Clerk's Stamp

COURT FILE NUMBER	1703 12327
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	EDMONTON
	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 ARRANGEMENT OF CANADA NORTH GROUP INC., CANADA NORTH CAMPS INC., CAMPCORP STRUCTURES LTD., D.J. CATERING LTD., 816956 ALBERTA LTD., 1371047 ALBERTA LTD. and 1919209 ALBERTA LTD.
DOCUMENT	**APPLICANTS' BENCH BRIEF FOR SECOND EXTENSION APPLICATION AND OTHER RELIEF**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	Stephanie A. Wanke DLA Piper (Canada) LLP 1201 Scotia Tower 2 10060 Jasper Avenue Edmonton AB T5J 4E5 T 780.429.6822 F 780.702.4379 File No. 37060-00001

JUDICIAL CENTRE OF EDMONTON
FILED
SEP 18 2017
Clerk of the Court

CAN: 25470920.1

INDEX

A. INTRODUCTION

1. Since the Initial Order was granted in these proceedings on July 5, 2017 under the *Companies' Creditors Arrangement Act,* RSC 1985, c C-36 ("**CCAA**"), Canada North Group Inc., Canada North Camps Inc. ("**CNC**"), Campcorp Structures Ltd., D.J. Catering Ltd., 816956 Alberta Ltd., 1371047 Alberta Ltd. ("**1371047 Alberta Ltd.**") and 1919209 Alberta Ltd. (collectively, the "**Applicants**"), have worked diligently and in good faith towards putting a Plan of Arrangement to their creditors.

2. To continue towards that end, the Applicants now seek the following relief:

   (a) An extension of the Stay of Proceedings to January 31, 2018;

   (b) Authorization to carry out an Investment and Sales Solicitation Process (the "**ISSP**") substantially in accordance with the outline and indicative timeline as described in the First Report of the Chief Restructuring Officer (the "**CRO**") filed on September 18, 2018 (the "**CRO's First Report**");

   (c) An Order sealing the Confidential Supplement to the Fourth Affidavit of Shayne McCraken sworn on September 18, 2018 (the "**4th Supplement**");

   (d) Authorization to sell the Head Office (as defined in the Fourth Affidavit of Shayne McCracken sworn on September 18, 2018 (the "**4th Affidavit**") and to enter into a sub-lease for replacement space;

   (e) Authorization to disburse the proceeds from the sale of the Head Office; and

   (f) An Order directing ECN Financial Inc. ("**ECN**") to repay financing equipment payments debited by ECN from CNC after the date CNC file a Notice of Intention under the *Bankruptcy and Insolvency Act* ("**BIA**"), which proceeding was then taken up and continued in these proceedings under these CCAA proceedings.

3. The information to support the above relief is found in the CRO's First Report, the 4th Affidavit, the 4th Supplement and the Second Report of Ernst & Young Inc, as Monitor filed September 18, 2017 (the "**Monitor**") (the "**Monitor's Second Report**").

B. EXTENSION OF STAY OF PROCEEDINGS

4. The extension should be granted as the CCAA Parties continue to acted in good faith and with due diligence. Further, the circumstances make a further extension order appropriate.

5. S. 11.02(2) of the *CCAA* provides the jurisdiction for the Court to extend an Initial Application:

   Stays, etc. — other than initial application

   A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

   (a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

6. S. 11.02(3) of the *CCAA* further provides the test for an extension:

Burden of proof on application

The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

7. The position of the Applicants at the first extension hearing was thoroughly canvassed by Justice Hillier in his written reasons for granting that extension in *Re Canada North Group Inc.,* 2017 ABQB 508 at paras. 43 - 50 **[Tab 1**].

8. Since that application, significant progress has been made by the Applicants, as outlined in detail in the CRO's First Report, the Monitor's Second Report and the 4^{th} Affidavit and Supplement.

9. In particular, the necessary groundwork has been laid to allow for the development of a successful ISSP.

10. Further, the Applicants continue to operate in the ordinary course. As set out in paragraph 40 of the 4^{th} Affidavit, the working capital position of the Applicants is projected to improve by $2.1M by March 3, 2018 as a result of these ongoing operations.

11. Between the fire camp work this summer and fall and a return to more normal operations for the camp business projected for the upcoming season, the ongoing operations of the Applicants are to the benefit of the creditors, not their prejudice.

12. It is noteworthy that the improvement in working capital is not withstanding the significant professional fees required to conduct a CCAA proceeding. Any alternative realization strategy would also incur significant professional fees but would not have these costs offset by the positive contribution margin of the ongoing operations.

13. Granting this next extension will advance the purposes of the *CCAA* in providing the necessary breathing space to allow the Applicants to restructure:

A number of decisions have considered whether "circumstances exist that make the order appropriate". In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.), the Court emphasized that the underlying purpose of the legislation must be considered when construing the provisions in the *CCAA*. Justice Deschamps stated at para. 70:

> ... Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs.

When granting an extension, it is a prerequisite for the petitioner to provide evidence of what it intends to do in order to demonstrate to the court and stakeholders that extending the proceedings will advance the purpose of the *CCAA*. The debtor company must show that it has at least "a kernel of a plan": *Azure Dynamics Corp., Re*, 2012 BCSC 781 (B.C. S.C. [In Chambers]).

North American Tungsten Corp., Re, 2015 CarswellBC 2232 at paras 25 - 26 **[Tab 2]**

14. The preliminary plan of the CCAA Parties remains to return operations to profitability given the returned demand, consider sale of some of the assets of the CCAA Parties, and seek new financing or equity investment as required to provide a viable Plan of Arrangement.

C. AUTHORIZATION TO ENTER INTO ISSP

15. The Applicants seek authorization to carry out the ISSP substantially in accordance with the outline and indicative timeline as described in the CRO's First Report.

16. The ISSP is designed to ensure broad market exposure for the Application to all potential options. This process is fair and transparent and optimizes the chances of maximizing the enterprise value of the Applicants.

17. Such a process is consistent with the principles for ISSPs (or SISPs) as outlined in *CCM Master Qualified Fund Ltd. v blutip Power Technologies Ltd.*, 2012 ONSC 1750 at para 6 **[Tab 3]**:

> Although the decision to approve a particular form of sales process is distinct from the approval of a proposed sale, the reasonableness and adequacy of any sales process proposed by a court-appointed receiver must be assessed in light of the factors which a court will take into account when considering the approval of a proposed sale. Those factors were identified by the Court of Appeal in its decision in <u>Royal Bank v. Soundair Corp.</u> *1991), 7 C.B.R. (3d) 1 (Ont. C.A.)*: (i) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; (ii) the efficacy and integrity of the process by which offers are obtained; (iii) whether there has been unfairness in the working out of the process; and, (iv) the interests of all parties.[1] Accordingly, when reviewing a sales and marketing process proposed by a receiver a court should assess:

(i) the fairness, transparency and integrity of the proposed process;

(ii) the commercial efficacy of the proposed process in light of the specific circumstances facing the receiver; and,

(iii) whether the sales process will optimize the chances, in the particular circumstances, of securing the best possible price for the assets up for sale.

18. Although *CCM Master* is a receivership decision, Justice Brown in *PCAS Patient Care Automation Services Inc., Re* 2012 ONSC 2840 at para 17 **[Tab 4]** confirms his above comments apply in the CCAA context as well.

19. The ISSP is also set to work in parallel with ongoing negotiations with certain interested investors.

20. The solicitation agent selected by the Applicants and the CRO, Peters & Co., is in the process of being retained. The length of the extension allows time for Peters & Co. to be engaged and for the Applicants, working with the CRO and the Monitor, to make significant progress with the ISSP.

21. Authorizing the Applicants to proceed as requested provides the necessary authorization for the next step in the restructuring in a practical and flexible manner.

D. SEALING

22. The Supplement contains commercially sensitive material about the operations of the Applicants that could be damaging to the Applicants if it was made public to their customers and competitors. It also contains sensitive information in respect of a pending sale of the Head Office.

23. As set out in *Sierra Club of Canada* v. *Canada (Minister of Finance)*, 2002 SCC 41 at paras 53 - 56 **[Tab 5]**, a confidentiality order is appropriate when it prevents a serious risk to an important interest, including a commercial interest, and the salutory effects outweigh the deleterious effects.

