of Canada, 1994) at 64, online at *http://www.bank-banque-canada.ca/english/res/tr68-e.htm.*

29 Without enforceable termination and netting out provisions, the insolvent company maintains complete control and may repudiate a contract at any time without notice. Because the non-defaulting party cannot count on performance, it cannot effectively re-hedge its risk by entering into an offsetting contract incorporating similar terms. Given the volatility of the market, the non-defaulting party is exposed to excessive and unmanageable risk.[FN7]

30 Quite apart from the unfairness of cherry picking, other undesirable consequences follow. In order to determine credit availability, risk management companies account for "out of the money" transactions by deducting the value of "in the money" transactions. This practice is only appropriate if termination and netting out provisions are enforceable, and unaffected by an insolvency.[FN8] If forward gas contracts are not exempt from the *CCAA* stay provisions and no offsetting deductions are permitted, available credit quickly will be gobbled up. As a result, risk management companies will limit the capital they can allocate to this market, or ask cash-strapped gas producers to put up additional security to cover any short-falls. The unfortunate effect will be reduced availability of physical forward gas sales contracts to small producers, who are most in need of hedges to manage price risks. It will also encourage business to migrate to the United States, where physically-settled transactions are protected under United States bankruptcy law,[FN9] putting Canadian risk management companies at a competitive disadvantage. These results weaken the risk management structure within the derivatives market, and are contrary to the object of the eligible financial contract amendment.

Interpretation of the CCAA

31 An analysis of the language of s. 11.1(1) indicates that the eligible financial contract definition addresses derivative instruments and confirms that Parliament must have intended to protect the derivatives market from the uncertainties of insolvency.

32 The global derivatives market has shown phenomenal growth over the last decade. Derivative instruments, whose variety and number are limited only by ingenuity, are identified by a bewildering array of newly coined terms.[FN10] However, derivative instruments really consist of a couple of basic financial building blocks assembled to produce an almost infinite series of exotic-sounding products. See Clifford W. Smith, Charles W. Smithson and D. Sykes Wilford, *Managing Financial Risk* (New York: Harper & Row, 1990); see also Charles W. Smithson, "A LEGO Approach to Financial Engineering: An Introduction to Forwards, Futures, Swaps and Options", *Midland Corporate Finance Journal*, 4, no. 4 (Winter 1982) at 16-28. There are four basic building blocks: forwards and futures,[FN11] which in the case of commodities are physically settled, and swaps[FN12] and options,[FN13] which are financially settled. These interlocking pieces are refined, developed and combined to produce sophisticated products. A forward contract can be regarded as the most fundamental piece because other building blocks, the swap contract and the futures contract, for example, are no more than variations on forward contracts. See Richard Briffett, "An Introduction to Derivative Instruments and How They are Used", 1995, online at *http://www.law.emory.edu/~lawrld/deriv2.html.*

33 Parliament appears to have taken the building block approach to derivative instruments in stride in its formulation of s. 11.1(1). Each of the basic interlocking pieces seems to be included in the "eligible financial contract" definition: future and forward commodity contracts at s. 11.1(1)(h); commodity swaps at s. 11.1(1)(e); and options at s. 11.1(1)(j). A series of other well-recognized derivative instruments are included in the definition. But the derivatives market is always changing and the list of eligible financial contracts is not static. This is acknowledged in s. 11.1(1)(k) which includes combinations of other instruments, as well as derivatives or agreements similar to contracts

referred to in other subsections. It seems, therefore, that derivative instruments of all varieties are embraced by the eligible financial contract definition.

34 Physically-settled forward commodity contracts are an important part of the derivatives market, both in their own right and as components of other instruments. Can it be said that on a proper reading they are excluded from the definition of eligible financial contracts? An interpretation of s. 11.1(h), viewed in the context of the other definitions in s. 11.1(1), indicates that is not the case.

35 The legislature is presumed to avoid "superfluous or meaningless words ... it does not pointlessly repeat itself or speak in vain"; "every word of a statute must be given meaning": R. Sullivan, *Driedger on the Construction of Statutes 3rd ed.* (Toronto: Butterworths, 1994) at 159-60; *Communities Economic Development Fund v. Canadian Pickles Corp.* (1991), [1992] 1 W.W.R. 193 (S.C.C.) at 209.

36 The definition of eligible financial contracts includes spot contracts[FN14] at (h), spot foreign exchange contracts at (c), and repurchase or reverse repurchase contracts[FN15] at (g). These contracts can only be settled by physical delivery, never by financial payment. If eligible financial contracts require cash settlement, these terms are robbed of any meaning. Therefore an across-the-board interpretation of eligible financial contracts that excludes physically-settled transactions cannot stand.

37 Nor is there ambiguity in the expressions "eligible financial contract" or "forward commodity contract" to justify defining either term by reference to physical or financial settlement. It is only when a statute is fairly capable of two constructions that words of qualification can be used to resolve the established ambiguity or imprecision: *Howley v. Canada (Deputy Attorney General)* (1976), 69 D.L.R. (3d) 689 (S.C.C.) at 695. It is not necessary to require financial settlement in order to impart meaning on section 11.1(1)(h); these contracts are risk management tools and serve a financial purpose unrelated to settlement. The presumption of straightforward expression also obliterates the physical and financial settlement distinction. The term "forward commodity contract" is included in the section without any words of qualification. One could postulate that had Parliament intended to restrict s. 11.1(1)(h) to financially-settled commodity contracts, it could, for example, have defined those contracts as "a spot, future, forward or other commodity contract which is settled by cash payment and not by delivery of product".

38 Parliament addresses cash-settled commodity-based contracts in other subsections of s. 11.1(1). These include cap, collar or floor transactions[FN16] at (d), commodity swaps[FN17] at (e) and "any derivative ... in respect of ... an agreement or contract referred to in paragraph (a) to (i)" at (j). The last section is of particular importance, because its broad wording encompasses financially-settled derivatives of any other species of contract contemplated in s. 11.1(1), including derivatives of both physically- and financially-settled contracts. Because these sections deal specifically with cash-settled commodity contracts, "forward commodity contracts" in s. 11.1(1)(h) undoubtedly refer to something else — that something else must be physically-settled commodity contracts.

Restricting the Meaning of "Commodity"

39 But once the term "forward commodity contract" is interpreted to include physically-settled transactions, it could potentially include every contract to buy or sell on a future date any "thing produced for use or sale ... article of commerce ... [or] object of trade": *Oxford English Dictionary*, 2nd ed., *s.v.* "commodity". Even commercial contracts would not be protected from termination, making it impossible to maintain the status quo while a debtor company reorganized its affairs. Such a broad interpretation would defeat the *CCAA's* predominant purpose: preserving the insolvent company as a viable operation while reorganizing its affairs to benefit both the company and its creditors: *Meridian Development Inc. v. Toronto Dominion Bank*, *supra*, at 155; *Quintette Coal Ltd. v. Nippon Steel Corp.*, *supra*, at 309. Section 11.1(1) is an exception to a statutory protection which must "be interpreted in light of [the] underlying rationale and not be used to undermine the broad purpose of the legislation ...": Driedger, 3rd ed., at 369-70. See *National Trust Co. v. Mead* (1990), 71 D.L.R. (4th) 488 (S.C.C.) at 497-99. This dictates a narrower

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construction of provisions which are excepted from a stay order: *Re Smith Brothers Contracting Ltd.* (1998), 53 B.C.L.R. (3d) 264 (B.C. S.C.) at 272.

40 The chambers judge chose to sort the contracts by physical or financial settlement in order to limit the impact of s. 11.1(1)(h). That approach is inconsistent with the words used in the section and Parliament's purpose in enacting the eligible financial contract provisions. If all physically-settled instruments are protected from termination by the non-defaulting party, an important chunk of the derivatives market is vulnerable in an insolvency, weakening the Canadian risk management structure.

41 The chambers judge based his interpretation on the word "financial" in the term "eligible financial contract". Although a more restrictive interpretation of "forward commodity contract" may be warranted, any boundaries on its meaning must come from the words of the section rather than the label Parliament attached to the species of contracts. "Commodity" is the critical word, and it is not defined in the *CCAA*. The word "commodity" must be examined in the context of the legislation to see whether Parliament intended a broad dictionary meaning — to include a forward contract to buy or sell practically anything of value — or something less expansive.

42 Other statutes provide definitions which are considerably narrower than the dictionary definition. For example, the *Securities Act*, R.S.A. 1980, c. S-6.1 defines "commodity" at s. 1(b.01) to include:

> (i) any good, article, service, right or interest of which any unit is, from its nature or by mercantile custom, treated as the equivalent of any other unit;
>
> (ii) the currency of any jurisdiction;
>
> (iii) any gem, gemstone or other precious stone;

The *Commodity Futures Act*, R.S.O. 1990, c. C.20 defines Acommodity" in s. 1:

> Acommodity" means ... any agricultural product, forest product, product of the sea, mineral, metal, hydrocarbon fuel, currency or precious stone or other gem ..."

43 A common feature in these definitions is that the articles are fungible in nature — each unit is interchangeable for another. They have no specific or defining characteristics and may easily be replaced. Grottenhaler and Henderson, *supra*, at 5-8 describe the similarities among the list of items contained in the definition of eligible financial contracts in s. 11.1(1):

> Most of these transactions involve payments flowing between the parties depending on the fluctuation in the price or rate. Importantly, they also, for the most part, involve commodities or rights for which there is an active market. They are fungible in the sense that it is not difficult in most cases to find a replacement transaction and to do so in a relatively short time period.

44 Unlike leases and ordinary executory contracts whose markets change at a leisurely pace, derivative products are subject to a volatile underlying market: Luinenberg and Soda, *supra*, at 86. "[T]he spot market price for the underlying asset of a successful derivative security must be volatile and unpredictable with a sufficient (trading) volume to ensure convergence to a competitive equilibrium price": Sean M. O'Connor, "The Development of Financial Derivatives Markets: The Canadian Experience", Technical Report No. 62, (Bank of Canada, 1993) at 21.

45 Like the other items in s. 11.1(1), forward commodity contracts are financial hedges and risk management tools. Interpreting them in the context of the rest of the section requires that they share certain traits. The contracts

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listed in s. 11.1(1) deal with units that are the equivalent of any other unit. Therefore commodities must be interchangeable, and readily identifiable as fungible commodities capable of being traded on a futures exchange or as the underlying asset of an over-the-counter derivative transaction. Commodities must trade in a volatile market, with a sufficient trading volume to ensure a competitive trading price, in order that forward commodity contracts may be "marked to market" and their value determined. This removes from the ambit of s. 11.1(1)(h) contracts for commercial merchandise and manufactured goods which neither trade on a volatile market nor are completely interchangeable for each other.

Application

46 It is clear that natural gas meets this narrower definition of commodity. Unlike consumer goods which vary widely in size, style and quality, one mcf of gas is identical to another mcf of gas. Natural gas trades on a highly liquid and volatile market, and while its price fluctuates from moment to moment, that price is readily ascertainable. Forward gas contracts therefore have a calculable cash equivalent.

47 Since physically-settled forward commodity contracts are included in the definition of eligible financial contracts, and gas is a commodity, the next issue is whether the agreements in question are forward commodity contracts. As the term is not defined in the *CCAA*, industry and expert definitions provide valuable guidance.

48 Haedicke and Aronowitz, *supra*, footnote 12, at 88:74-75 define a "forward contract" for the energy industry as:

> A customized contract to buy or sell a commodity for delivery at a certain future time for a certain price. It is customized by individual negotiations between two parties, rather than standardised and traded on a board of trade. The parties to the forward contract usually know each other, and in most cases the contract is settled by actual delivery of the commodity.

49 James Joyce, a specialist in energy risk assessment who provided an expert report in this case, identified the key elements of a forward commodity contract in the natural gas industry to include:

a) a buyer of natural gas;

b) a seller of natural gas;

c) a defined contract term longer than the next day;

d) a defined volume of natural gas;

e) a defined delivery and receipt point (including any transportation requirements, as applicable); and

f) a defined price or pricing mechanism. (AB VII at 1049.)

50 Not every contract involving the purchase and sale of natural gas is a forward commodity contract. For example, Joyce's definition would not capture standard gas utility contracts, which do not usually commit a consumer to purchase a specified volume of gas for a specified price. Instead they are demand driven, with consumers purchasing the amount of gas needed from time to time at prices which fluctuate depending on rates set by a regulatory authority.

51 The Haedicke and Aronowitz and Joyce definitions reasonably set out the requirements for a forward commodity contract in the natural gas industry. The gas purchase and sale contracts under consideration in this appeal,

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which are negotiated bilateral contracts as required in the Haedicke and Aronowitz definition, also contain all the elements referred to in the Joyce definition. Therefore the agreements are forward commodity contracts.

52 The final measure is to test the fairness of this result. A manufacturer of consumer goods selling specified products to particular customers may encounter serious financial obstacles if, in *CCAA* proceedings, customers are permitted to terminate contracts for the purchase of goods. The manufacturer may never find substitute purchasers with the same requirements, impairing its cash flow and ability to stay in business during the restructuring period. This defeats the purpose of the *CCAA*. But the same cannot be said of a gas producer whose long term gas supply contracts are terminated. Blue Range and Humble may readily sell their gas in the spot market, assuring them a source of income. In addition, they may negotiate new long term gas supply contracts, perhaps on more favourable terms.