24. Allowing companies to restructure under the CCAA without requiring them to unnecessarily make public information that could be damaging to their business is an important commercial interest as it is directly tied to the policy goals of the CCAA.

E. SALE OF THE HEAD OFFICE AND ENTRY INTO THE SUB-LEASE

25. Pursuant to s. 36 of the CCAA **[Tab 6]** 1371047 Alberta Ltd., requires Court Approval to sell the Head Office.

26. In respect of the factors the Court is directed to consider at s. 36(3):

(a) the process was an open market listing, which is the ordinary commercial way to sell realty;

(b) the Monitor is supportive of the sale;

(c) the Monitor has provided its opinion that the sale is more beneficial than a sale or disposition under a bankruptcy;

(d) the sale allows the mortgage to be paid in full, a reduction in the overall debt of the Applicants, a cost-savings both in cash flow and ongoing operations for CNC, to the benefit of the creditors collectively; and

(e) the sale price is supported by the realtor and the appraisal.

27. Paragraph 9 of the Initial Order requires Court Approval for the Applicants to distribute the proceeds from the sale of the Head Office.

28. The proposed distribution is to pay outstanding property taxes, the real estate commission, the BDC Mortgage and the transaction costs, including the costs associated with entering into the sublease and moving to new space, with the balance being paid to 1371047 Alberta Ltd.

29. The payment of taxes, commission, transaction and moving costs is necessary in order to close the sale and keep the Applicants in operation. Subject to receiving the security opinion of the Monitor, payment to BDC is also appropriate.

30. Entry into the sub-lease is a required corollary to the sale of the Head Office.

F. RETURN OF FUNDS DEBITED BY ECN

31. ECN is a financing equipment lessor of CNC.

32. Between November 2013 and May 2015, CNC, Paul McCracken and Shayne McCracken entered into a series of financing equipment leases with ECN (the "**Lease Agreements**").

33. In accordance with the Lease Agreements, Canada North Camps Inc. executed certain pre-authorized debit forms to provide for automatic payments to ECN.

34. On June 26, 2017, CNC had filed a Notice of Intention to Make a Proposal (the "**NOI**").

35. ECN was provided a copy of the NOI and later was served a copy of the Initial Order.

36. Payments under the Lease Agreement were stayed by the NOI and then by the Initial Order.

37. On July 1, 2017, ECN debited CNC's RBC account for $1,080.99 (the "**July 1st Payment**").

38. On July 10, 2017, ECN debited CNC's RBC account for two payments of $5,904.57 (the "**July 10th Payments**" and, collectively, with the July 1st Payment, the "**Payments**")

39. On July 31, 2017, CNC demanded ECN return the Payments.

40. On August 9, 2017, ECN refused to return the Payments to CNC.

41. S. 69 of the BIA provides a Stay of Proceedings upon filing of an NOI. That Stay of Proceedings was continued by paragraph 13 of the Initial Order.

42. As a financing equipment lessor, ECN was not entitled to the payments that it debited: *Royal Bank v. Cow Harbour Construction Ltd.*, 2012 ABQB 59 at para. 19 **[Tab 7]**

43. It is understandable that, in the time immediately following an insolvency process, it may take a company a short period of time to cancel automatic payments or put a stop on debits.

44. What is not understandable is that, when the wrongful debit was pointed out to ECN, it refused to return the Payments.

45. The Applicants are required to uphold the Initial Order and ensure that all parties are being treated fairly under the Initial Order. As a result, the Applicants are proceedings to request the Order that ECN return the funds.

46. There is a significant cost to the Applicants proceeding with even a simple application given the number of parties involved in each proceeding.

47. As a result, the Applicants are also seeking costs payable by ECN at a level that will deter future creditors from requiring that the Applicants obtain a further Order instead of simply following the Initial Order.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 18th DAY OF SEPTEMBER, 2017.

DLA PIPER (CANADA) LLP

Stephanie A. Wanke
Counsel for Canada North Group Inc., Canada North Camps Inc., Campcorp Structures Ltd., D.J. Catering Ltd., 816956 Alberta Ltd., 1371047 Alberta Ltd. and 1919209 Alberta Ltd.

TAB 1

2017 ABQB 508
Alberta Court of Queen's Bench

Re Canada North Group Inc

2017 CarswellAlta 1609, 2017 ABQB 508

In the Matter of the Companies' Creditors Arrangement Act, RSC 1985, c C-36, as amended

And In the Matter of a Plan of Arrangement of Canada North Group Inc., Canada North Camps Inc., Campcorp Structures Ltd., D.J. Catering Ltd., 816956 Alberta Ltd. and 1371047 Alberta Ltd.

S.D. Hillier J.

Heard: July 27, 2017
Judgment: August 17, 2017
Docket: Edmonton 1703-12327

Counsel: S.A. Wanke, S. Norris, for Applicants / Cross-Respondents
C.P. Russell, Q.C., for Respondent / Cross-Applicant
D.R. Bieganek, Q.C., for Monitor, Ernst &Young LLP
J. Oliver, for Business Development Bank of Canada
T.M. Warner, for ECN Capital Corp.
M.J. McCabe, Q.C., for PricewaterhouseCoopers
R.J. Wasylyshyn, for Weslease Income Growth Fund LP
H.M.B. Ferris, for First Island Financial Services Ltd.
G.F. Body, for Canada Revenue Agency

Subject: Insolvency

Headnote
Bankruptcy and insolvency

***S.D. Hillier J.*:**

I Introduction

1 Canada North Camps Inc. (CNC), Campcorp Structures Ltd., D.J. Catering Ltd., 816956 Alberta Ltd. and 1371047 Alberta Ltd. (collectively, the Group) request extension of a Stay under s. 11.02(2) of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (*CCAA*) until November 3, 2017 and ancillary orders.

2 The Canadian Western Bank (CWB) cross-applies for an order lifting the Stay and appointing either a full or interim Receiver pursuant to s. 243 (or ss. 47 and 244 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (*BIA*)), s. 13(2) of the *Judicature Act*, RSA 2000, c J-2, s. 99(a) of the *Business Corporations Act*, RSA 2000, c B-9, and s. 65(7) of the *Personal Property Security Act*, RSA 2000, c P-7.

II History

3 The Group operates or provides a number of services including work camps in the natural resource sector, modular construction manufacturing, camp land rentals as well as real estate holdings including a golf course. CWB has been the Group's major secured creditor for a significant period of time.

4 1919209 Alberta Ltd. (1919) is an insolvent affiliated debtor holding company of two of the companies in the Group. It was incorporated to lease camp equipment from Weslease Income Growth Fund LP (Weslease) and provide that camp equipment to Canada North Camps Inc. for its use. 1919's operations are integrated with those of the other applicants.

5 CNC entered into an agreement to construct a camp on Wandering River. 1371047, and Wandering River Properties Ltd. (owned 2/3 by 1371047) subsequently purchased a parcel for that purpose. CNC joined with the local Heart Lake First Nation and formed Heart Lake CNC LP, Heart Lake Canada North Group GP Ltd., Wandering River Properties Ltd., and Canada North Group LP Holdings Ltd.

6 An action by Max Fuel Distributors Ltd. as against Shayne McCracken arises from the operation of the camp business. The other creditors of the Group are stayed from enforcing collateral claims against Shayne McCracken.

7 The Group's operations and profitability have been significantly impacted since 2014 by the downturn in the economy. Earlier attempts by the Group and CWB to deal with the debt and cash flow issues proved to be unsuccessful.

8 In March 2017, the parties signed a Forbearance Agreement but problems continued. When they were unable to reach a new resolution in a full meeting on June 21, 2017, the Group issued Notices of Intention to make proposals under the *BIA* effective June 26, 2017.

9 On July 5, 2017, Nielsen J. granted an initial Stay under s. 11.02(1) of the *CCAA*. He imposed numerous terms, including that:

- Ernst & Young be appointed as Monitor;
- R. e. I. Group Inc. be appointed as Chief Restructuring Officer (CRO);
- the Stay continue until August 3, 2017, subject to review;
- Debtor in Possession (DIP) financing from the Business Development Bank of Canada (BDC) be made available, not to exceed $1M;
- Notice of Intention proceedings under the *BIA* be "taken up" and continued under the *CCAA*.

10 On July 27, 2017, the Group applied under s. 11.02(2) of the *CCAA* for an extension of the Stay to November 3, 2017. It also applied to add 1919 as an applicant in these proceedings.

11 As well, it applied to expand the Stay to apply to proceedings against the entities involved in the Wandering River contract, and against Shayne McCracken.

12 Finally, the Group applied for an increase in the DIP financing to a maximum of $2,500,000 and an interim lender's charge up to the same amount due to elevated costs associated with a significant short-term increase in work under a camps contract with the British Columbia provincial government for workers on the wildfires.

13 The CWB cross-applied for an order lifting the Stay and appointing a full or interim Receiver.

14 The Monitor sought approval of his First Report and activities, a suspension of limitation periods on claims, and the power to examine the parties regarding questioned transactions on lot sales prior to the *CCAA* Order (preferences) under s. 36.2 of the *CCAA*. Other interested parties also made submissions as affecting their interests.

15 In an oral decision, this Court extended the Stay to September 29, 2017 with a review to be held on September 26, 2017. The cross-application was dismissed. The Court also issued a series of ancillary directions. The parties were advised that written reasons would be issued dealing with the main issue as to extension of the Stay or appointment of a Receiver. These are the written reasons.

III Affidavit Evidence

16 The Group's stated preliminary plan is to return operations to profitability as demand increases, consider sale of some of its assets, and seek new financing or equity investment as required in order to provide a viable Plan of Arrangement.

17 The Group has presented extensive affidavits from Ms. Shayne McCracken, Director and Secretary of the applicants, in support of the various applications, containing the following key assertions:

• the Group has acted in good faith and with due diligence, working closely with the CRO and cooperating with the Monitor as they gain an understanding of the business and structure;

• the Group has specifically worked with the CRO and Monitor to improve financial reporting and accounting processes;

• together they have taken initial steps to develop a Plan of Arrangement to present to creditors, including a detailed overview of assets and liabilities;

• the Group has been the subject of unsolicited investment and purchase interest, which the Group, Monitor and CRO are pursuing;

• meetings have taken place with interested parties as well as arrangements related to drawdowns on DIP financing;

• work has included contracts with the Province of British Columbia to address efforts in consequence of raging wildfires in that province.

18 Ms. McCracken's affidavits purport to meet head on the concerns of CWB with the accounting treatment of certain accounts receivable, particularly in relation to the Grand Rapids Pipeline Project and the margining of custom negotiated deferred revenue. In late 2016, cost estimates were prepared for demobilization of the Grand Rapids camp, including removal of the camp for just over $2M and reclamation work estimated at roughly $5.36M based on detailed costing. Ms. McCracken asserted that the practice of clients assuming the costs of setting up and removing camps by advance invoicing is used by others in the camp industry.

19 The margining of custom negotiated deferred revenue allows the Group access to necessary financing to commence work prior to being paid. Ms. McCracken found support for the accounting practice in question in the custom negotiated deferred revenue term of the margining requirement that was part of the credit agreement with CWB.

20 Two significant receivables were placed on the books between March and May 2017 (it is unclear when they were actually posted and sent to the client) on Grand Rapids. This ostensibly led to a claim against the financing and increased CWB's exposure significantly at a time when the parties were trying to sort things out following the Forbearance Agreement in mid-March.

21 Ms. McCracken specifically denied CWB's allegation that these invoices were provided in bad faith to artificially inflate the amount available on the operating line. She deposed that the invoicing for this work was reviewed by the Group's corporate counsel. As well, it was part of the financial reporting to CWB and there were regular conversations with account managers at CWB who were aware of the origin and nature of all significant receivables, including the

Grand Rapid receivables. Ms. McCracken maintained the view that the receivables were appropriately margined as deferred revenue.

22 Ms. McCracken noted that Grand Rapids has now raised issues with respect to payment of some of the invoices and a meeting is scheduled with it in Calgary in early August to discuss payment of those invoices.

23 Ms. Jessica Taha filed extensive material for CWB challenging the Stay, and supporting the appointment of a Receiver. The following assertions are germane, particularly as concerns margining of receivables:

- the Group had been margining receivables for which work had not yet been done (citing Grand Rapids);
- as a result, the operating line was overdrawn by over $3.8M for work not yet done which only came to light at the June 21, 2017 meeting; subsequent information reflects that it is overdrawn by $8M;
- the Group had only performed 10% of required work on one contract and only 40% for another, and none of this was consistent with the margining as represented by the Group, and arranged between the parties dating back to 2012;
- despite representations to the contrary before Nielsen J., CWB was not aware of this prior to the June 21, 2017 meeting.

24 Ms. Taha attested to her belief that as the level of work dropped dramatically in the economic downturn, the Group changed its approach without advising CWB, and started to render invoices for work which had not yet been done, categorizing those invoices as deferred revenue capable of margining.

25 In response, Ms. McCracken maintained her position that the Grand Rapids deferred revenue was properly included in the financial statements. She deposed that Ms. Taha's position that deferred revenue was only permitted to be used for margining based on the percentage of the work performed is inconsistent with the supporting material provided by Ms. Taha. The Group kept their branch representatives apprised of the status of the deferred revenue inclusions in the margining calculations and none raised a concern.

26 In counter response, CWB prepared three affidavits of senior officers at the Edmonton Main Branch deposing that they were unaware of the material amounts that were being margined without the work having been done, and each was unaware of anyone else at CWB having had such knowledge until the meeting on June 21, 2017.

27 Glenn MacDougall, Manager of ECN Capital Corp. (ECN), also filed an affidavit. ECN is an equipment lessor and creditor of the Group. In short, he opines that the work resulting from the BC wildfires is a temporary salve on the Group's financial circumstances, and it is unlikely that the Group will be able to make a viable Plan of Arrangement. He deposed that ECN would be materially prejudiced by the continuation of the Stay, as it will erode the value of ECN's security.

28 With respect to expanding the Stay, Ms. McCracken deposed that direct claims against affiliates have been reviewed. The Group now seeks to expand the stay to specific affiliates where those affiliates are facing claims directly connected to the overall camp operations, in order to preserve the *status quo*, prevent unnecessary expenditures of effort on litigation, maximize recovery for all parties, and allow for an orderly determination of priority and claims.

29 Regarding inclusion of 1919, Ms. McCracken deposed that 1919 has no revenue other than lease income from Canada North and is completely dependent on such payments to fulfill its obligations under the leases. It is included in the consolidated cash flow projections and financial statements for the Group, as it is treated as a flow through entity. The equipment it leases is essential to the uninterrupted operations of the Group.

30 Finally, Ms. McCracken explained that the increased work for the B.C. government, although welcome, creates a cash flow issue as the work is invoiced approximately a week after completion and receipt of payment typically takes

approximately four weeks from invoicing. Consequently, the Group anticipates a cash flow shortage in August 2017 that will not be met by the present DIP facility. On July 21, 2017, the interim lender approved an increase to the DIP financing to a maximum of $2,500,000.

IV Monitor's First Report

31 The Monitor has provided a First Report, advising of various steps taken in conjunction with the CRO, highlights of which include:

General

• a new cash management procedure has been initiated to ensure efficient control of cash and cash reporting, with a review of cash flow projections;

• the Group's management and staff have been making significant efforts in all respects and are cooperating fully with the efforts of the CRO;

• based on the Monitor's own work with Group management, the Group appears to have acted in good faith and with due diligence;

• the actual end cash balance for the two weeks ending July 15, 2017 was higher than projected by over $400K and collections higher than projected by nearly $350K;

• while cash disbursements were lower, this was largely due to temporary deferrals;

• the contracts relating to the B.C. wildfires will have a significant positive impact on future cash inflows and receivables.

Accounts Receivable

• the Group has used atypical accounting practices as reflected in four areas;

• the steps being adopted in response to CWB's concerns include removing Grand Rapids and Heart Lake related receivables as a conservative strategy while quantum is reviewed;

• some but not all of the room guarantees or reservations have been reversed out.