53 The appellants are also fairly treated. Through the use of the termination and netting out provisions they may crystallize their losses, deal with their exposure through further hedging transactions and avoid piling on losses that are likely to arise in the volatile gas market. This permits them to continue to offer these risk management tools to small gas producers who are in need of them, and preserves the integrity of these financial instruments in the derivatives market.

SUMMARY

54 Eligible financial contracts in s. 11.1(1) include both physically-settled and financially- settled transactions. Restricting forward commodity contracts in s. 11.1(1)(h) to cash-settled contracts is contrary to the plain meaning of the section and inconsistent with Parliament's objective of protecting the risk management structure within the derivatives market. Nor is such a restriction necessary to achieve the purpose of the *CCAA*. While forward commodity contracts may be physically settled by the delivery of product, they must be restricted to contracts for fungible commodities which trade in a liquid and volatile market.

55 Natural gas is such a commodity. Each of the agreements under consideration in this appeal is an eligible financial contract because it is either a forward commodity contract (s. 11.1(1(h)), a master agreement in respect of a forward commodity contract (s. 11.1(1)(k)), or a guarantee of the liabilities under a forward commodity contract (s. 11.1(1)(m)).

56 The appeal is allowed.

Supplementary reasons.

***Berger J.A.*:**

57 Counsel will note that this judgment is styled "Reasons for Judgment Reserved". The label "Reserved" no longer has the significance it once had. The Court's policy set out in *Hutterian Brethren Church of Starland v. Starland (Municipal District No. 47)* (1993), 9 Alta. L.R. (3d) 1 (Alta. C.A.), at 15 and *R. v. Bonneteau* (1994), 24 Alta. L.R. (3d) 153 (Alta. C.A.), at 158 was abolished on September 1, 1999.

58 The effect of the new policy, which still permits circulation of draft reasons to members of the Court off the panel (for comment only), was stated as follows by Hetherington, J.A. in *R. v. F. (D.M.)* (1999), 139 C.C.C. (3d) 144 (Alta. C.A.):

> In the past this court has said that, so far as statements of law or principle are concerned, a reserved judgment which is not a dissenting judgment sets out views accepted by a majority of the members of the court. (See *Hutterian Brethren Church of Starland v. Starland No. 47 (Municipal District)* (1993), 9 Alta. L.R. (3d) 1, at 15, and *R. v. Bonneteau* (1994), 24 Alta. L.R. (3d) 153, at 158.) However, this is no longer the case. The practices of

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the court have changed. Now so far as statements of law or principle are concerned, a reserved judgment which is not a dissenting judgment sets out the views of a majority of the panel which heard the appeal. It can not be inferred that a majority of the members of the court share those views.

Q: What's the difference between being rich and being poor?

A: About 15 seconds, some days.

"What's the Difference on Wall Street", January 28, 1999, "Derivatives Humor for 1999 - January to August", Copyright 1996-1999 by The William Margrabe Group, Inc., online at *http://www.margrabe.com/Humor/Humor99.html.*

— for those with an alliterative bent: strips, straps, STRYPES, straddles, strangles and structures;

— for animal lovers: turtle trades, CUBS, ELKS, STEERS, COBRAs, hamster options, kangaroo bonds and naked dog baskets;

— for individualists: SLOBs, sticky floaters, ZENS, SPINs and hermaphrodite options;

— and for the remorseful investor: gilt strips.

See The William Margrabe Group, Inc.'s Derivatives Dictionary, Copyright 1996-2000 by The William Margrabe Group, Inc., online at *http://www.margrabe.com/Dictionary.html.*

Appeal allowed.

FN* A corrigendun was issued November 30, 2000; the changes have been incorporated herein.

FN1 Blue Range and Humble are represented in this appeal by PriceWaterhouseCoopers Inc., in its capacity as monitor under the *CCAA*.

FN2 Both Enron companies are the North American merchant trading arms of Enron Corp., a Houston-based integrated natural gas and electricity company. These companies offer risk management services primarily related to the energy sector. Duke is a limited partnership carrying on business as a natural gas marketer in Alberta. Engage is the merchant trading arm of Westcoast Energy Inc. and The Coastal Corporation, and offers risk management services to entities operating in the energy sector. The appellants are joined in this appeal by two intervenors: TransCanada Energy Ltd. is Canada's largest domestic marketer of natural gas and other commodities; International Swaps and Derivatives Association, Inc. is the global trade association representing the world's major institutions in the privately negotiated derivatives industry.

FN3 Footnote deleted.

FN4 Similar "eligible financial contract" definitions were added in 1992 to s. 39.15(7) of the *Canada Deposit Insurance Corporation Act*, R.S.C. 1985, c. C-36 (S.C. 1992, c.26, s.11); and in 1996 to s. 22.1(2) of the *Winding-Up and Restructuring Act*, R.S.C. 1985, c. W-11 (S.C. 1996, c. 6, s.142).

FN5 As one might have guessed, Blue Range's and Humble's predictions were wrong. They overestimated the volume of gas they would produce and underestimated the market price for gas. The companies therefore did not receive market price for the gas they produced and also had to purchase gas in the spot market to honour their contractual

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commitments. These were significant contributing causes of the insolvency: Affidavit of Jeffrey Tonkin sworn March 2, 1999 (AB II at 4).

FN6 Enron calls financially settled transactions "derivative contracts" or "gas-based derivative contracts": Affidavit of P. R. Milnthorp dated March 19, 1999 (AB II at 16-17). This terminology is confusing. Forward commodity contracts are themselves considered to be derivatives. See, for example, Luinenburg and Soda, *supra*, at 43: "Well-known derivative products include ... *forwards*" [original emphasis]; Bienenstock and Basta, *supra*, at 239; "Examples of derivatives are forward contracts"; J.C. Hull, *Options, Futures and Other Derivatives* 3rd ed. (Upper Saddle River: Prentice Hall, 1997) at 1-2: "A *forward contract* is a particularly simple derivative .... A key variable determining the value of a forward contract at any given time is the market price of the asset" [original emphasis]; G. L. E. May, "Overview of Financial, Tax and Accounting Principles for Derivative Financial Instruments", Canadian Tax Foundation, 1995 Conference Report 29:1 at 29:3: "Generally, derivative financial instruments are contingent claims that give owners the obligation or right to buy or sell a quantity at a predetermined price in the future...."

FN7 Extreme volatility leads to roller coaster profits and losses, making the derivatives market a high stakes game that is not for the passive, the inexperienced or the faint of heart. These features of the market are well-recognized:

FN8 In fact this type of accounting will actually be prohibited for some market participants, like banks, that are required by regulation to maintain adequate capital. See for example Guideline A of "Guideline with respect to Capital Adequacy Requirements for Banks", issued by the office of the Superintendent of Financial Institutions. Without an unqualified legal opinion to the effect that termination and close-out netting provisions are effective on insolvency, participants who account for transactions in this fashion will be offside their capital requirements. See Grottenhaler and Henderson, *supra*, at 5.1-5.2.1.

FN9 United States bankruptcy law also exempts forward commodity contracts from the stay provisions; however, the exemption is based not only on the nature of the contract, but also on the nature of the market participant. Under the U.S. *Bankruptcy Code*, special protection is available to "forward contract merchants" (defined at 11 U.S.C. s. 101(26)), stockbrokers and financial institutions to terminate, net and set-off "forward contracts" (defined at 11 U.S.C. s. 101(25)) when the other party to the contract files a petition in bankruptcy. The provisions were designed to protect transactions involving forward contract merchants, rather than ordinary supply contracts between producers and end-users. So long as one of the parties is a forward contract merchant, the contract is exempted, whether it was entered into with a producer, end-user or third party: Sullivan & Cromwell opinion, March 31, 1999 (AB VII at 1060-61). Sullivan & Cromwell also expressed the opinions that Enron would be a "forward commodity merchant" and that the agreements to which it is a party in this appeal would be "forward contracts", within the meaning of the U.S. *Bankruptcy Code*: *id.* (AB VII at 1063).

FN10 The derivatives market has an argot of its own (not to be confused with an ARGO, which hedges the swap leg with puts). The lingo includes:

FN11 Both future and forward commodity contracts are physically-settled. The essential difference between them is their manner of trading. A futures contract trades on an exchange or board of trade. The exchange's clearing house assumes the obligation of both the buyer and seller of the contract and guarantees the transaction, but requires market users to post collateral or "margin", and maintain minimum capital requirements. See Gonzalez-Hermosillo, *supra*, at 28-30. Forward contracts are off-exchange or over-the-counter transactions involving custom contracts negotiated between two parties. Market participants are end-users and dealers who deal directly with each other. Forward contracts are subject to more risks than exchange-traded contracts, including the risk that the contracting party will default on the original contract: *id.* at 59.

FN12 A swap is no more than a series of forward contracts. A gas commodity swap contract is an agreement between two parties to buy or sell a stream of cash flows over a predetermined length of time. One party agrees to pay based on

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a fixed price, while the other agrees to pay based on a floating or market price. Because payments are measured by the difference in prices on the same notional volume of gas, the contracts are always financially-settled: Mark E. Haedicke and Alan B. Aronowitz, "Gas Commodity Markets" in *Energy Law and Transactions* Vol. IV (New York: Matthew Bender & Co. Inc., 1999) at 88:19.

FN13 An option holder pays a premium to acquire the right, but not the obligation, to purchase a specified volume of gas ata specified price, called the strike price, during a specified period of time. The value of the option will depend upon the price of the gas, which will fluctuate from day to day. An option to purchase gas at $2.50 per Mmbtu may have a negligible value if gas trades at $1.50 but will be worth more than $2 if gas trades at $4.50. The option holder need never exercise the option and acquire the gas, but for a more modest investment can benefit from the spread between the strike price and the market value. The holder has no exposure to risk from unfavourable price movements, other than a loss of the premium paid to acquire the option. See Laura J. Porterfield, "Derivative financial instruments: time for better disclosure", *The CPA Journal Online*, July 1994, copyright 1997 New York State Society of Certified Public Accountants, online at *http://www.nysscpa.org/cpajournal/old/15611641.htm.*

FN14 Spot contracts, used either in respect of commodities or foreign exchange, contemplate only physical delivery. That delivery is immediate in contrast to a future delivery. See *Black's Law Dictionary*, 6th ed. Time is not a variable and price fluctuations have no effect. As a result, spot contracts have no financial character and no means by which they may be settled in any way other than physical delivery of product, except perhaps by payment of a stiff penalty.

FN15 A "repurchase contract" or "repo" is "a contract to sell a security combined with a simultaneous agreement by the original seller to repurchase the security at a later date": Bienenstock and Basta, *supra*, at 257. It is a present-day sale combined with an agreement to repurchase the same security in the future. These transactions must be physically-settled by an exchange of cash for the return of the security. Financial settlement is never possible.

FN16 Çaps, floors and collars are forms of commodity swaps. In a cap transaction, one party pays a single or periodic fixed amount and the other party pays periodic amounts based on the excess of a commodity price over a specified price; in a floor transaction, the other party pays periodic amounts based on the excess of a specified price over a commodity price. A collar transaction is a combination of a cap and a floor, where one party pays the floating rate commodity price on the cap and the other pays the floating rate commodity price on the floor. As with other swaps, payments are measured by the difference in prices, and the contracts are always financially-settled. See Schedule "A" to Stikeman, Elliott "Memorandum of Law for the International Swaps and Derivatives Association, Inc.", February 1998 (Supp. AB III at 260-61).

FN17 See footnote 12, *supra.*

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TAB 3

C

2009 CarswellOnt 6184, 59 C.B.R. (5th) 72

Canwest Global Communications Corp., 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 GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A"

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Judgment: October 13, 2009
Docket: CV-09-8241-OOCL

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Counsel: Lyndon Barnes, Edward Sellers, Jeremy Dacks for Applicants

Alan Merskey for Special Committee of the Board of Directors

David Byers, Maria Konyukhova for Proposed Monitor, FTI Consulting Canada Inc.

Benjamin Zarnett, Robert Chadwick for Ad Hoc Committee of Noteholders

Edmond Lamek for Asper Family

Peter H. Griffin, Peter J. Osborne for Management Directors, Royal Bank of Canada

Hilary Clarke for Bank of Nova Scotia

Steve Weisz for CIT Business Credit Canada Inc.

Subject: Insolvency

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Arrangements — Miscellaneous

Debtor companies experienced financial problems due to deteriorating economic environment in Canada — Debtor companies took steps to improve cash flow and to strengthen their balance sheets — Economic conditions did not improve nor did financial circumstances of debtor companies — They experienced significant tightening of credit from critical suppliers and trade creditors, reduction of advertising commitments, demands for reduced credit terms by newsprint and printing suppliers, and restrictions on or cancellation of credit cards for certain employees — Application was brought for relief pursuant to Companies' Creditors Arrangement Act — Application granted — Proposed monitor was appointed — Companies qualified as debtor companies under Act — Debtor companies were in default of their obligations — Required statement of projected cash-flow and other financial documents required under s. 11(2) were filed — Stay of proceedings was granted to create stability and allow debtor companies to pursue their restructuring — Partnerships in application carried on operations that were integral and closely interrelated to business of debtor companies — It was just and convenient to grant relief requested with respect to partnerships — Debtor-in-possession financing was approved — Administration charge was granted — Debtor companies' request for authorization to pay pre-filing amounts owed to critical suppliers was granted — Directors' and officers' charge was granted — Key employee retention plans were approved — Extension of time for calling of annual general meeting was granted.