Status of Restructuring Efforts and Related Plan

• the Group's business and operations are very complex;

• the CRO believes, based on preliminary work to date and co-operation of the management team, that there is certainly potential for a going concern plan that could provide significantly greater value to stakeholders as compared to a liquidation;

• the CRO is of the initial view that several profit and gross margin improvements have been realized by the Group due to changes to operations, staffing and other operational matters.

1919

• the leasing arrangement with Weslease has been extended for use by the Group valued at approximately $6M and listed as: three Jack+Jill dorms, two power distribution centres and one waste water treatment plant;

• expansion of the Stay to include 1919 is reasonable.

32 As well, the Monitor and the Group have been in contact with various parties who have expressed interest in participating in a restructuring through refinancing, purchasing assets or investing in the Group.

V Law

33 An initial Stay under s. 11.02(1) of the *CCAA* may be imposed for a maximum period of 30 days. The role of this Court on a subsequent application under s. 11.02(2) is not to re-evaluate the initial decision, but rather to consider whether the applicant has established that the current circumstances support an extension as being appropriate and that the applicant has acted, and is acting, in good faith and with due diligence, as required under s. 11.02(3).

34 The purpose of the *CCAA* is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Appropriateness of an extension under the *CCAA* is assessed by inquiring into whether the order sought advances the policy objectives underlying the *CCAA*. A stay can be lifted if the reorganization is doomed to failure, but where the order sought realistically advances those objectives, a *CCAA* court has the discretion to grant it: *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at paras 15, 70, 71, [2010] 3 SCR 62.

35 In applying for an extension, the applicant must provide evidence of at least "a kernel of a plan" which will advance the *CCAA* objectives: *North American Tungsten Corp, Re*, 2015 BCSC 1376, 2015 CarswellBC 2232at para 26, citing *Azure Dynamics Corp, Re*, 2012 BCSC 781, 91 CBR (5th) 310.

36 Pursuant to s. 11.02(3), the applicant is required to demonstrate that it has acted, and continues to act, in good faith. Honesty is at the core of "good faith": *San Francisco Gifts Ltd., Re*, 2005 ABQB 91at para16, 10 CBR (5th) 275.

37 Section 11.02(3) refers to consideration of good faith and due diligence in both the past and present tense. Romaine J. in *Alberta Treasury Branches v Tallgrass Energy Corp*, 2013 ABQB 432 at para 13, 9 CBR (6th) 161 confirmed the language of s. 11.02(3), to the effect that the court needs to be satisfied that the applicant has acted in the past, and is acting, in good faith. See also *Alexis Paragon Limited Partnership (Re)*, 2014 ABQB 65 at para 16, 9 CBR (6th) 43.

38 By contrast, in *Muscletech Research and Development Inc (Re)*, [2006] OJ No 462 at para 4, 19 CBR (5th) 57 (Sup Ct Just), Farley J. held that the question of good faith relates to how the parties are conducting themselves in the context of the *CCAA* proceedings. Courts in subsequent cases adopted this view: *Pacific Shores Resort & Spa Ltd (Re)*, 2011 BCSC 1775 at para 31-32, [2011] BCJ No 2482, and *4519922 Canada Inc. (Re)*, 2015 ONSC 124 in paras 44-46, 22 CBR (6th) 44.

39 In *Guestlogix Inc, Re*, 2016 ONSC 1348, [2016] OJ No 1129, the Court expanded the stay to proceedings against a guarantor, noting that it was insolvent and in default of its obligations, highly integrated with the debtor company, and the debtor company would be able to include all the assets of the guarantor in a potential transaction if the guarantor were added.

40 The Court has broad equitable jurisdiction to determine appropriate allocation among assets of administration, interim financing and directors' charges: *Hunters Trailer& Marine, Re*, 2001 ABQB 1094, 30 CBR (4th) 206. The Court in *Canwest Publishing Inc (Re)*, 2010 ONSC 222 at para 54, 63 CBR (5th) 115 set out factors to be considered in determining priority of charges under s. 11.52 of the *CCAA* which are critical to the successful restructuring of the business:

(a) the size and complexity of the businesses being restructured;

(b) the proposed role of the beneficiaries of the charge;

(c) whether there is an unwarranted duplication of roles;

(d) whether the quantum of the proposed charge appears to be fair and reasonable;

(e) the position of the secured creditors likely to be affected by the charge; and

(f) the position of the Monitor.

41 Section 11.2(4) of the *CCAA* provides that in deciding whether to make an order allowing DIP financing, the Court must consider:

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

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

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

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

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

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

(g) the monitor's report.

42 In *US Steel Canada Inc (Re)*, 2014 ONSC 6145 at paras 12-18, 20 CBR (6th) 116 the Court discussed the authority under s. 11.2 to grant priority to the DIP lender's charge to secure the DIP loan. In addition to the factors set out in s. 11.2(4), it considered the following in granting priority:

(a) notice had been given to all of the secured parties likely to be affected and broadly to all *PPSA* registrants, and other interested entities;

(b) the maximum amount of the DIP loan was appropriate based on the anticipated cash flow requirements of the applicant as reflected in its cash flow projections for the entire restructuring period, in order to continue to carry on its business during the restructuring period;

(c) the cash flows were the subject of a favourable report of the Monitor in its First Report;

(d) the Applicant's business would continue to be managed by the applicant's management with the assistance of the CRO during the restructuring period;

(e) the existing operational relationships between the applicant and its largest creditor would continue; and

(f) the DIP loan would assist in, and enhance, the restructuring process.

VI Analysis

Extension of Order

43 Various factors were profiled by Ms. Wanke before Nielsen J. to support the Group's position that a restructuring under the *CCAA* is possible; if the objective is liquidation, then appointment of a Receiver is appropriate. Nielsen J. recognized the possibility of a successful restructuring in rejecting the application to appoint a Receiver and granting the application to impose a Stay under the *CCAA* with a Monitor and CRO. In recognizing that a lot of work had been done, he found that those supporting the steps to restructure should be given that opportunity in the collective best interest despite the prejudice of deferral and risk as regards repayment of CWB and other creditors.

44 I now have the responsibility to measure the progress in the period leading up to expiry of the initial Stay. Without second-guessing the initial decision, I must assess the current circumstances, including the good faith and due diligence of the parties in light of steps taken to date.

45 The legislative objective of a *CCAA* order is to provide the Court considerable scope to maintain the *status quo* for a company to make proposal arrangements to facilitate remaining in operation for a collective benefit. One may have preferred to see some further advancement on the "germ of a Plan" but I am satisfied that the CRO has begun consultations with unsolicited parties who have expressed an interest and that a structure for such a Plan is now an important priority.

46 I am mindful that the Monitor was obliged to report on just under three weeks of activity in rendering a First Report by July 24, 2017. Various factors have impacted the lack of concrete progress on a Plan at this point, including the value of the Group as a going concern estimated at $97M (equipment, manufacturing and real estate) with diverse activities, assets and work product, the complexity of restructuring, and the need to modernize the sophistication of a family operation that is unable to operate as it has done historically.

47 Professional advisors are now in place assisting in this required modernization. Potential investors have and continue to express interest in the Group. It appears that DIP funding has been used prudently to cover operational expenses including higher than expected professional expenses. Cash flows are quite healthy and the Group owns a number of assets of marketable value.

48 CWB notes that Nielsen J. indicated on the initial Stay application that the Group would have to show more than a germ of a plan at the next hearing. It is not entirely surprising that three weeks did not prove long enough to complete the steps necessary to create a Plan of Arrangement. There is no allegation of delay or inertia by the Monitor or the CRO in performance of significant responsibilities undertaken since confirmation of their appointment July 5, 2017. The Monitor reported that the Group has been working with due diligence and in full cooperation. A number of competing interests require the attention of the Monitor. Having considered all of the circumstances before the Court, I am satisfied that the Group has established due diligence.

49 It bears noting that CWB is not the only party who would be affected by receivership. Employees, other creditors, clients, and the public would also be affected. Changes have already been implemented by the CRO, as observed and reported by the Monitor.

50 The Group has had the recent opportunity to enter into contracts with the Province of B.C. in relation to the wildfires. It appears that despite the Group's liquidity crisis — impacted by various factors, including market conditions — the business of the Group may well be salvageable. This assessment appears to be supported by: the cash flow projections, recoveries on receivables, and changes begun by the CRO in consultation with the Monitor with particular regard to increased work potential and to increase the sophistication of accounting.