Cases considered by *Pepall J.*:

Cadillac Fairview Inc., Re (1995), 1995 CarswellOnt 36, 30 C.B.R. (3d) 29 (Ont. Gen. Div. [Commercial List]) — referred to

Calpine Canada Energy Ltd., Re (2006), 19 C.B.R. (5th) 187, 2006 ABQB 153, 2006 CarswellAlta 446 (Alta. Q.B.) — referred to

General Publishing Co., Re (2003), 39 C.B.R. (4th) 216, 2003 CarswellOnt 275 (Ont. S.C.J.) — referred to

Global Light Telecommunications Inc., Re (2004), 2004 BCSC 745, 2004 CarswellBC 1249, 2 C.B.R. (5th) 210, 33 B.C.L.R. (4th) 155 (B.C. S.C.) — referred to

Grant Forest Products Inc., Re (2009), 2009 CarswellOnt 4699, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) — followed

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Sierra Club of Canada v. Canada (Minister of Finance) (2002), 287 N.R. 203, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 18 C.P.R. (4th) 1, 44 C.E.L.R. (N.S.) 161, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 20 C.P.C. (5th) 1, 40 Admin. L.R. (3d) 1, 2002 SCC 41, 2002 CarswellNat 822, 2002 CarswellNat 823, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 93 C.R.R. (2d) 219, [2002] 2 S.C.R. 522 (S.C.C.) — followed

Smurfit-Stone Container Canada Inc., Re (2009), 50 C.B.R. (5th) 71, 2009 CarswellOnt 391 (Ont. S.C.J. [Commercial List]) — referred to

Stelco Inc., Re (2004), 48 C.B.R. (4th) 299, 2004 CarswellOnt 1211 (Ont. S.C.J. [Commercial List]) — referred to

Stelco Inc., Re (2004), 2004 CarswellOnt 2936 (Ont. C.A.) — referred to

Statutes considered:

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

Generally — referred to

Bankruptcy Code, 11 U.S.C.

Chapter 15 — referred to

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

Generally — referred to

s. 106(6) — referred to

s. 133(1) — referred to

s. 133(1)(b) — referred to

s. 133(3) — referred to

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

Generally — considered

s. 2 "debtor company" — referred to

s. 11 — considered

s. 11(2) — referred to

s. 11.2 [en. 1997, c. 12, s. 124] — considered

s. 11.2(1) [en. 2005, c. 47, s. 128] — referred to

s. 11.2(4) [en. 2005, c. 47, s. 128] — considered

s. 11.4 [en. 1997, c. 12, s. 124] — considered

s. 11.4(1) [en. 1997, c. 12, s. 124] — referred to

s. 11.4(3) [en. 1997, c. 12, s. 124] — considered

s. 11.51 [en. 2005, c. 47, s. 128] — considered

s. 11.52 [en. 2005, c. 47, s. 128] — considered

s. 23 — considered

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Courts of Justice Act, R.S.O. 1990, c. C.43

s. 137(2) — considered

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 38.09 — referred to

APPLICATION for relief pursuant to *Companies' Creditors Arrangement Act.*

***Pepall J.*:**

1 Canwest Global Communications Corp. ("Canwest Global"), its principal operating subsidiary, Canwest Media Inc. ("CMI"), and the other applicants listed on Schedule "A" of the Notice of Application apply for relief pursuant to the *Companies' Creditors Arrangement Act.*[FN1] The applicants also seek to have the stay of proceedings and other provisions extend to the following partnerships: Canwest Television Limited Partnership ("CTLP"), Fox Sports World Canada Partnership and The National Post Company/La Publication National Post ("The National Post Company"). The businesses operated by the applicants and the aforementioned partnerships include (i) Canwest's free-to-air television broadcast business (ie. the Global Television Network stations); (ii) certain subscription-based specialty television channels that are wholly owned and operated by CTLP; and (iii) the National Post.

2 The Canwest Global enterprise as a whole includes the applicants, the partnerships and Canwest Global's other subsidiaries that are not applicants. The term Canwest will be used to refer to the entire enterprise. The term CMI Entities will be used to refer to the applicants and the three aforementioned partnerships. The following entities are not applicants nor is a stay sought in respect of any of them: the entities in Canwest's newspaper publishing and digital media business in Canada (other than the National Post Company) namely the Canwest Limited Partnership, Canwest Publishing Inc./Publications Canwest Inc., Canwest Books Inc., and Canwest (Canada) Inc.; the Canadian subscription based specialty television channels acquired from Alliance Atlantis Communications Inc. in August, 2007 which are held jointly with Goldman Sachs Capital Partners and operated by CW Investments Co. and its subsidiaries; and subscription-based specialty television channels which are not wholly owned by CTLP.

3 No one appearing opposed the relief requested.

Backround Facts

4 Canwest is a leading Canadian media company with interests in twelve free-to-air television stations comprising the Global Television Network, subscription-based specialty television channels and newspaper publishing and digital media operations.

5 As of October 1, 2009, Canwest employed the full time equivalent of approximately 7,400 employees around the world. Of that number, the full time equivalent of approximately 1,700 are employed by the CMI Entities, the vast majority of whom work in Canada and 850 of whom work in Ontario.

6 Canwest Global owns 100% of CMI. CMI has direct or indirect ownership interests in all of the other CMI Entities. Ontario is the chief place of business of the CMI Entities.

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7 Canwest Global is a public company continued under the *Canada Business Corporations Act*[FN2]. It has authorized capital consisting of an unlimited number of preference shares, multiple voting shares, subordinate voting shares, and non-voting shares. It is a "constrained-share company" which means that at least 66 2/3% of its voting shares must be beneficially owned by Canadians. The Asper family built the Canwest enterprise and family members hold various classes of shares. In April and May, 2009, corporate decision making was consolidated and streamlined.

8 The CMI Entities generate the majority of their revenue from the sale of advertising (approximately 77% on a consolidated basis). Fuelled by a deteriorating economic environment in Canada and elsewhere, in 2008 and 2009, they experienced a decline in their advertising revenues. This caused problems with cash flow and circumstances were exacerbated by their high fixed operating costs. In response to these conditions, the CMI Entities took steps to improve cash flow and to strengthen their balance sheets. They commenced workforce reductions and cost saving measures, sold certain interests and assets, and engaged in discussions with the CRTC and the Federal government on issues of concern.

9 Economic conditions did not improve nor did the financial circumstances of the CMI Entities. They experienced significant tightening of credit from critical suppliers and trade creditors, a further reduction of advertising commitments, demands for reduced credit terms by newsprint and printing suppliers, and restrictions on or cancellation of credit cards for certain employees.

10 In February, 2009, CMI breached certain of the financial covenants in its secured credit facility. It subsequently received waivers of the borrowing conditions on six occasions. On March 15, 2009, it failed to make an interest payment of US$30.4 million due on 8% senior subordinated notes. CMI entered into negotiations with an ad hoc committee of the 8% senior subordinated noteholders holding approximately 72% of the notes (the "Ad Hoc Committee"). An agreement was reached wherein CMI and its subsidiary CTLP agreed to issue US$105 million in 12% secured notes to members of the Ad Hoc Committee. At the same time, CMI entered into an agreement with CIT Business Credit Canada Inc. ("CIT") in which CIT agreed to provide a senior secured revolving asset based loan facility of up to $75 million. CMI used the funds generated for operations and to repay amounts owing on the senior credit facility with a syndicate of lenders of which the Bank of Nova Scotia was the administrative agent. These funds were also used to settle related swap obligations.

11 Canwest Global reports its financial results on a consolidated basis. As at May 31, 2009, it had total consolidated assets with a net book value of $4.855 billion and total consolidated liabilities of $5.846 billion. The subsidiaries of Canwest Global that are not applicants or partnerships in this proceeding had short and long term debt totalling $2.742 billion as at May 31, 2009 and the CMI Entities had indebtedness of approximately $954 million. For the 9 months ended May 31, 2009, Canwest Global's consolidated revenues decreased by $272 million or 11% compared to the same period in 2008. In addition, operating income before amortization decreased by $253 million or 47%. It reported a consolidated net loss of $1.578 billion compared to $22 million for the same period in 2008. CMI reported that revenues for the Canadian television operations decreased by $8 million or 4% in the third quarter of 2009 and operating profit was $21 million compared to $39 million in the same period in 2008.

12 The board of directors of Canwest Global struck a special committee of the board ("the Special Committee") with a mandate to explore and consider strategic alternatives in order to maximize value. That committee appointed Thomas Strike, who is the President, Corporate Development and Strategy Implementation of Canwest Global, as Recapitalization Officer and retained Hap Stephen, who is the Chairman and CEO of Stonecrest Capital Inc., as a Restructuring Advisor ("CRA").

13 On September 15, 2009, CMI failed to pay US$30.4 million in interest payments due on the 8% senior subordinated notes.

14 On September 22, 2009, the board of directors of Canwest Global authorized the sale of all of the shares of Ten

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Network Holdings Limited (Australia) ("Ten Holdings") held by its subsidiary, Canwest Mediaworks Ireland Holdings ("CMIH"). Prior to the sale, the CMI Entities had consolidated indebtedness totalling US$939.9 million pursuant to three facilities. CMI had issued 8% unsecured notes in an aggregate principal amount of US$761,054,211. They were guaranteed by all of the CMI Entities except Canwest Global, and 30109, LLC. CMI had also issued 12% secured notes in an aggregate principal amount of US$94 million. They were guaranteed by the CMI Entities. Amongst others, Canwest's subsidiary, CMIH, was a guarantor of both of these facilities. The 12% notes were secured by first ranking charges against all of the property of CMI, CTLP and the guarantors. In addition, pursuant to a credit agreement dated May 22, 2009 and subsequently amended, CMI has a senior secured revolving asset-based loan facility in the maximum amount of $75 million with CIT Business Credit Canada Inc. ("CIT"). Prior to the sale, the debt amounted to $23.4 million not including certain letters of credit. The facility is guaranteed by CTLP, CMIH and others and secured by first ranking charges against all of the property of CMI, CTLP, CMIH and other guarantors. Significant terms of the credit agreement are described in paragraph 37 of the proposed Monitor's report. Upon a CCAA filing by CMI and commencement of proceedings under Chapter 15 of the Bankruptcy Code, the CIT facility converts into a DIP financing arrangement and increases to a maximum of $100 million.

15 Consents from a majority of the 8% senior subordinated noteholders were necessary to allow the sale of the Ten Holdings shares. A Use of Cash Collateral and Consent Agreement was entered into by CMI, CMIH, certain consenting noteholders and others wherein CMIH was allowed to lend the proceeds of sale to CMI.

16 The sale of CMIH's interest in Ten Holdings was settled on October 1, 2009. Gross proceeds of approximately $634 million were realized. The proceeds were applied to fund general liquidity and operating costs of CMI, pay all amounts owing under the 12% secured notes and all amounts outstanding under the CIT facility except for certain letters of credit in an aggregate face amount of $10.7 million. In addition, a portion of the proceeds was used to reduce the amount outstanding with respect to the 8% senior subordinated notes leaving an outstanding indebtedness thereunder of US$393.25 million.

17 In consideration for the loan provided by CMIH to CMI, CMI issued a secured intercompany note in favour of CMIH in the principal amount of $187.3 million and an unsecured promissory note in the principal amount of $430.6 million. The secured note is subordinated to the CIT facility and is secured by a first ranking charge on the property of CMI and the guarantors. The payment of all amounts owing under the unsecured promissory note are subordinated and postponed in favour of amounts owing under the CIT facility. Canwest Global, CTLP and others have guaranteed the notes. It is contemplated that the debt that is the subject matter of the unsecured note will be compromised.

18 Without the funds advanced under the intercompany notes, the CMI Entities would be unable to meet their liabilities as they come due. The consent of the noteholders to the use of the Ten Holdings proceeds was predicated on the CMI Entities making this application for an Initial Order under the CCAA. Failure to do so and to take certain other steps constitute an event of default under the Use of Cash Collateral and Consent Agreement, the CIT facility and other agreements. The CMI Entities have insufficient funds to satisfy their obligations including those under the intercompany notes and the 8% senior subordinated notes.

19 The stay of proceedings under the CCAA is sought so as to allow the CMI Entities to proceed to develop a plan of arrangement or compromise to implement a consensual "pre-packaged" recapitalization transaction. The CMI Entities and the Ad Hoc Committee of noteholders have agreed on the terms of a going concern recapitalization transaction which is intended to form the basis of the plan. The terms are reflected in a support agreement and term sheet. The recapitalization transaction contemplates amongst other things, a significant reduction of debt and a debt for equity restructuring. The applicants anticipate that a substantial number of the businesses operated by the CMI Entities will continue as going concerns thereby preserving enterprise value for stakeholders and maintaining employment for as many as possible. As mentioned, certain steps designed to implement the recapitalization transaction have already been taken prior to the commencement of these proceedings.