51 However, CWB takes the position that the Group has been in default of its obligations to CWB for many months. CWB extended time for the Group to find refinancing and continued to make available to the Group the operating line facility in the amount of $12,000,000, margined on accounts receivable of the Group. CWB asserts that the Group took advantage of CWB by falsely including one or more multi-million dollar accounts receivable for which the work had not yet been done.

52 The parties disagree as to whether the law supports serious consideration of past bad faith if it is relevant to the viability of the *CCAA* proposal or its continuation.

53 The language of s. 11.02(3) of the *CCAA* does not temporally restrict the consideration of bad faith. The wording of that provision is captured broadly in *Tallgrass*. It would appear that *Muscletech* and the cases which followed it stand for

the proposition that courts should look only to conduct in the context of the *CCAA* process. This represents a restrictive reading of s. 11.02(3) and the purpose of such a narrow interpretation is unclear.

54 It is logical that past due diligence will usually have minimal relevance as a factor. However, past bad faith illuminated after *CCAA* proceedings have been initiated may undermine the confidence of creditors and the Court in the viability of *CCAA* proceedings. In my view, past bad faith may well be a relevant factor in the Court's assessment under s. 11.02(3). This is in keeping with the approach taken in *Alexis Paragon*, 2014 ABQB 65 at paras 37-38.

55 I note that the facts in this case are distinguishable from those in *San Francisco* where the alleged deception appeared to be aimed at deriving an advantage from customers through knock off products and counterfeit safety labels, rather than deriving an advantage from a financing secured creditor through accounting practices as alleged here by CWB.

56 Again, the major issue in this regard is, and has been profiled as, the status of accounts receivable in terms of the margining of contracts for work not yet performed or not fully performed.

57 CWB takes the position that, upon consultation with her client and corporate counsel, Ms. Wanke misrepresented the situation to Nielsen J. in her oral submissions on July 5, 2017. While this Court is not reviewing the basis for Nielsen J.'s order, the issue of margining was raised at that time and the allegation of bad faith remains a live issue. I understand the interpretation placed by CWB on the representations made in front of Nielsen J. both from Affidavits and then information provided to legal counsel. Ms. Wanke summarized her understanding as being that this was part of the camp business on the books of the Group and not a lack of good faith. I accept her expression on this review to the effect that she would have preferred to have been more familiar with the Grand Rapids contract at the time but that this issue only surfaced latterly. She said she would have stated the client's position somewhat differently, but that the net effect remains that the margining was consistent with the Group's understanding of its entitlement.

58 CWB's concerns regarding the margining are understandable. It takes the position that while margining on deferred revenue was permissible, the Grand Rapids contracts do not qualify for that treatment according to the terms as agreed to between the parties notwithstanding the assertions advanced by the Group. CWB says there was an understanding as relates to the formula to be applied to these receivables that was violated, especially as to the two major Grand Rapids accounts issued between the end of March 2017 and beginning of May 2017. Counsel for CWB took the Court through a number of documents relating to the credit agreement between CWB and the Group to explain what the Group's reasonable understanding should have been in relation to contracts qualifying for special treatment of the accounts receivable for margining purposes.

59 The Monitor has reviewed and discounted a number of entries as inappropriate; it will likely have to further endorse commitment to revise other receivables. The Court agrees that a commitment to revise other receivables may be appropriate. However, there are a number of priorities competing for the attention of the CRO. It is difficult to measure whether any breaches of the protocol were intentionally deceptive as distinct from aggressive and misguided. That distinction is harder to make based on duelling affidavits as distinct from oral testimony, questioning or at minimum some objective detailed analysis by the Monitor to assist the Court's interpretation of events.

60 I have struggled to understand the treatment of invoicing as to the records of accounts receivable, particularly as the idea of charging for work not done is rather foreign to my experience as to the entitlement to collect. So too, the deferral of the time for payment extending from 45 days to 120 days obfuscates the idea of entitlement. The matter is complicated by the risk and relative reliability of these receivables as assets, distinct from a bad or at least tainted debt that needs to be monitored for collection procedures. All of these aspects appear to arise in far greater sums for 2016 than in any previous year which, understandably, is further troubling to principals at CWB.

61 I endorse the concerns of CWB as legitimate. Even in the absence of a finding of bad faith, the practice employed as reflected in treatment of the Grand Rapids receivables raises legitimate concerns regarding the future viability of the Group. I accept that the practice in question has resulted in margining which has led to overall debt to CWB which

is incongruent with the Group's receivables as they would be represented in the normal course, as confirmed in the Monitor's First Report.

62 I also note CWB's concern that the cash flow projection relied on by the Monitor did not take into account unpaid professional fees relating to the work toward reorganization, and the projected loss to the end of October 2017 is considerably offset only by the fortuitous and uncertain wildfire camp work. CWB's receivables, to the extent they are collectible, are being used up by payment of the professional fees and interim financing.

63 Nevertheless, I am not prepared to conclude on the basis of the material as presented to me that the Group has failed to act in good faith to the extent of disentitling the extension sought.

64 Clearly, the parties now disagree on the interpretation of the arrangement between them as regards margining based on deferred revenue. The issue before this Court is not the correct interpretation of the various document referred to by CWB's counsel, but rather whether the Group's reliance on its understanding amounted to bad faith. There has been no trial of the latter issue. While raising questions, the evidence adduced on this application falls short of supporting a finding of bad faith in the sense of knowing reliance on an unsupportable interpretation of the documents, or intentional concealing of the practice or any relevant financial information. This is particularly so in light of the evidence of the Group's understanding that the arrangement between CWB and the Group expressly contemplated that the Group was permitted to margin deferred revenue when no work had been done.

65 If the CWB was not aware of the effect or extent of this type of margining, it is not clear from the evidence that the Group understood it was acting other than consistently with the intention of the parties in this regard. This view of the matter is generally supported by the Monitor's information that the sophistication of all facets of the accounting system in place has not kept up with the sophistication of its business. The CRO is working to address accounting practices which require improvement.

66 There is undeniably a considerable difference in the parties' interpretations of the conduct and reporting. Obviously, a debtor may be motivated to maximize access to funding. The past practice here is somewhat unclear, but even if the Group exceeded the terms or protocol as generally agreed, I do not ascribe bad faith to its actions.

67 Overall, I find that extension of the Stay is in the best interest. However, a further vigorous review must take place within a reasonable period of time.

68 The November 3, 2017 date targeted by the Group is not reasonable in the circumstances.

69 As such, the next hearing is set for September 26, 2017. The Court will require a Report from the Monitor at least 7 business days prior to that date.

Increase in DIP Financing

70 Ms. McCracken suggests in her affidavit that they only need a small increase in the DIP loan to cover operations in light of healthy cash flows and significant assets.

71 While the creditors may rightly take issue with the characterization of the increase as "small", I approve the request to increase the DIP financing from $1M to $2.5M in the form of order proposed by counsel for the Group to address the anticipated cash flow shortage resulting from welcome work during what is typically a slower season for the Group. Counsel for CWB took no issue with the form of order.

72 At the close of submissions, counsel for CRA alerted the Court, as well as BDC in particular, that it took issue with the increase in DIP financing and that it would be applying for priority with respect to $1.14M owing to the Minister by the Group for unremitted source deductions and GST. It was seeking an order to vary so as to put the administrative charge, director's charge and interim lender charges in second place behind the CRA. In light of that information, BDC

counsel indicated that the CRA's position would not impair BDC's ability to advance the DIP financing, noting that the matter would be argued at a later date.

1919

73 The application to add 1919 was not opposed. As was the case in *Guestlogix*, the operations of 1919 are inextricably linked to those of the Group, as it leases important equipment and provides it Canada North.

74 I order that 1919 be added as a party included in the Group. Counsel for the Group agreed to include in the order a clause restating the allocation provision in the initial Stay Order to recognize that Welease has made this concern known at this point. Counsel for CWB did not take issue with such a provision in the order.

Approval of Monitor's First Report

75 And at the request of the Monitor, I approve:

• his First Report and activities;

• suspend the limitation periods on claims;

• confer power to examine parties on questioned transactions regarding lot sales prior to *CCAA*.

76 The further Report of the Monitor is required at least 7 days before the next hearing.

Expansion of Stay

77 The Stay is expanded to apply to proceedings against Heart Lake and associated parties involved in the Grand Rapids contracts, and proceedings by Max Fuel against Ms. McCracken. Counsel for CWB did not take issue with this. In the result, the applications for appointment of a Receiver, interim or otherwise, are dismissed.

Sealing of Confidential Information

78 I order that the confidential information identified as such on the Court file be sealed.

Service Protocol to Reduce Costs

79 The Monitor is to maintain a service list of parties who provide the Monitor with email addresses. Those parties may be served by email effective the date of the email. All others are to be served by the Monitor posting its and others' materials on its website, effective as at the date of posting.

VII Conclusion

80 I have determined that it is in the collective interest to extend the *CCAA* Stay to September 29, 2017. The Order will be subject to review by me on September 26, 2017 in usual consultation with the Court Coordinator.

End of Document

TAB 2

2016 BCSC 12
British Columbia Supreme Court

North American Tungsten Corp., Re

2016 CarswellBC 20, 2016 BCSC 12, [2016] B.C.W.L.D. 625, 262 A.C.W.S. (3d) 292, 33 C.B.R. (6th) 45

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

In the Matter of the Canada Business Corporations Act, R.S.C. 1985, c. C-44, as amended

In the Matter of North American Tungsten Corporation Ltd., Petitioner

Butler J.

Heard: November 16-17, 2015
Judgment: January 7, 2016
Docket: Vancouver S154746

Counsel: John R. Sandrelli, Tevia R.M. Jeffries, for Petitioner
Kibben M. Jackson, Fergus McDonnell, for Monitor, Alvarez & Marsal Canada Inc.
William E.J. Skelly, Lisa C. Hiebert, for Callidus Capital Corporation
Mary Buttery, H. Lance Williams, for Government of Northwest Territories
Jonathan McLean, Angela L. Crimeni, for Wolfram Bergbau and Hütten AG
Kieran E. Siddall, Scott Boucher, for Global Tungsten & Powders Corp.
Gordon G. Plottel, for Finning International
Matthew Nied, for Amalgamated Mining Inc.
Jason W. Levine, Melissa A. Nicolls, for Her Majesty the Queen, Department of Indian Affairs & Northern Development Canada
Jose A. Delgado, for Driving Force Inc.
Kenneth Landa, for Her Majesty the Queen in Right of Canada

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

Headnote

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

Government of Northwest Territories (NWT) held security for reclamation obligations of debtor, including first registered charge over mining property — NWT sought to sell mining claim property belonging to debtor by way of asset purchase agreement (APA) — Application was opposed by certain creditors who held charge on mining property second to that of NWT who claimed that acceptance of NWT bid would turn contingent liability of debtor into hard asset — NWT brought application for order approving sale of mining claim property belonging to debtor company to it by way of APA pursuant to $4.5 million credit bid — Application granted — Debtor's reclamation obligations were due and owing — Whether bid was cash or NWT's credit bid, purchase price must first satisfy outstanding Companies' Creditors Arrangement Act (CCAA) charges and then be applied against NWT security — Under current market conditions, there was no possibility for other creditors to recover on their security — Highest offer received by monitor for mining property was $500,000 less than NWT credit bid — Effort made to obtain best price for mining property was more than sufficient — Consideration received was fair and reasonable, taking into account market value of mining property — Allocation of CCAA charges were to be made by monitor.

Table of Authorities

Cases considered by *Butler J.*:

Comstock Canada Ltd., Re (2013), 2013 CarswellOnt 18611, 2014 ONSC 493 (Ont. S.C.J. [Commercial List]) — considered

Hunjan International Inc., Re (2006), 2006 CarswellOnt 2718, 21 C.B.R. (5th) 276 (Ont. S.C.J.) — referred to

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4838, 56 C.B.R. (5th) 224 (Ont. S.C.J. [Commercial List]) — considered

TBS Acquireco Inc., Re (2013), 2013 ONSC 4663, 2013 CarswellOnt 9481, 3 C.B.R. (6th) 261 (Ont. S.C.J. [Commercial List]) — referred to

White Birch Paper Holding Co., Re (2010), 2010 QCCS 4915, 2010 CarswellQue 10954, 72 C.B.R. (5th) 49 (C.S. Que.) — followed

Statutes considered:

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

s. 36 — considered

s. 36(3) — considered

Waters Act, S.N.W.T. 2014, c. 18
Generally — referred to

Regulations considered:

Waters Act, S.N.W.T. 2014, c. 18
Waters Regulations, N.W.T. Reg. R-019-2014

s. 11 — considered

APPLICATION by Government of Northwest Territories by way of asset purchase agreement.

***Butler J.*:**

1 On November 16 and 17, 2015, I heard a number of applications in this *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*") proceeding. Global Tungsten & Powders Corp. and Wolfram Bergbau and Hütten AG (collectively the "Tungsten Purchasers") applied to cancel supply agreements with North American Tungsten Corporation (the "Company"). The Company applied for the following orders:

a) Extension of the Stay of Proceedings to March 31, 2016;

b Enhancement of the powers of the Monitor during the extension;

c) A second administration charge to secure fees and disbursements for the Monitor and counsel during the extension; and

d) Lifting the stay of proceedings to permit redundant equipment to be released to security holders.

2 These applications were not contentious. The Monitor noted that the Company and its management continued to act in good faith and with due diligence in relation to the restructuring proceedings and recommended that the Court grant these orders. Following submissions of counsel and some minor changes to the proposed terms, I granted those orders.

3 At the same hearing, the Government of the Northwest Territories ("GNWT") brought an application for an order approving the sale of the Mactung mining claim property ("Mactung"), belonging to the Company, to it by way of an asset purchase agreement (the "APA") pursuant to a $4.5 million credit bid. The application was opposed by the Tungsten Purchasers. Callidus Capital Corporation ("Callidus") did not oppose the sale, but sought a variation in the terms of the sale regarding interest to be paid to the GNWT on funds it would advance pending sale of the Cantung Mine assets of the Company. At the conclusion of the hearing, I approved the sale of the Mactung property to the GNWT and indicated to the parties that I would provide brief reasons for the decision. These are my reasons.

Background

4 The initial order made on June 9, 2015 was varied a number of times to extend the initial 30-day stay of proceedings. It was eventually extended to November 30, 2015. On July 17, 2015, an order was made authorizing the Company to conduct a sale and investment solicitation process ("SISP"). Alvarez & Marsal Canada Securities ULC was retained as the Financial Advisor to assist the Company and the Monitor in conducting the SISP. A number of bids were delivered to the Monitor. In consultation with the Company's senior secured creditors, Callidus and the GNWT, it was determined that none of the bids were likely to result in a transaction being consummated. The SISP was terminated by the Monitor and these applications were brought.

5 In accordance with the Company's proposal, it discontinued production at the Cantung Mine as of late October 2015 and continued with the transition of the mine to care and maintenance. The majority of the remaining mine employees finished work on November 18, 2015. Some of the Company's head office employees were terminated effective November 30, 2015, although four were expected to be employed by the Company through December 2015 to assist the Monitor. The Chief Executive Officer and Chief Financial Officer resigned as officers and directors of the Company effective upon the granting of the order enhancing the powers of the Monitor.

6 The Monitor described in detail the SISP process in its Tenth Report. A brief summary includes the following:

• the financial advisor contacted 256 potentially interested parties;

• 18 potential purchasers executed confidentiality agreements and received detailed information regarding the Company and the proposed sale; and

• three qualified bids for the Mactung property were received by the Monitor. When the bids were reviewed with the senior creditors it was determined that none of the bids were likely to result in a transaction. At the hearing of these applications the Monitor advised the Court that this was because of the inadequate financial terms contained in the offers.

7 The GNWT holds security for the reclamation obligations of the Company, including a first registered charge over the Mactung property. There is no question that it is a valid charge. The GNWT charge is subordinate to the priority charges created by orders in the *CCAA* proceedings. These include the Administration Charge, the Directors Charge, the A/R Financing Charge and the Interim Lender's Charge. The Tungsten Purchasers also hold security against the Mactung property which ranks in priority up to $5.0 million plus interest and costs, behind the security held by the GNWT.