20 CMI has agreed to maintain not more than $2.5 million as cash collateral in a deposit account with the Bank of

Nova Scotia to secure cash management obligations owed to BNS. BNS holds first ranking security against those funds and no court ordered charge attaches to the funds in the account.

21 The CMI Entities maintain eleven defined benefit pension plans and four defined contribution pension plans. There is an aggregate solvency deficiency of $13.3 million as at the last valuation date and a wind up deficiency of $32.8 million. There are twelve television collective agreements eleven of which are negotiated with the Communications, Energy and Paperworkers Union of Canada. The Canadian Union of Public Employees negotiated the twelfth television collective agreement. It expires on December 31, 2010. The other collective agreements are in expired status. None of the approximately 250 employees of the National Post Company are unionized. The CMI Entities propose to honour their payroll obligations to their employees, including all pre-filing wages and employee benefits outstanding as at the date of the commencement of the CCAA proceedings and payments in connection with their pension obligations.

Proposed Monitor

22 The applicants propose that FTI Consulting Canada Inc. serve as the Monitor in these proceedings. It is clearly qualified to act and has provided the Court with its consent to act. Neither FTI nor any of its representatives have served in any of the capacities prohibited by section of the amendments to the CCAA.

Proposed Order

23 I have reviewed in some detail the history that preceded this application. It culminated in the presentation of the within application and proposed order. Having reviewed the materials and heard submissions, I was satisfied that the relief requested should be granted.

24 This case involves a consideration of the amendments to the CCAA that were proclaimed in force on September 18, 2009. While these were long awaited, in many instances they reflect practices and principles that have been adopted by insolvency practitioners and developed in the jurisprudence and academic writings on the subject of the CCAA. In no way do the amendments change or detract from the underlying purpose of the CCAA, namely to provide debtor companies with the opportunity to extract themselves from financial difficulties notwithstanding insolvency and to reorganize their affairs for the benefit of stakeholders. In my view, the amendments should be interpreted and applied with that objective in mind.

(a) Threshhold Issues

25 Firstly, the applicants qualify as debtor companies under the CCAA. Their chief place of business is in Ontario. The applicants are affiliated debtor companies with total claims against them exceeding $5 million. The CMI Entities are in default of their obligations. CMI does not have the necessary liquidity to make an interest payment in the amount of US$30.4 million that was due on September 15, 2009 and none of the other CMI Entities who are all guarantors are able to make such a payment either. The assets of the CMI Entities are insufficient to discharge all of the liabilities. The CMI Entities are unable to satisfy their debts as they come due and they are insolvent. They are insolvent both under the *Bankruptcy and Insolvency Act*[FN3] definition and under the more expansive definition of insolvency used in *Stelco Inc., Re*[FN4]. Absent these CCAA proceedings, the applicants would lack liquidity and would be unable to continue as going concerns. The CMI Entities have acknowledged their insolvency in the affidavit filed in support of the application.

26 Secondly, the required statement of projected cash-flow and other financial documents required under section 11(2) of the CCAA have been filed.

(b) Stay of Proceedings

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27 Under section 11 of the CCAA, the Court has broad jurisdiction to grant a stay of proceedings and to give a debtor company a chance to develop a plan of compromise or arrangement. In my view, given the facts outlined, a stay is necessary to create stability and to allow the CMI Entities to pursue their restructuring.

(b) Partnerships and Foreign Subsidiaries

28 The applicants seek to extend the stay of proceedings and other relief to the aforementioned partnerships. The partnerships are intertwined with the applicants' ongoing operations. They own the National Post daily newspaper and Canadian free-to-air television assets and certain of its specialty television channels and some other television assets. These businesses constitute a significant portion of the overall enterprise value of the CMI Entities. The partnerships are also guarantors of the 8% senior subordinated notes.

29 While the CCAA definition of a company does not include a partnership or limited partnership, courts have repeatedly exercised their inherent jurisdiction to extend the scope of CCAA proceedings to encompass them. See for example *Lehndorff General Partner Ltd., Re*[FN5]; *Smurfit-Stone Container Canada Inc., Re*[FN6]; and *Calpine Canada Energy Ltd., Re*[FN7]. In this case, the partnerships carry on operations that are integral and closely interrelated to the business of the applicants. The operations and obligations of the partnerships are so intertwined with those of the applicants that irreparable harm would ensue if the requested stay were not granted. In my view, it is just and convenient to grant the relief requested with respect to the partnerships.

30 Certain applicants are foreign subsidiaries of CMI. Each is a guarantor under the 8% senior subordinated notes, the CIT credit agreement (and therefore the DIP facility), the intercompany notes and is party to the support agreement and the Use of Cash Collateral and Consent Agreement. If the stay of proceedings was not extended to these entities, creditors could seek to enforce their guarantees. I am persuaded that the foreign subsidiary applicants as that term is defined in the affidavit filed are debtor companies within the meaning of section 2 of the CCAA and that I have jurisdiction and ought to grant the order requested as it relates to them. In this regard, I note that they are insolvent and each holds assets in Ontario in that they each maintain funds on deposit at the Bank of Nova Scotia in Toronto. See in this regard *Cadillac Fairview Inc., Re*[FN8] and *Global Light Telecommunications Inc., Re*[FN9]

(C) DIP Financing

31 Turning to the DIP financing, the premise underlying approval of DIP financing is that it is a benefit to all stakeholders as it allows the debtors to protect going-concern value while they attempt to devise a plan acceptable to creditors. While in the past, courts relied on inherent jurisdiction to approve the terms of a DIP financing charge, the September 18, 2009 amendments to the CCAA now expressly provide jurisdiction to grant a DIP financing charge. Section 11.2 of the Act states:

> (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.
>
> (2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> (3) The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order

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was made.

(4) In deciding whether to make an order, the court is to consider, among other things,

(a) the period during which the company is expected to be subject to proceedings under this Act;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report referred to in paragraph 23(1)(b), if any.

32 In light of the language of section 11.2(1), the first issue to consider is whether notice has been given to secured creditors who are likely to be affected by the security or charge. Paragraph 57 of the proposed order affords priority to the DIP charge, the administration charge, the Directors' and Officers' charge and the KERP charge with the following exception: "any validly perfected purchase money security interest in favour of a secured creditor or any statutory encumbrance existing on the date of this order in favour of any person which is a "secured creditor" as defined in the CCAA in respect of any of source deductions from wages, employer health tax, workers compensation, GST/QST, PST payables, vacation pay and banked overtime for employees, and amounts under the Wage Earners' Protection Program that are subject to a super priority claim under the BIA". This provision coupled with the notice that was provided satisfied me that secured creditors either were served or are unaffected by the DIP charge. This approach is both consistent with the legislation and practical.

33 Secondly, the Court must determine that the amount of the DIP is appropriate and required having regard to the debtors' cash-flow statement. The DIP charge is for up to $100 million. Prior to entering into the CIT facility, the CMI Entities sought proposals from other third party lenders for a credit facility that would convert to a DIP facility should the CMI Entities be required to file for protection under the CCAA. The CIT facility was the best proposal submitted. In this case, it is contemplated that implementation of the plan will occur no later than April 15, 2010. The total amount of cash on hand is expected to be down to approximately $10 million by late December, 2009 based on the cash flow forecast. The applicants state that this is an insufficient cushion for an enterprise of this magnitude. The cash-flow statements project the need for the liquidity provided by the DIP facility for the recapitalization transaction to be finalized. The facility is to accommodate additional liquidity requirements during the CCAA proceedings. It will enable the CMI Entities to operate as going concerns while pursuing the implementation and completion of a viable plan and will provide creditors with assurances of same. I also note that the proposed facility is simply a conversion of the pre-existing CIT facility and as such, it is expected that there would be no material prejudice to any of the creditors of the CMI Entities that arises from the granting of the DIP charge. I am persuaded that the amount is appropriate and required.

34 Thirdly, the DIP charge must not and does not secure an obligation that existed before the order was made. The only amount outstanding on the CIT facility is $10.7 in outstanding letters of credit. These letters of credit are secured by existing security and it is proposed that that security rank ahead of the DIP charge.

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35 Lastly, I must consider amongst others, the enumerated factors in paragraph 11.2(4) of the Act. I have already addressed some of them. The Management Directors of the applicants as that term is used in the materials filed will continue to manage the CMI Entities during the CCAA proceedings. It would appear that management has the confidence of its major creditors. The CMI Entities have appointed a CRA and a Restructuring Officer to negotiate and implement the recapitalization transaction and the aforementioned directors will continue to manage the CMI Entities during the CCAA proceedings. The DIP facility will enhance the prospects of a completed restructuring. CIT has stated that it will not convert the CIT facility into a DIP facility if the DIP charge is not approved. In its report, the proposed Monitor observes that the ability to borrow funds from a court approved DIP facility secured by the DIP charge is crucial to retain the confidence of the CMI Entities' creditors, employees and suppliers and would enhance the prospects of a viable compromise or arrangement being made. The proposed Monitor is supportive of the DIP facility and charge.

36 For all of these reasons, I was prepared to approve the DIP facility and charge.

(d) Administration Charge

37 While an administration charge was customarily granted by courts to secure the fees and disbursements of the professional advisors who guided a debtor company through the CCAA process, as a result of the amendments to the CCAA, there is now statutory authority to grant such a charge. Section 11.52 of the CCAA states:

> (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of
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> > (a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;
> >
> > (b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and
> >
> > (c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.
>
> (2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

38 I must therefore be convinced that (1) notice has been given to the secured creditors likely to be affected by the charge; (2) the amount is appropriate; and (3) the charge should extend to all of the proposed beneficiaries.

39 As with the DIP charge, the issue relating to notice to affected secured creditors has been addressed appropriately by the applicants. The amount requested is up to $15 million. The beneficiaries of the charge are: the Monitor and its counsel; counsel to the CMI Entities; the financial advisor to the Special Committee and its counsel; counsel to the Management Directors; the CRA; the financial advisor to the Ad Hoc Committee; and RBC Capital Markets and its counsel. The proposed Monitor supports the aforementioned charge and considers it to be required and reasonable in the circumstances in order to preserve the going concern operations of the CMI Entities. The applicants submit that the above-note professionals who have played a necessary and integral role in the restructuring activities to date are necessary to implement the recapitalization transaction.

40 Estimating quantum is an inexact exercise but I am prepared to accept the amount as being appropriate. There has obviously been extensive negotiation by stakeholders and the restructuring is of considerable magnitude and

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complexity. I was prepared to accept the submissions relating to the administration charge. I have not included any requirement that all of these professionals be required to have their accounts scrutinized and approved by the Court but they should not preclude this possibility.

(e) Critical Suppliers

41 The next issue to consider is the applicants' request for authorization to pay pre-filing amounts owed to critical suppliers. In recognition that one of the purposes of the CCAA is to permit an insolvent corporation to remain in business, typically courts exercised their inherent jurisdiction to grant such authorization and a charge with respect to the provision of essential goods and services. In the recent amendments, Parliament codified the practice of permitting the payment of pre-filing amounts to critical suppliers and the provision of a charge. Specifically, section 11.4 provides:

> (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring a person to be a critical supplier to the company if the court is satisfied that the person is a supplier of goods or services to the company and that the goods or services that are supplied are critical to the company's continued operation.
>
> (2) If the court declares a person to be a critical supplier, the court may make an order requiring the person to supply any goods or services specified by the court to the company on any terms and conditions that are consistent with the supply relationship or that the court considers appropriate.
>
> (3) If the court makes an order under subsection (2), the court shall, in the order, declare that all or part of the property of the company is subject to a security or charge in favour of the person declared to be a critical supplier, in an amount equal to the value of the goods or services supplied under the terms of the order.
>
> (4) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

42 Under these provisions, the Court must be satisfied that there has been notice to creditors likely to be affected by the charge, the person is a supplier of goods or services to the company, and that the goods or services that are supplied are critical to the company's continued operation. While one might interpret section 11.4 (3) as requiring a charge any time a person is declared to be a critical supplier, in my view, this provision only applies when a court is compelling a person to supply. The charge then provides protection to the unwilling supplier.

43 In this case, no charge is requested and no additional notice is therefore required. Indeed, there is an issue as to whether in the absence of a request for a charge, section 11.4 is even applicable and the Court is left to rely on inherent jurisdiction. The section seems to be primarily directed to the conditions surrounding the granting of a charge to secure critical suppliers. That said, even if it is applicable, I am satisfied that the applicants have met the requirements. The CMI Entities seek authorization to make certain payments to third parties that provide goods and services integral to their business. These include television programming suppliers given the need for continuous and undisturbed flow of programming, newsprint suppliers given the dependency of the National Post on a continuous and uninterrupted supply of newsprint to enable it to publish and on newspaper distributors, and the American Express Corporate Card Program and Central Billed Accounts that are required for CMI Entity employees to perform their job functions. No payment would be made without the consent of the Monitor. I accept that these suppliers are critical in nature. The CMI Entities also seek more general authorization allowing them to pay other suppliers if in the opinion of the CMI Entities, the supplier is critical. Again, no payment would be made without the consent of the Monitor. In addition, again no charge securing any payments is sought. This is not contrary to the language of section 11.4 (1) or to its purpose. The CMI Entities seek the ability to pay other suppliers if in their opinion the supplier is critical to their business and ongoing operations. The order requested is facilitative and practical in nature. The proposed Monitor

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supports the applicants' request and states that it will work to ensure that payments to suppliers in respect of pre-filing liabilities are minimized. The Monitor is of course an officer of the Court and is always able to seek direction from the Court if necessary. In addition, it will report on any such additional payments when it files its reports for Court approval. In the circumstances outlined, I am prepared to grant the relief requested in this regard.

(f) Directors' and Officers' Charge

44 The applicants also seek a directors' and officers' ("D &O") charge in the amount of $20 million. The proposed charge would rank after the administration charge, the existing CIT security, and the DIP charge. It would rank pari passu with the KERP charge discussed subsequently in this endorsement but postponed in right of payment to the extent of the first $85 million payable under the secured intercompany note.

45 Again, the recent amendments to the CCAA allow for such a charge. Section 11.51 provides that:

> (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company
>
> (2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> (3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.
>
> (4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

46 I have already addressed the issue of notice to affected secured creditors. I must also be satisfied with the amount and that the charge is for obligations and liabilities the directors and officers may incur after the commencement of proceedings. It is not to extend to coverage of wilful misconduct or gross negligence and no order should be granted if adequate insurance at a reasonable cost could be obtained.

47 The proposed Monitor reports that the amount of $20 million was estimated taking into consideration the existing D&O insurance and the potential liabilities which may attach including certain employee related and tax related obligations. The amount was negotiated with the DIP lender and the Ad Hoc Committee. The order proposed speaks of indemnification relating to the failure of any of the CMI Entities, after the date of the order, to make certain payments. It also excludes gross negligence and wilful misconduct. The D&O insurance provides for $30 million in coverage and $10 million in excess coverage for a total of $40 million. It will expire in a matter of weeks and Canwest Global has been unable to obtain additional or replacement coverage. I am advised that it also extends to others in the Canwest enterprise and not just to the CMI Entities. The directors and senior management are described as highly experienced, fully functional and qualified. The directors have indicated that they cannot continue in the restructuring effort unless the order includes the requested directors' charge.

48 The purpose of such a charge is to keep the directors and officers in place during the restructuring by providing them with protection against liabilities they could incur during the restructuring: *General Publishing Co., Re*[FN10] Retaining the current directors and officers of the applicants would avoid destabilization and would assist in the re-

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structuring. The proposed charge would enable the applicants to keep the experienced board of directors supported by experienced senior management. The proposed Monitor believes that the charge is required and is reasonable in the circumstances and also observes that it will not cover all of the directors' and officers' liabilities in the worst case scenario. In all of these circumstances, I approved the request.

(g) Key Employee Retention Plans

49 Approval of a KERP and a KERP charge are matters of discretion. In this case, the CMI Entities have developed KERPs that are designed to facilitate and encourage the continued participation of certain of the CMI Entities' senior executives and other key employees who are required to guide the CMI Entities through a successful restructuring with a view to preserving enterprise value. There are 20 KERP participants all of whom are described by the applicants as being critical to the successful restructuring of the CMI Entities. Details of the KERPs are outlined in the materials and the proposed Monitor's report. A charge of $5.9 million is requested. The three Management Directors are seasoned executives with extensive experience in the broadcasting and publishing industries. They have played critical roles in the restructuring initiatives taken to date. The applicants state that it is probable that they would consider other employment opportunities if the KERPs were not secured by a KERP charge. The other proposed participants are also described as being crucial to the restructuring and it would be extremely difficult to find replacements for them

50 Significantly in my view, the Monitor who has scrutinized the proposed KERPs and charge is supportive. Furthermore, they have been approved by the Board, the Special Committee, the Human Resources Committee of Canwest Global and the Ad Hoc Committee. The factors enumerated in *Grant Forest Products Inc., Re*[FN11] have all been met and I am persuaded that the relief in this regard should be granted.

51 The applicants ask that the Confidential Supplement containing unredacted copies of the KERPs that reveal individually identifiable information and compensation information be sealed. Generally speaking, judges are most reluctant to grant sealing orders. An open court and public access are fundamental to our system of justice. Section 137(2) of the *Courts of Justice Act* provides authority to grant a sealing order and the Supreme Court of Canada's decision in *Sierra Club of Canada v. Canada (Minister of Finance)*[FN12]provides guidance on the appropriate legal principles to be applied. Firstly, the Court must be satisfied that the order is necessary in order to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonable alternative measures will not prevent the risk. Secondly, the salutary effects of the order should outweigh its deleterious effects including the effects on the right to free expression which includes the public interest in open and accessible court proceedings.

52 In this case, the unredacted KERPs reveal individually identifiable information including compensation information. Protection of sensitive personal and compensation information the disclosure of which could cause harm to the individuals and to the CMI Entities is an important commercial interest that should be protected. The KERP participants have a reasonable expectation that their personal information would be kept confidential. As to the second branch of the test, the aggregate amount of the KERPs has been disclosed and the individual personal information adds nothing. It seems to me that this second branch of the test has been met. The relief requested is granted.

Annual Meeting

53 The CMI Entities seek an order postponing the annual general meeting of shareholders of Canwest Global. Pursuant to section 133 (1)(b) of the CBCA, a corporation is required to call an annual meeting by no later than February 28, 2010, being six months after the end of its preceding financial year which ended on August 31, 2009. Pursuant to section 133 (3), despite subsection (1), the corporation may apply to the court for an order extending the time for calling an annual meeting.

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54 CCAA courts have commonly granted extensions of time for the calling of an annual general meeting. In this case, the CMI Entities including Canwest Global are devoting their time to stabilizing business and implementing a plan. Time and resources would be diverted if the time was not extended as requested and the preparation for and the holding of the annual meeting would likely impede the timely and desirable restructuring of the CMI Entities. Under section 106(6) of the CBCA, if directors of a corporation are not elected, the incumbent directors continue. Financial and other information will be available on the proposed Monitor's website. An extension is properly granted.

Other

55 The applicants request authorization to commence Chapter 15 proceedings in the U.S. Continued timely supply of U.S. network and other programming is necessary to preserve going concern value. Commencement of Chapter 15 proceedings to have the CCAA proceedings recognized as "foreign main proceedings" is a prerequisite to the conversion of the CIT facility into the DIP facility. Authorization is granted.

56 Canwest's various corporate and other entities share certain business services. They are seeking to continue to provide and receive inter-company services in the ordinary course during the CCAA proceedings. This is supported by the proposed Monitor and FTI will monitor and report to the Court on matters pertaining to the provision of inter-company services.

57 Section 23 of the amended CCAA now addresses certain duties and functions of the Monitor including the provision of notice of an Initial Order although the Court may order otherwise. Here the financial threshold for notice to creditors has been increased from $1000 to $5000 so as to reduce the burden and cost of such a process. The proceedings will be widely published in the media and the Initial Order is to be posted on the Monitor's website. Other meritorious adjustments were also made to the notice provisions.

58 This is a "pre-packaged" restructuring and as such, stakeholders have negotiated and agreed on the terms of the requested order. That said, not every stakeholder was before me. For this reason, interested parties are reminded that the order includes the usual come back provision. The return date of any motion to vary, rescind or affect the provisions relating to the CIT credit agreement or the CMI DIP must be no later than November 5, 2009.

59 I have obviously not addressed every provision in the order but have attempted to address some key provisions. In support of the requested relief, the applicants filed a factum and the proposed Monitor filed a report. These were most helpful. A factum is required under Rule 38.09 of the Rules of Civil Procedure. Both a factum and a proposed Monitor's report should customarily be filed with a request for an Initial Order under the CCAA.

Conclusion

60 Weak economic conditions and a high debt load do not a happy couple make but clearly many of the stakeholders have been working hard to produce as desirable an outcome as possible in the circumstances. Hopefully the cooperation will persist.

Application granted.

FN1 R.S.C. 1985, c. C. 36, as amended

FN2 R.S.C. 1985, c.C.44.

FN3 R.S.C. 1985, c. B-3, as amended.

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FN4 (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]); leave to appeal refused 2004 CarswellOnt 2936 (Ont. C.A.).

FN5 (1993), 9 B.L.R. (2d) 275 (Ont. Gen. Div. [Commercial List]).

FN6 [2009] O.J. No. 349 (Ont. S.C.J. [Commercial List]).

FN7 (2006), 19 C.B.R. (5th) 187 (Alta. Q.B.).

FN8 (1995), 30 C.B.R. (3d) 29 (Ont. Gen. Div. [Commercial List]).

FN9 (2004), 33 B.C.L.R. (4th) 155 (B.C. S.C.).

FN10 (2003), 39 C.B.R. (4th) 216 (Ont. S.C.J.).

FN11 [2009] O.J. No. 3344 (Ont. S.C.J. [Commercial List]). That said, given the nature of the relationship between a board of directors and senior management, it may not always be appropriate to give undue consideration to the principle of business judgment.

FN12 [2002] 2 S.C.R. 522 (S.C.C.).

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TAB 4

BANKRUPTCY AND INSOLVENCY LAW OF CANADA

FOURTH EDITION

REVISED

VOLUME 4

by

The Honourable

L. W. HOULDEN, B.A., LL.B.,

formerly a Judge of The Court of Appeal for Ontario

and

The Honourable

G. B. MORAWETZ, B.A., LL.B.

of the Superior Court of Justice

and

JANIS SARRA, B.A., M.A., LL.B., LL.M., S.J.D.

of UBC Faculty of Law and the Ontario Bar

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had met the requirements, accepting that the suppliers were critical in nature, and made a general authorization allowing the debtor to pay other suppliers if, in the opinion of the debtor, the supplier was critical, and no payment would be made without the consent of the monitor. Pepall J. was of the view that the order requested was facilitative and practical in nature. The proposed monitor supported the applicants' request and stated that it would work to ensure that payments in respect of pre-filing liabilities were minimized: *Re Canwest Global Communications Corp.* (2009), 2009 CarswellOnt 6184, 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]).

The court held that the purpose of s. 11.4 is to codify the authority to permit suppliers that are critical to the continued operation of the company to be paid and to require the granting of a charge in circumstances where the court is compelling a party to supply; and that if no charge is proposed to be granted, there is no need to give notice to the secured creditors: *Re Canwest Publishing Inc. / Publications Canwest Inc.* (2010), 2010 CarswellOnt 212, 63 C.B.R. (5th) 115, 2010 ONSC 222, [2010] O.J. No. 188 (Ont. S.C.J. [Commercial List]).

The Ontario Superior Court of Justice granted *CCAA* protection to a group of entities, which included a partnership, and granted a critical suppliers' charge for the payment of goods and services supplied after the date of the initial order, to rank behind the administrative charge. Section 11.4 of the *CCAA* provides the court jurisdiction to declare a person to be a critical supplier. The *CCAA* does not contain a definition of critical supplier, but pursuant to s. 11.4(1), the court must be satisfied that the person sought to be declared a critical supplier is a supplier of goods or services to the company and that the goods or services that are supplied are critical to the company's continued operations. Justice Morawetz was satisfied that the interruption of supply by the critical suppliers could have an immediate material adverse impact on the debtor entities and he made the requested declaration requiring the critical suppliers to continue to supply on terms and conditions consistent with existing arrangements and past practice: *Re Priszm Income Fund* (2011), 2011 CarswellOnt 2258, 2011 ONSC 2061 (Ont. S.C.J.).

N§103 Payment to Unsecured Creditors Prior to Filing a Plan

Although, as a general rule, the court will not permit payments to be made to unsecured creditors during the course of *CCAA* proceedings, the court may, in exceptional circumstances, permit arrangements to be made with and payments to be made to an unsecured creditor if they are critical to the debtor being able to continue in business: *Re Air Canada* (2003), 47 C.B.R. (4th) 163, 2003 CarswellOnt 5296 (Ont. S.C.J. [Commercial List]).

The Alberta Court of Queen's Bench approved the establishment of a "hardship fund" to be used to pay pre-*CCAA* filing obligations owing to certain suppliers of the debtor. The pre-filing suppliers were in significant financial difficulty, and if some relief was not available, these local operations faced bankruptcy. While the debtor was not suggesting that the recipients of the funds were "critical suppliers," it appeared to be the had met the requirements, accepting that the suppliers were critical in nature, and made a general authorization allowing the debtor to pay other suppliers if, in the opinion of the debtor, the supplier was critical, and no payment would be made without the consent of the monitor. Pepall J. was of the view that the order requested was facilitative and practical in nature. The proposed monitor supported the applicants' request and stated that it would work to ensure that payments in respect of pre-filing liabilities were minimized: *Re Canwest Global Communications Corp.* (2009), 2009 CarswellOnt 6184, 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]).

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TAB 5

Industry Canada Industrie Canada Canada

Industry Canada

Corporate and Insolvency Law Policy

First • Previous • Next

CCAA: Initial application

Clause by Clause Briefing Book

An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts

Bill Clause No. 128
Section No. 11.3
Topic: Assignments

Proposed Wording

11.3 (1) The court may, on the application of a debtor company, make an order assigning the rights and obligations of the company under any agreement to any person, to be specified by the court, who has agreed to the assignment.

(2) The applicant must give notice of the assignment in the prescribed manner to every party to the agreement.