8 The Company was required to post security for the reclamation obligations as a condition of the Water Licence required for the Cantung Mine which was issued by the GNWT. As of March 31, 2015, it had posted $6.2 million in cash (the "Deposit") and $5.5 million in promissory notes as security for the reclamation obligations. In March 2014, the Company submitted an application to the GNWT to amend the Water Licence. This was approved in March 2015 by the Water Board. The Water Board has the power to require an applicant to furnish and maintain security in an amount determined in accordance with regulations. It requested an increase in the reclamation security to $27.95 million. Section 11 of the relevant regulations (*Waters Regulations*, N.W.T. Reg 019-2014) states that the amount of the reclamation security fixed by the Water Board cannot exceed the aggregate of the costs of abandonment of the undertaking, the restoration of the site of the undertaking, and any ongoing measures that may remain to be taken after the abandonment of the undertaking. The Company disagrees with the amount assessed by the Water Board, but has conceded that the amount of the security should be at least $15 million.

9 The Company's reclamation obligations are secured by the Amended and Restated Reclamation Security Agreement dated August 24, 2010 (the "RSA"). These obligations are defined in the RSA as "obligations pursuant to all permits and licenses with respect to environmental compliance, reclamation and post-closure control measures for environmental impacts in connection with the closure of mining operations at the Cantung Mine, including, without limitation [the Company's] obligations under the Surface Leases and the Water License." Pursuant to clause 3.1 of the RSA, the Company granted a general and continuing security interest in all the property, assets and undertakings of the Company relating to the Mactung property for "the payment and performance of any and all indebtedness, obligations and liabilities, present or future, direct or indirect, absolute or contingent, matured or not, at any time owing by [the Company] hereunder and under the Water License..."

10 Clause 3.4 of the RSA provides for defaults:

> The Obligations secured hereby shall become immediately due and payable and the security interests created hereunder shall become enforceable in each and every of the following events (herein called a "Default"):
>
> > . . .
> >
> > (c) upon any default by [the Company] in respect of any indebtedness in excess of $100,000 in the aggregate, ...;
> >
> > (d) if at any time after the date hereof [the Company]: (i) files a voluntary petition in bankruptcy or files any proposal or notice of intent to file a proposal, or files any application or otherwise commences any action or proceeding seeking reorganization, arrangement, consolidation or readjustment of its financial obligations or which seeks to stay or has the effect of staying any creditors, or for any other relief under the *Bankruptcy and Insolvency Act of Canada* or the CCAA...;
> >
> > . . .
> >
> > (h) if [the Company] abandons all or any material part of its assets or ceases or threatens to cease to carry on business, in each case, such that its ability to meet its obligations hereunder is at material risk; or
> >
> > (i) if [the Company] is in breach of any of its obligations under Section 2.1 of this Agreement.

11 There is no doubt that events as described by these four subsections of clause 3.4 have occurred and that the Company has defaulted on its obligations under the RSA.

Position of the GNWT

12 The GNWT notes that the *CCAA* gives courts a wide discretion to make any order which they consider to be appropriate in the context of the proceedings. It relies on s. 36 of the *CCAA*, which gives a court the authority to approve an asset sale outside of a plan of arrangement. Section 36(3) sets out a non-exhaustive list of factors which a court should

consider when deciding to approve such a sale. The GNWT says that when all of the factors are considered in the case of the proposed sale of the Mactung property, it is clear that the sale should be approved. The process leading up to the sale was reasonable; the Monitor approved that process and is of the opinion that the sale would be at least as beneficial to creditors as a disposition under bankruptcy. There was adequate consultation with creditors and the consideration to be received is reasonable and fair, taking into account the market value of the Mactung property. The GNWT also notes that the Monitor is of the view that the sale price and terms are commercially reasonable and satisfactory and is supportive of the sale.

13 The consideration for the sale is a credit bid. The GNWT says that credit bidding has been approved by courts in other Canadian jurisdictions and that there is no reason not to approve such a bid in the circumstances of this case where all of the other requirements under s. 36 of the *CCAA* are met.

Position of the Purchasers

14 The Tungsten Purchasers oppose the proposed sale on a number of grounds. First, they say that there is no amount due and owing by the Company to the GNWT pursuant to its reclamation obligations. The *Waters Act*, S.N.W.T. 2014, c. 18, sets out specific circumstances in which the GNWT is permitted to make use of the reclamation security and those circumstances have not occurred. Nothing has been spent on reclamation activities to date.

15 The Tungsten Purchasers say that if the Company performs reclamation activities and the environmental liability is reduced below the amount of the Deposit, there would be no need to resort to the security. Further, if another party acquires the Cantung Mine, it would have to post satisfactory security and the Company's security would be released. In these circumstances, the Tungsten Purchasers say that a credit bid should not be considered. This is because the GNWT is not entitled to a beneficial interest in the proceeds of the sale of the collateral because it could only call on the security if and when it has spent money on reclamation.

16 The Tungsten Purchasers also say that the GNWT offer should be rejected based on consideration of the factors in s. 36(3) of the *CCAA*. It says there is no information from which the Court could conclude that the $4.5 million price is a reasonable reflection of the market value of the Mactung property. Further, the Tungsten Purchasers were not involved in the SISP, and so have little or no information about the offers made for the Mactung property. In addition, the credit bid is not reasonable or fair as the GNWT has no need or ability to reimburse itself for the costs of the reclamation obligations of the Cantung Mine.

17 Finally, the Tungsten Purchasers say that, at the very least, the sale should be delayed until March 31, 2016. It is possible that tungsten prices could rebound in the first quarter of the year. If that occurs, a potential purchaser may offer well in excess of $4.5 million for the Mactung property or could offer to purchase the Cantung Mine. If the latter occurs, the purchaser would be required to post security for the reclamation obligations. This would allow the Company's security to be released. In the meantime, there is no prejudice to the GNWT as the care and maintenance costs could be paid from the $6.2 million Deposit.

18 In short, the Tungsten Purchasers say that acceptance of the GNWT bid would turn a contingent liability of the Company into a hard asset. There is no prejudice to the GNWT if the bid is not accepted at this time as the Mactung property will only be more valuable in the future. The only parties suffering prejudice are the Tungsten Purchasers, as they will lose any chance of recovery on the substantial debts owed to them by the Company.

Reasons for Decision

19 The Tungsten Purchasers' arguments raise three issues: 1) do the reclamation obligations create a debt which is due and owing; 2) in the circumstances of this case, can the Court approve an asset sale which is entirely based on a credit bid; and 3) in all of the circumstances is it fair and reasonable to approve the sale of the Mactung property to the GNWT.

Is there a debt due and owing by the Company?

20 The arguments of the Tungsten Purchasers, if accepted, would put the GNWT in an impossible situation: it could never enforce its reclamation security without actually performing the reclamation work and spending more on that work than the amount of the Deposit. This must be wrong as it ignores the language of the RSA. The Company granted the RSA to secure its obligation to perform the reclamation work that would be required after closure of the Cantung Mine. In doing so, it agreed that in the event of a default, its obligations "shall become immediately due and payable and the security interests created hereunder shall become enforceable".

21 As I have already indicated, there is no doubt there have been several defaults by the Company. The filing of the *CCAA* proceeding was a default; the failure to post $27.95 million in security (or some lesser amount agreed to by the Water Board) when asked to do so by the Water Board was a default; the failure to satisfy indebtedness to other parties in excess of $100,000 was a default; and the fact the Company has now ceased to carry on business is a default. As a result of these events, the Company's reclamation obligations are due and owing. The fact that the precise amount of the indebtedness cannot be determined does not mean that the debt created by the reclamation obligations and secured by the RSA is not due and owing.

Can the Court approve an asset sale which is entirely based on a credit bid?