(3) Subsection (1) does not apply in respect of rights and obligations

(a) under an eligible financial contract within the meaning of subsection 11.05 (3);

(b) under a collective agreement; or

(c) that are not assignable by reason of their nature.

(4) In deciding whether to make an assignment, the court must consider, among other things,

(a) whether the person to whom the rights and obligations are to be assigned would be able to perform the obligations; and

(b) whether it would be appropriate to assign the rights and obligations to that person.

(5) The court may not make an order assigning an agreement unless it is satisfied that all financial defaults in relation to the agreement will be remedied.

Rationale

The intention of the reform is to protect and enhance the assets of the debtor company by allowing the debtor company to assign existing agreements to third parties for value.

Subsection (1) requires that court approval be obtained because there may be valid concerns that the party to whom the debtor company wishes to assign the agreement may not be appropriate. The court can act as a disinterested third party to make a determination of the appropriateness of the proposed assignee based on the facts of the particular case.

A court hearing will only be required in circumstances where a counter-party refuses to agree to an assignment or an assignment to a particular third party. Subsection (2) is intended to ensure that the counter-parties to the agreement have an opportunity to present their interests to the court.

Subsection (3) excludes certain agreements from the application of the section. Paragraphs (a) and (b) refer to agreements that have special treatment under the CCAA and assignment would be contrary to that treatment. Paragraph (c) provides the court with the opportunity to extend the exclusion provision to include agreements that it considers non-assignable due to the agreements nature. The last paragraph is intended to provide flexibility to the court to review each agreement in light of the circumstances to determine whether or not it would be appropriate to allow the assignment.

Subsection (4) provides the courts with legislative guidance as to when an agreement may be assigned. The guidance is limited to enable the court to exercise its discretion to address individual fact situations.

Subsection (5) provides balance between the interests of the debtor and counter-parties to an agreement that is to be assigned. It would be unfair that the estate benefit financially by an assignment at the same time that a counter party is required to take a loss. If the agreement is in financial default, the counter-party would only have a claim against the debtor in bankruptcy.

Present Law

None.

Senate Recommendation

The reform follows Senate recommendation #31.

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Bill Clause No. 128
Section No. 11.04
Topic: Guarantors

Proposed Wording

11.04 No order made under section **11.02** has **affect on** any action, suit or proceeding against a person, other than **the** company in respect of **whom the order is made**, who is obligated under a letter of credit or guarantee in relation to the company.

Rationale

The reform is a technical amendment to re-order provisions of this Act, correct cross-referencing and correct for grammatical error.

The current section refers to an order made in respect of a company, which has made an application under this Act. Because of reforms to section 11 and 11.02, it was necessary to amend the language of the section to refer to "the company in respect of whom the order is made." The language changes do not affect the provision's effect.

Present Law

11.2 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.

Senate Recommendation

None.

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Bill Clause No. 128
Section No. 11.4
Topic: Critical Supplier

Proposed Wording

11.4 (1) On application by a debtor company, the court may make an order declaring a person to be a critical supplier to the company if the court is satisfied that the person is a supplier of goods or services to the company and that those goods or services are critical to the company's continued operation.

(2) If the court declares a person to be a critical supplier, the court may make an order requiring the person to supply any goods or services specified by the court to the company on any terms and conditions that are consistent with the supply relationship or that the court considers appropriate.

(3) If the court makes an order under subsection (2), the court shall, in the order, declare that the property of the company is subject to a security or charge in favour of the person declared to be a critical supplier, in an amount equal to the value of the goods or services supplied under the terms of the order.

(4) The court may specify in the order that the security or charge ranks in priority over the claim of any secured creditor of the company.

Rationale

Companies undergoing a restructuring must be able to continue to operate during the period. On the other hand, suppliers will attempt to restrict their exposure to credit risk by denying credit or refusing services to those debtor companies. To balance the conflicting interests, the court will be given the authority to designate certain key suppliers as "critical suppliers". The designation will mean that the supplier will be required to continue its business relationship with the debtor company but, in return, the critical supplier will be given security for payment.

Subsection (1) provides that a court may designate a supplier to the debtor company to be a critical supplier. The designation should not be lightly granted but should only be made where the supplier is of such a nature that the debtor company would not be able to continue to operate without a continuing business relationship.

Subsection (2) provides that a court may require a critical supplier to continue to supply goods and services to the debtor company. The court will have the authority to determine the appropriate terms and conditions of the business relationship, however, the court should look to the existing terms or, if necessary, the prevailing market terms.

Subsection (3) stipulates that the court must provide the critical supplier with a security charge for the value of the goods or services supplied as a critical supplier. The provision is to ensure that the critical supplier is paid for its goods or services.

Subsection (4) provides the court with the ability to determine the priority of the security charge. It is expected that the court will recognize the uniqueness of this situation and grant the critical supplier a high priority.

Present Law

None.

Senate Recommendation

None.

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Bill Clause No. 128
Section No. 11.05
Topic: Eligible Financial Contracts

Proposed Wording

11.05 (1) No order may be made under **section 11.02** staying or restraining the exercise of any right to terminate, amend or claim any accelerated payment, **or a forfeiture of the term**, under an eligible financial contract.

(2) For greater certainty, **if** an eligible financial contract entered into before an order is made under section **11.02** is terminated on or after the date of the order, the setting off of obligations between the company and the other parties to the eligible financial contract, in accordance with its provisions, is permitted and, if net termination values determined in accordance with the eligible financial contract are owed by the company to another party to the eligible financial contract, that other party **is** deemed to be a creditor of the company with a claim against the company in respect of the net termination values.

(3) **The following definitions apply** in this section.

"eligible financial contract" means

(a) a currency or interest rate swap agreement;

(b) a basis swap agreement;

(c) a spot, future, forward or other foreign exchange agreement;

(d) a cap, collar or floor transaction;

(e) a commodity swap;

(f) a forward rate agreement;

(g) a repurchase or reverse repurchase agreement;

(h) a spot, future, forward or other commodity contract;

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities;

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs *(a)* to *(i)*;

(k) any master agreement in respect of any agreement or contract referred to in paragraphs *(a)* to *(j)*;

(l) any master agreement in respect of a master agreement referred to in paragraph *(k)*;

(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs *(a)* to *(l)*; or

(n) any agreement of a prescribed kind.

"net termination value" means the net amount obtained after setting off the mutual obligations between the parties to an eligible financial contract in accordance with its provisions.

Rationale

The reform is a technical amendment to re-order provisions of this Act, correct cross-referencing and correct for grammatical errors.

The reform included removing subsection 11.1(2) – the substance of the subsection is now found at section 11.06. The two matters in previously found in section 11.1 (eligible financial contracts and Canadian Payment Association) were not interconnected and it was determined appropriate to separate them into different sections.

The phrase "forfeiture of term" has been added at subsection (1) to clarify that the court does not have the authority to restrict the exercise of rights under eligible financial contracts.

Present Law

11.1 (1) In this section, "eligible financial contract" means

(a) a currency or interest rate swap agreement,

(b) a basis swap agreement,

(c) a spot, future, forward or other foreign exchange agreement,

(d) a cap, collar or floor transaction,

(e) a commodity swap,

(f) a forward rate agreement,

(g) a repurchase or reverse repurchase agreement,

(h) a spot, future, forward or other commodity contract,

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs

(a) to *(i)*,

(k) any master agreement in respect of any agreement or contract referred to in paragraphs *(a)* to *(j)*,

(l) any master agreement in respect of a master agreement referred to in paragraph *(k)*,

(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs *(a)* to *(l)*, or

(n) any agreement of a kind prescribed;

"net termination value" means the net amount obtained after setting off the mutual obligations between the parties to an eligible financial contract in accordance with its provisions.

(3) For greater certainty, where an eligible financial contract entered into before an order is made under section 11 is terminated on or after the date of the order, the setting off of obligations between the company and the other parties to the eligible financial contract, in accordance with its provisions, is permitted, and if net termination values determined in accordance with the eligible financial contract are owed by the company to another party to the eligible financial contract, that other party shall be deemed to be a creditor of the company with a claim against the company in respect of the net termination values.

Senate Recommendation

None.

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Bill Clause No. 128
Section No. 11.5
Topic: Removal of Directors

Proposed Wording

11.5 (1) The court may, on the application of any person interested in the matter, make an order removing from office any director of a debtor company in respect of which an order has been made under this Act if the court is satisfied that the director is unreasonably impairing or is likely to unreasonably impair the possibility of a viable compromise or arrangement being made in respect of the company or is acting or is likely to act inappropriately as a director in the circumstances.

(2) The court may, by order, fill any vacancy created under subsection (1).

Rationale

The directors of a debtor company have a predominant role during the restructuring process. Unlike in a bankruptcy, the directors retain control of the debtor's assets (rather than having a receiver or trustee appointed) and also control the development of the proposal that will be put to the creditors. This is a strong position from which the directors may positively or negatively affect the restructuring process.

Under corporate law, directors have a fiduciary duty to act in the best interest of the corporation, which the courts have interpreted in the seminal *Peoples* case to mean to make a "better" corporation. What is meant by a "better" corporation means will vary in the individual circumstances. The remedies available to stakeholders, however, when a director fails to act in the correct manner can be both difficult and time consuming to obtain.

The Stelco CCAA proceeding brought this issue to the forefront. In that situation, the board of directors appointed two shareholder activists to fill positions left vacant prior to the CCAA filing. On application of Stelco pensioners, the bankruptcy judge ordered the appointees removed because of the perceived conflict of interest they engendered and the real risk that their appointment would poison the negotiations with other stakeholders. The Court of Appeal reversed the decision on the grounds that the CCAA does not give the court the authority to remove directors – rather, the stakeholders were required to prove oppression under corporate law. The matter is now being appealed to the Supreme Court of Canada.

The difficulties in the Stelco case show that the current legislation is neither efficient nor flexible enough to deal with real factual problems in a timely manner. The reform is intended to provide shareholders, creditors and other stakeholders with the opportunity to quickly address problematic situations.

Subsection (2) provides the court with the authority to fill any vacancy created by a removal order. The subsection is intended to address the situation where there is only one or a small number of directors or the unlikely situation where the court determines that it is in the best interest of the debtor to remove the board en masse. In these limited situations, the court may be hesitant to grant the order only because it would leave the debtor without a quorum of directors. Providing the court with the authority to fix that situation without resorting to the time consuming process of holding a shareholder meeting to elect new directors will ensure that the restructuring can continue. In addition, the court will hear from the interested parties, including respecting persons who should be appointed to fill the vacancies.

Present Law

None.

Senate Recommendation

The reform follows Senate recommendation #35.

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Bill Clause No. 128
Section No. 11.06
Topic: Payments Association

Proposed Wording

11.06 Canadian Payments Association established by the *Canadian Payments Act* from ceasing to act as a clearing agent or group clearer for a company in accordance with that Act and the by-laws and rules of that Association.

Rationale

The reform is a technical amendment to re-order provisions of this Act and correct cross-referencing.

Present Law

11.1 (2) No order may be made under this Act staying or restraining the exercise of any right to terminate, amend or claim any accelerated payment under an eligible financial contract or preventing a member of the Canadian Payments Association established by the *Canadian Payments Act* from ceasing to act as a clearing agent or group clearer for a company in accordance with that Act and the by-laws and rules of that Association.

Senate Recommendation

None.

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Bill Clause No. 128
Section No. 11.07
Topic: Aircraft Objects

Proposed Wording

11.07 No order **may be** made under section **11.02 that has the effect of preventing** a creditor who holds security on aircraft objects — or a lessor of aircraft objects — under an agreement with a company from taking possession of the **aircraft objects**

> *(a)* if, after the commencement of proceedings under this Act, the company defaults in protecting or maintaining the **aircraft objects** in accordance with the agreement;

(b) 60 days after the commencement of proceedings under this Act unless, during that period, the company

(i) remedied the default of every other obligation under the agreement, other than a default constituted by the commencement of proceedings under this Act or the breach of a provision in the agreement relating to the company's financial condition,

(ii) agreed to perform the obligations under the agreement, other than an obligation not to become insolvent or an obligation relating to the company's financial condition, until proceedings under this Act end, and

(iii) agreed to perform all the obligations arising under the agreement after the proceedings under this Act end; or

(c) if, during the period that begins **60 days after the commencement of the proceedings under this Act** and ends on the day on which proceedings under this Act end, the company defaults in performing an obligation under the agreement, other than an obligation not to become insolvent or an obligation relating to the company's financial condition.

Rationale

The existing provision is to be introduced into the CCAA by the coming into force of the *Act to implement the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment* (the Act). Due to commitments made under the Act, it became necessary to create an exception so that creditors with security on aircraft objects are not subject to the stay of proceedings under the CCAA if the debtor fails to protect or maintain the object in accordance with the agreement. The Act also provides that 60 days following the filing of the notice of intention, the creditor can seize the object unless the debtor has remedied all defaults under the agreement. Finally, it releases the stay if after the 60-day period the debtor goes into default.

The reform is a technical amendment to re-order provisions of this Act, correct cross-referencing, correct grammatical errors and introduce the defined term "aircraft objects".

Present Law

11.31 No order made under section 11 prevents a creditor who holds security on aircraft objects — or a lessor of aircraft objects or a conditional seller of aircraft objects — under an agreement with a debtor company in respect of which an application is made under this Act from taking possession of the equipment

(a) if, after the commencement of proceedings under this Act, the company defaults in protecting or maintaining the equipment in accordance with the agreement;

(b) sixty days after the commencement of proceedings under this Act unless, during that period, the company

(i) remedied the default of every other obligation under the agreement, other than a default constituted by the commencement of proceedings under this Act or the breach of a provision in the agreement relating to the company's financial condition,

(ii) agreed to perform the obligations under the agreement, other than an obligation not to become insolvent or an obligation relating to the company's financial condition, until proceedings under this Act end, and

(iii) agreed to perform all the obligations arising under the agreement after the proceedings under this Act end; or *(c)* if, during the period that begins on the expiry of the sixty-day period and ends on the day on which proceedings under this Act end, the company defaults in performing an obligation under the agreement, other than an obligation not to become insolvent or an obligation relating to the company's financial condition.

Senate Recommendation

None.

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Bill Clause No. 128
Section No. 11.08
Topic: Government Function Stay

Proposed Wording

11.08 No order may be made under **section 11.02 that affects**

(a) the exercise **or performance** by the Minister of Finance or the Superintendent of Financial Institutions of any power, duty or function assigned to them by the *Bank Act*, the *Cooperative Credit Associations Act*, the *Insurance Companies Act* or the *Trust and Loan Companies Act*;

(b) the exercise **or performance** by the Governor in Council, the Minister of Finance or the Canada Deposit Insurance Corporation of any power, duty or function assigned to them by the *Canada Deposit Insurance Corporation Act*; or

(c) the exercise by the Attorney General of Canada of any power, assigned to him or her by the *Winding-up and Restructuring Act*.

Rationale

The reform is a technical amendment to re-order provisions of this Act, correct cross-referencing and correct for grammatical errors.

Present Law

11.11 No order may be made under this Act staying or restraining

(a) the exercise by the Minister of Finance or the Superintendent of Financial Institutions of any power, duty or function assigned to them by the *Bank Act*, the *Cooperative Credit Associations Act*, the *Insurance Companies Act* or the *Trust and Loan Companies Act*;

(b) the exercise by the Governor in Council, the Minister of Finance or the Canada Deposit Insurance Corporation of any power, duty or function assigned to them by the *Canada Deposit Insurance Corporation Act*; or

(c) the exercise by the Attorney General of Canada of any power, assigned to him or her by the *Winding-up and Restructuring Act*.

Senate Recommendation

None.

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Date Modified: 2011-09-06

TAB 6

C

2011 CarswellOnt 2258, 2011 ONSC 2061, 75 C.B.R. (5th) 213

Priszm Income Fund, 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 Priszm Income Fund, Priszm Canadian Operating Trust, Priszm Inc. and Kit Finance Inc. (Applicants)

Ontario Superior Court of Justice

Morawetz J.

Heard: March 31, 2011
Judgment: March 31, 2011
Docket: CV-11-915900CL

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Counsel: A.J. Taylor, M. Konyukhova for Priszm Entities

G. Finlayson — Conflict Counsel for the Priszm Entities

M. Wasserman for Proposed Monitor, FTI Consulting Canada Inc.

P. Shea for Prudential Insurance

P. Huff for Directors of Priszm

C. Cosgriffe for Yum! Restaurants International (Canada) LP

D. Ullmann for 2279549 Ontario Inc.

Subject: Insolvency

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Grant of stay — Miscellaneous

P Fund, P Trust, P GP, P LP and K Inc. were collectively referred to as P Entities — P Entities owned and operated 428 quick service restaurants — P LP was franchisee of franchisor, Y LP — Business of P LP was to develop, acquire, make investments in and conduct business in connection with quick service restaurant business — P Entities ceased paying certain obligations to Y LP and could not meet their liabilities as they came due; it became insolvent — P Fund, P Trust, P GP, and K Inc., applicants, sought relief under Companies' Creditors Arrangements Act (CCAA) and also sought to have stay of proceedings of initial order under CCAA extended to P LP — Application granted — Applicants' submission that they were debtor companies to which CCAA applied was accepted — P Entities were in process of coordinating sale process for certain assets, and stay of proceedings was appropriate — While CCAA definition of eligible company does not expressly include partnerships, CCAA courts have exercised jurisdiction to stay proceedings with respect to partnerships and limited partnerships where it is just and convenient to do so — Courts have held that this relief is appropriate where operations of debtor companies are so intertwined with those of partnerships, that not extending stay would significantly impair effectiveness of stay in respect of debtor companies — It was appropriate to extend CCAA protection to P LP.

Cases considered by *Morawetz J.*:

Canwest Global Communications Corp., Re (2009), 2009 CarswellOnt 6184, 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) — referred to

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — followed

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

Stelco Inc., Re (2004), 48 C.B.R. (4th) 299, 2004 CarswellOnt 1211 (Ont. S.C.J. [Commercial List]) — followed

Stelco Inc., Re (2004), 2004 CarswellOnt 2936 (Ont. C.A.) — referred to

Stelco Inc., Re (2004), 338 N.R. 196 (note), 2004 CarswellOnt 5200, 2004 CarswellOnt 5201 (S.C.C.) — referred to

Statutes considered:

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

Generally — referred to

s. 2 "insolvent person" — considered

s. 11.2(4) [en. 2005, c. 47, s. 128] — considered

s. 11.4 [en. 1997, c. 12, s. 124] — considered

s. 11.4(1) [en. 1997, c. 12, s. 124] — considered

s. 11.5(1) [en. 1997, c. 12, s. 124] — considered

s. 11.5(2) [en. 1997, c. 12, s. 124] — considered

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APPLICATION by affiliated debtor companies for relief under Companies' Creditors Arrangements Act and to have stay of proceedings of initial order extended to limited partnership.

***Morawetz J.*:**

1 Priszm Income Fund ("Priszm Fund"), Priszm Canadian Operating Trust ("Priszm Trust"), Priszm Inc. ("Priszm GP") and KIT Finance Inc. ("KIT Finance") (collectively, the "Applicants") seek relief under the *Companies' Creditors Arrangements Act*, R.S.C. 1985, c. C-36 (the "CCAA"). The Applicants also seek to have the stay of proceedings and other benefits of an initial order under the CCAA extended to Priszm Limited Partnership ("Priszm LP"). Priszm Fund, Priszm Trust, Priszm GP, Priszm LP and KIT Finance are collectively referred to as the "Priszm Entities".

Background

2 The Priszm Entities own and operate 428 KFC, Taco Bell and Pizza Hut restaurants in seven provinces across Canada. As a result of declining sales and the inability to secure additional or alternate financing, the Priszm Entities cannot meet their liabilities as they come due and are therefore insolvent.

3 The Priszm Entities seek a stay of proceedings under the CCAA to allow them to secure a going concern solution for the business including approximately 6,500 employees and numerous suppliers, landlords and other creditors and to maximize recovery for the Priszm Entities' stakeholders.

4 On the return of the motion, the only party that took issue with the proposed relief was Yum! Restaurants International (Canada) LP (the "Franchisor"). Counsel to the Franchisor indicated that the Franchisor was not opposing the form of order, but explicitly does not consent to the stated intention of the Priszm Entities not to pay franchise royalties to the Franchisor.

5 The background facts with respect to this application are set out in the Affidavit of Deborah J. Papernick, sworn March 31, 2011 (the "Papernick Affidavit"). Further details are also contained in a pre-filing report submitted by FTI Consulting Canada Inc. ("FTI") in its capacity as proposed monitor. FTI has been acting as financial advisor to the Priszm Entities since December 13, 2010.

6 Priszm LP is a franchisee of the Franchisor and is Canada's largest independent quick service restaurant operator. Priszm LP is the largest operator of the KFC concept in Canada, accounting for approximately 60% of all KFC product sales in Canada. In addition, Priszm LP operates a number of multi-branded restaurants that combine a KFC restaurant with either a Taco Bell or a Pizza Hut restaurant.

7 As of March 25, 2011, the Priszm Entities operated 428 restaurants in seven provinces: British Columbia, Alberta, Manitoba, Ontario, Quebec, Nova Scotia and New Brunswick.

8 The business of Priszm LP is to develop, acquire, make investments in and conduct the business and ownership, operation and lease of assets and property in connection with the quick service restaurant business in Canada.

9 Priszm Fund is an income trust indirectly holding approximately 60% of Priszm LP's trust units.

10 Priszm Trust is an unincorporated, limited purpose trust wholly-owned by Priszm Fund created to acquire and hold 60% of the outstanding partnership units of Priszm LP, as well as approximately 60% of Priszm GP's units, for Priszm Fund.

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11 Priszm GP is a corporation which acts as general partner of Priszm LP.

12 KIT Finance is a corporation created to act as borrower for the Prudential Loan, described below.

13 The principal and head offices of Priszm Fund, Priszm LP and Priszm GP are located in Vaughan, Ontario.

14 As at March 31, 2011, the Priszm Entities had short-term and long-term indebtedness totalling: $98.8 million pursuant to the following instruments:

(a) Note purchase and private shelf agreement dated January 12, 2006 ("Note Purchase Agreement") between KIT Finance, Priszm GP and Prudential Investment Management ("Prudential") - $67.3 million;

(b) Subordinated Debentures issued by Priszm Fund due June 30, 2012 - $30 million - $31.5 million.

15 The indebtedness under the Note Purchase Agreement (the "Prudential Loan") is guaranteed by and secured by substantially all of the assets of Priszm GP, KIT Finance and Priszm LP and by limited recourse guarantees and pledge agreements granted by Priszm Fund and Priszm Trust.

16 In addition, the Priszm Entities have approximately $39.1 million of accrued and unpaid liabilities.

17 As a result of slower than forecast sales, on September 5, 2010, Priszm Fund breached the Prudential Financial covenant and remains in non-compliance. As a result, the Prudential Loan became callable.

18 Priszm Fund has also failed to make an interest payment of $975,000 due on December 31, 2010 in respect to the Subordinated Debentures.

19 The Priszm Entities have also ceased paying certain obligations to the Franchisor as they come due.

Findings

20 I am satisfied that Priszm GP and KIT Finance are "companies" within the definition of the CCAA. I am also satisfied that Priszm Fund and Priszm Trust fall within the definition of "income trust" under the CCAA and are "companies" to which the CCAA applies.

21 I am also satisfied that the Priszm Entities are insolvent. In arriving at this determination, I have considered the definition of "insolvent" in the context of the CCAA as set out in *Stelco Inc., Re* (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]), leave to appeal refused, 2004 CarswellOnt 2936 (Ont. C.A.), leave to appeal to S.C.C. refused 2004 CarswellOnt 5200 (S.C.C.). In *Stelco*, Farley J. applied an expanded definition of insolvent in the CCAA context to reflect the "rescue" emphasis of the CCAA, modifying the definition of "insolvent person" within the meaning of s. 2(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") to include a financially troubled corporation that is "reasonably expected to run out of liquidity within reasonable proximity of time as compared with the time reasonably required to implement a restructuring".

22 In this case, the Priszm Entities are unable to meet their obligations to creditors and have ceased paying certain obligations as they become due.

23 Further, the Priszm Entities are affiliated debtor companies with total claims against in excess of $100 million.

24 I accept the submission put forth by counsel to the Applicants to the effect that the Applicants are "debtor

companies" to which the CCAA applies.

25 At the present time, the Priszm Entities are in the process of coordinating a sale process for certain assets. In these circumstances, I have been persuaded that a stay of proceedings is appropriate. In arriving at this determination, I have considered *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) and *Nortel Networks Corp., Re* (Ont. S.C.J. [Commercial List]).

26 The CCAA definition of an eligible company does not expressly include partnerships. However, CCAA courts have exercised jurisdiction to stay proceedings with respect to partnerships and limited partnerships where it is just and convenient to do so. See *Lehndorff, supra*, and *Canwest Global Communications Corp., Re*, 2009 CarswellOnt 6184 (Ont. S.C.J. [Commercial List]).

27 The courts have held that this relief is appropriate where the operations of the debtor companies are so intertwined with those of the partnerships or limited partnerships in question, that not extending the stay would significantly impair the effectiveness of a stay in respect of the debtor companies.

28 Having reviewed the affidavit of Ms. Papernick, I have been persuaded that it is appropriate to extend CCAA protection to Priszm LP.

29 The Priszm Entities are also seeking an order: (a) declaring certain of their suppliers to be critical suppliers within the meaning of the CCAA; (b) requiring such suppliers to continue to supply on terms and conditions consistent with existing arrangements and past practice as amended by the initial order; (c) granting a charge over the Property as security for payment for goods and services supplied after the date of the Initial Order.

30 Section 11.4 of the CCAA provides the court jurisdiction to declare a person to be a critical supplier. The CCAA does not contain a definition of "critical supplier" but pursuant to 11.4(1), the court must be satisfied that the person sought to be declared a critical supplier "is a supplier of goods or services to the company and that the goods or services that are supplied are critical to the company's continued operations".

31 Counsel submits that the Priszm Entities' business is virtually entirely reliant on their ability to prepare, cook and sell their products and that given the perishable nature of their products, the Priszm Entities maintain very little inventory and rely on an uninterrupted flow of deliveries and continued availability of various products. In addition, the Priszm Entities are highly dependent on continued and timely provision of waste disposal and information technology services and various utilities.

32 With the assistance of the proposed monitor, the Priszm Entities have identified a number of suppliers which are critical to their ongoing operation and have organized these suppliers into five categories:

(a) chicken suppliers;

(b) other food and restaurant consumables;

(c) utility service providers;

(d) suppliers of waste disposal services;

(e) providers of appliance repair and information technology services.

33 A complete list of the suppliers considered critical by the Priszm Entities (the "Critical Suppliers") is attached

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at Schedule "A" to the proposed Initial Order.

34 Having reviewed the record, I have been satisfied that any interruption of supply by the Critical Suppliers could have an immediate material adverse impact on the Priszm Entities business, operations and cash flow such that it is, in my view, appropriate to declare the Critical Suppliers as "critical suppliers" pursuant to the CCAA.

35 Further, I accept the submission of counsel to the Priszm Entities that it is appropriate to grant a Critical Suppliers' Charge to rank behind the Administrative Charge.

36 The Priszm Entities also seek approval of the DIP Facility in the amount up to $3 million to be secured by the DIP Lenders' Charge.

37 Subsection 11.2(4) of the CCAA sets out the factors to be considered by the court in deciding whether to grant a DIP Financing Charge. These factors include:

(a) the period during which the company is expected to be subject to proceedings under the CCAA;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report.

38 Counsel submits that the following factors support the granting of the DIP Lenders' Charge:

(a) the Priszm Entities expect to continue daily operations during the proceedings;

(b) management will be overseen by the monitor who will oversee spending under the DIP Financing;

(c) while it is not anticipated that the Priszm Entities will require any additional financing prior to June 30, 2011, actual funding requirements may vary;

(d) the ability to borrow funds from a court-approved DIP Facility will be crucial to retain the confidence of stakeholders;

(e) secured creditors have either been given notice of the DIP Lenders' Charge or are not affected by it;

(f) the DIP Lenders' Charge does not secure an obligation that existed before the granting of the Initial Order; and

(g) the proposed monitor is supportive of the DIP Facility and the DIP Lenders' Charge.

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39 Based on the foregoing, I am of the view that it is appropriate to approve the DIP Facility and grant the DIP Lenders' Charge.

40 The trustees and directors of the Priszm Entities have stated their intention to resign. In order to ensure ongoing corporate governance, the Priszm Entities seek an order appointing 2279549 Ontario Inc. as the CRO. They have also requested that the Chief Restructuring Officer be afforded the protections outlined in the draft Initial Order.

41 The Applicants are seeking an Administration Charge over the property in the amount of $1.5 million to secure the fees of the proposed monitor, its counsel, counsel to the Priszm Entities and the CRO. It is proposed that this charge will rank in priority to all other security interests in the Priszm assets, other than any "secured creditor", as defined in the CCAA, who has not received notice of the application for CCAA protection.

42 The authority to provide such a charge is set out in s. 11.5(2) of the CCAA.

43 The Priszm Entities submit that the following factors support the granting of the Administration Charge:

(a) the Priszm Entities operate an extensive business;

(b) the beneficiaries will provide essential legal and financial advice and leadership;

(c) there is no anticipated unwarranted duplication of roles;

(d) secured creditors likely to be affected by the charge were provided with notice and do not object to the Administration Charge; and

(e) the proposed monitor, in its pre-filing report, supports the Administration Charge.

44 I am satisfied that this is an appropriate case in which to grant the Administration Charge in the form requested.

45 I am also satisfied that it is appropriate to grant a Directors' Charge in the amount of $9.8 million to protect directors and officers and the CRO from certain potential liabilities. In arriving at this determination, I have considered the provisions of s. 11.5(1) of the CCAA which addresses the issue of directors' and officers' charges. I have also considered that the Priszm Entities maintain directors' and officers' liability insurance ("D&O Insurance"). The current policy provides a total of $31 million in coverage. It is expected that the D&O Insurance will provide coverage sufficient to protect the directors and officers and the draft Initial Order provides that the Directors' Charge shall only apply to the extent that the D&O Insurance is not adequate.

46 For the foregoing reasons, I am satisfied that it is appropriate to grant the CCAA Initial Order in the form requested.

47 Paragraph 14 of the form of order provides for a stay of proceedings up to and including April 29, 2011. Paragraph 59 provides for the standard comeback provision.

48 The Initial Order was signed 9:30 a.m. Eastern Daylight Time on March 31, 2011.

Application granted.

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TAB 7

SUPREME COURT
OF BRITISH COLUMBIA
VANCOUVER REGISTRY

FEB 07 2012

ENTERED

No. S120712
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

AND

IN THE MATTER OF THE *CANADA BUSINESS CORPORATIONS ACT*, R.S.C. 1985, c. C-44

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*, S.B.C. 2002, c. 57

AND

IN THE MATTER OF CATALYST PAPER CORPORATION AND THE PETITIONERS LISTED IN SCHEDULE "A"

PETITIONERS

ORDER MADE AFTER APPLICATION

BEFORE THE HONOURABLE	)	
MR. JUSTICE SEWELL	)	6/February/2012
	)	

ON THE APPLICATION of the Petitioners coming on for hearing at Vancouver, British Columbia, on the 6th day of February, 2012; AND ON HEARING, Bill Kaplan, Q.C., Peter Rubin and Anthony Purgas, counsel for the Petitioners, John Grieve and Kibben Jackson, counsel for the Monitor PricewaterhouseCoopers Inc., and those other counsel listed in **Schedule "B"** hereto; AND UPON READING the material filed;

THIS COURT ORDERS AND DECLARES THAT:

1. Paragraph 25 of the Amended and Restated Initial Order of the Court dated February 3, 2012 shall be deleted in its entirety and replaced with the following:

25. (a) Those suppliers listed in **Schedule "C"** hereto are declared to be critical suppliers (each a "**Critical Supplier**" and collectively, the "**Critical Suppliers**") and shall in accordance with this paragraph, from February 7, 2012, continue to supply goods and services to the Petitioner Parties on such terms and conditions as are consistent with the supply relationship existing between the Critical Supplier and the Petitioner Parties as of January 27, 2012 (the "**Existing Supply Relationship**");

(b) (i) Each Critical Supplier shall only be required to provide credit to the Petitioner Parties up to an amount to be communicated to the Critical Supplier by the Monitor based on the Existing Supply Relationship (the "**Individual Credit Extension Amount**"); (ii) Other than goods or services ordered by the Petitioner Parties, the Petitioner Parties are entitled to refuse to take delivery of goods or services from a Critical Supplier if as a result of doing so the amount owing by the Petitioner Parties to that Critical Supplier would be greater than the Individual Credit Extension Amount; (iii) The Petitioner Parties shall not place an order for goods or services if, at the expected date of delivery of such goods and services such delivery would, pursuant to the terms and conditions of that Critical Supplier agreement, cause the Petitioner Parties to exceed the Individual Credit Extension Amount for such Critical Supplier; and (iv) If the Petitioner Parties receive supplies or services notwithstanding this subparagraph (b), the Critical Suppliers shall be entitled to claim payment in full of the amounts owing and the validity or amount of each Individual Critical Supplier Charge (as defined below) shall not be affected or impaired;

(c) No Critical Supplier shall be required to deliver goods or services to the Petitioner Parties: (i) if as a result of doing so the amount owing by the Petitioner

Parties to that Critical Supplier would be greater than the Individual Credit Extension Amount; or (ii) in circumstances where that Critical Supplier is not being paid for those goods or services in accordance with the terms and conditions of the Existing Supply Relationship;

(d) The Critical Suppliers are hereby granted a charge (the "**Critical Suppliers' Charge**") on the Charged Property as security for any amounts for which the Petitioner Parties become indebted to the Critical Suppliers for the supply of goods or services after February 6, 2012, including interest pursuant to subparagraph (j) below;

(e) Each Critical Supplier shall be entitled to an individual critical supplier charge (the "**Individual Critical Supplier Charge**"), which shall form part of the Critical Suppliers' Charge, in an amount that is equal to 130% of the amounts referred to in subparagraph (d) above. Such Individual Critical Supplier Charge shall form part of the Critical Suppliers' Charge. Each Individual Critical Supplier Charge shall rank *pari passu* with each other Individual Critical Supplier Charge and shall share rateably in any distribution of the proceeds of the Critical Suppliers' Charge;

(f) Except as otherwise agreed by the Petitioner Parties and the applicable Critical Supplier, the Critical Suppliers that supply chips and pulp logs to the Petitioner Parties, shall supply, and the Petitioner Parties shall accept, volumes of product consistent with, and in the same relative proportions as, what was supplied and accepted in 2011;

(g) In the event the Petitioner Parties refuse to accept the delivery of any goods or services, or the delivery of such goods or services is not required to be made by the Critical Supplier as a result of the circumstances set out in subparagraph (c) above, the applicable Critical Supplier shall be permitted to sell such goods or services to any other person;

(h) The Monitor shall provide weekly reporting to each Critical Supplier, Fraser Milner Casgrain LLP as Canadian counsel to the 2016 Steering Group and Goodmans LLP as Canadian counsel to the Ad Hoc Noteholders as to the amount owing to each Critical Supplier according to the Petitioner Parties' records, and the Petitioner Parties shall provide all reasonable assistance to the Monitor in order for the Monitor to provide such reporting. The Monitor shall provide such further information as the 2016 Steering Group, the Ad Hoc Noteholders and the Critical Suppliers may reasonably require;

(i) The Critical Suppliers' Charge shall have the priority set out in paragraphs 51 and 52 herein;

(j) Each Critical Supplier shall be entitled to charge and be paid interest on the amounts owing to that Critical Supplier, for goods and services delivered after the date of, and pursuant to this paragraph, from the date of delivery of the applicable invoice at the rate of interest being charged by the DIP Lender plus 2.00% per annum, which Critical Supplier interest rate is currently equivalent to 5.00% per annum;

(k) The Critical Suppliers and the Petitioner Parties shall each cooperate in determining the prevailing terms and conditions of their Existing Supply Relationship, and the Critical Suppliers and the Petitioner Parties are hereby granted liberty to apply for such further orders or directions as may be necessary to resolve any disputes arising in connection with their supply relationships;

(l) Leave is hereby granted to any Critical Supplier to file and serve a Notice of Application at any time after March 11, 2012 seeking to amend or rescind the terms of this Critical Supplier Order as it applies to such Critical Supplier. In the event of such an application, the onus of maintaining the Critical Supplier Order shall be on the Petitioner Parties; and

(m) The Petitioner Parties shall pay the costs of (a) Tolko Industries Ltd.; (b) TimberWest Forest Corp.; (c) International Forest Products Limited, Western Forest Products Inc. and Seaspan Marine Corporation; and (d) Canexus Chemicals Canada LP. and Casco, Inc., (collectively the "**Four Critical Supplier Groups**"), in respect of this application and the negotiation of the Critical Suppliers' Charge, on a special costs basis. Such special costs are fixed in the amount of $15,000 for each of the above Four Critical Supplier Groups.

2. Endorsement of this Order by counsel appearing on this application is hereby dispensed with.

THE FOLLOWING PARTIES APPROVE THE FORM OF THIS ORDER AND CONSENT TO EACH OF THE ORDERS, IF ANY, THAT ARE INDICATED ABOVE AS BEING BY CONSENT:

Signature of
[ ] party [X] lawyer for the Petitioner Parties
Bill Kaplan, Q.C. / Peter Rubin

BY THE COURT.

Registrar

Schedule "A"

LIST OF ADDITIONAL PETITIONERS

Catalyst Pulp Operations Limited

Catalyst Pulp Sales Inc.

Pacifica Poplars Ltd.

Catalyst Pulp and Paper Sales Inc.

Elk Falls Pulp and Paper Limited

Catalyst Paper Energy Holdings Inc.

0606890 B.C. Ltd.

Catalyst Paper Recycling Inc.

Catalyst Paper (Snowflake) Inc.

Catalyst Paper Holdings Inc.

Pacifica Papers U.S. Inc.

Pacifica Poplars Inc.

Pacifica Papers Sales Inc.

Catalyst Paper (USA) Inc.

The Apache Railway Company

Schedule "B"

Name of Counsel	Party
John Sandrelli	A Representative Group of 2016 Noteholders
Mary Buttery Lance Williams	Powell River Energy Inc. TimberWestForest Corp. Quadrant Investments Ltd.
Jane Milton, Q.C.	International Forest Products Limited Western Forest Products Inc. Seaspan Marine Corporation
Kendall Andersen	Tolko Industries Ltd.
David Gruber John Uhren (by telephone)	Certain holders of 2014 Notes and certain holders of 2016 Notes
Jonathan McLean Elizabeth Pillon (by telephone)	Canexus Chemicals Canada LP Casco, Inc.
Benjamin La Borie	Wilmington Trust FSB
Peter Reardon	JPMorgan Chase Bank, N.A.
Don Bobert	CEP Locals – 1, 76 (Powell River), 592, 686 (Port Alberni), 1132 (Crofton), 630, 1123 (Campbell River)
Allison Tremblay	United Steelworkers International, Local 2688
David McKinnon	Ad hoc group of Noteholders
James Harnum	Robert McCaig