22 As noted by the Tungsten Purchasers, credit bidding has not been dealt with extensively in Canadian jurisprudence. However, credit bids have been approved in *CCAA* proceedings. The leading case is *White Birch Paper Holding Co., Re*, 2010 QCCS 4915 (C.S. Que.), in which the successful bidder incorporated a $78 million credit bid component in its offer in a stalking horse bid process. The approval of the bid was made without a great deal of analysis. The possibility that credit bids would be considered was set out in the bidding procedure established by the court. At para. 33, the court noted that when the "bid process was put in place, those bidders able to benefit from a credit bidding situation could very well revert to the use of this lever or tool in order to arrive at a better bid." The court also noted at para. 34 that "if credit bidding is to take place, it goes without saying that the amount of the credit bid should not exceed, but should be allowed to go as, high as the face value amount of the credit instrument upon which the credit bidder is allowed to rely."

23 In *White Birch*, the court also concluded that the successful bid met the requirements of s. 36 of the *CCAA*. In doing so it referred to *Nortel Networks Corp., Re* (2009), 56 C.B.R. (5th) 224 (Ont. S.C.J. [Commercial List]) and adopted the comments of Morawetz J. at para. 35 regarding the duties of a court when considering a proposed sale of assets. In essence, the court analyzed the factors set out in s. 36(3) and concluded the sale should be approved. The inclusion of a substantial credit bid component in the terms of the bid was not objectionable and the credit component was to be valued on a dollar for dollar basis with a cash bid.

24 As the GNWT argued, credit bids have been accepted in Canadian insolvency proceedings: Pamela Huff et al, "Credit Bidding - Recent Canadian and US Themes", in Janis P. Sarra, ed. *Annual Review of Insolvency Law* (Toronto: Carswell, 2010). Other courts have approved credit bids in *CCAA* proceedings: *TBS Acquireco Inc., Re*, 2013 ONSC 4663 (Ont. S.C.J. [Commercial List]).

25 The Tungsten Purchasers' principal argument against the validity of the GNWT's credit bid was that it did not have a beneficial interest in the proceeds of sale of the collateral — the Mactung property. As I have accepted that the Company's reclamation obligations are a debt which is due and owing because of its defaults, this argument must be rejected. In other words, there is no principled reason why a credit bid should not be accepted.

26 The Tungsten Purchasers' other arguments on the validity of the credit bid focused on the uncertainty regarding the amount of the reclamation obligation. While the total amount of the debt cannot be determined, it is abundantly clear that it is at least $15 million and likely higher. The GNWT says it is in excess of $21.5 million. In any event, the net result of acceptance of a credit bid for the Mactung property would be no different than a purchase for cash. The priority of the secured charges against that asset are:

a) the *CCAA* charges (approximately $3 million);

b) the GNWT (at least $15 million);

c) the Tungsten Purchasers (US $5 million).

27 Whether the bid is cash or GNWT's credit bid, the purchase price must first satisfy the outstanding *CCAA* charges and then be applied against the GNWT security. Under the current market conditions, there is no possibility for the Tungsten Purchasers to recover on their security. The Monitor advised the Court that the highest offer received as a result of the SISP was $500,000 less than the GNWT credit bid.

Is it fair and reasonable to approve the sale of the Mactung property to the GNWT?

28 Section 36 of the *CCAA* provides as follows:

> 36. (1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.
>
> (2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.
>
> (3) In deciding whether to grant the authorization, the court is to consider, among other things,
>
> > (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
> >
> > (b) whether the monitor approved the process leading to the proposed sale or disposition;
> >
> > (c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;
> >
> > (d) the extent to which the creditors were consulted;
> >
> > (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
> >
> > (f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.
>
> . . .

29 As set out in s. 36(3), the list of factors is not exhaustive; the court must consider all of the circumstances to determine whether the proposed asset sale is fair and reasonable. The issue of fairness focuses on the process utilized to attempt to obtain the best price for the asset for the benefit of creditors. The question of reasonableness focuses on the consideration to be received. The duties of a court when considering a proposed asset sale were succinctly summarized by Morawetz J. in *Nortel* at para. 35:

> [35] The duties of the court in reviewing a proposed sale of assets are as follows:
>
> > 1) It should consider whether sufficient effort has been to obtain the best price and that the debtor has not acted improvidently;
> >
> > 2) It should consider the interests of all parties;
> >
> > 3) It should consider the efficacy and integrity of the process by which offers have been obtained; and

4) It should consider whether there has been unfairness in the working out of the process

30 When I consider all of the factors set out in s. 36(3) and the duty of the court as described in *Nortel*, I am satisfied that I should exercise my discretion to approve the sale of the Mactung property to the GNWT. My reasons for doing so include the following:

a) Courts will generally approve a sale where the Monitor is of the view that the sale price and terms are commercially reasonable and satisfactory: see, for example, *Comstock Canada Ltd., Re* (2013), 2014 ONSC 493 (Ont. S.C.J. [Commercial List]). Here, the Monitor stated in its Eleventh Report:

> 10.8 The purchase price offered by GNWT of $4.5 million is greater than any purchase price offered pursuant to any of qualified bids received in the Amended SISP. The purchase price is also vastly less than the estimated gross amount due to GNWT and secured against the Mactung assets, estimates of which range from approximately $15 to $28 million before taking into account cash security held by the GNWT.
>
> 10.9 After considering the matters set out above, and after discussions with the Company, GNWT and Callidus, the Monitor is satisfied that (i) the purchase price under the Mactung APA is superior to any purchase price contained in the three qualified bids, and (ii) subject to one comment below regarding GNWT's entitlement to subrogation, the terms of the Mactung APA are commercially reasonable. Accordingly, the Monitor supports GNWT's application for the Mactung Credit Bid Order.

b) The SISP was a thorough sales process as a result of which a large number of potential purchasers were identified and contacted. Detailed confidential information regarding the Cantung Mine and the Mactung property was provided to 18 interested parties. Site visits were arranged and management presentations were offered to interested parties. The depth and the period of exposure to the market were adequate and appropriate given the nature of the assets. The process was approved by the Monitor and managed by the Financial Advisor appointed by the Court. While it is unfortunate that the offers were less than satisfactory, the only conclusion I can reach is that the process was fair and reasonable.

c) The Monitor opined that the sale or disposition would be equally beneficial to creditors as a sale or disposition on bankruptcy. The Monitor could not state that it would be more beneficial given the large shortfall on the GNWT secured charge. In other words, whether the sale or disposition was conducted under bankruptcy or the *CCAA* would make no difference to creditors with a claim against the Mactung property.

d) The Monitor terminated the SISP after receipt of the inadequate offers from purchasers. The GNWT advanced the offer contained in the APA after the SISP was terminated. The Monitor consulted with Callidus and the GNWT, the senior creditors, about the offer. The Monitor did not consult more broadly given the circumstances: no offers had been received in excess of $4.0 million for the Mactung property; and the offer from the GNWT is not sufficient to satisfy the claims of creditors with either secured or unsecured claims against the Mactung property. The Tungsten Purchasers complain about the lack of consultation, however, in the circumstances of this case, I am satisfied that the consultation was adequate.

e) The acceptance of this offer means that the Tungsten Purchasers have no chance of any recovery on their security against the Mactung property. Similarly, unsecured creditors have no possibility of recovery against that property. However, the situation is no different from what would have occurred if an offer received as a result of the SISP had been accepted. The price of tungsten is so low that the Company's assets have little or no value and are encumbered by the substantial reclamation obligation owed to the GNWT. This situation arises because of market circumstances, not because of the terms of the GNWT credit bid.

f) The Tungsten Purchasers' alternate argument is that there is no prejudice to anyone if the GNWT offer is not approved and the matter is reconsidered in March 2016. The difficulty with this submission is that there is no process in place, and none is anticipated to be in place, to market the Mactung property in three months. There is no financing in place to support a continuation of the SISP or to put some kind of new process in place. In addition, the Company has no management after November 18, 2015. Quite simply, it is too late to sit back and hope for an increase in the price of tungsten. The sole rationale for delaying the sale is to market the properties when the price of tungsten has increased. However, it is folly to assume that this can be done without a plan, financing or a proper process. In addition, no evidence was placed before the Court to support the proposition that the price may rise in the near future.

g) By the terms of the APA, the GNWT will advance sufficient funds to pay out the *CCAA* charges which rank in priority to the GNWT. This will enable the holders of those charges to be paid immediately. The *CCAA* charges secure loans that were advanced and administrative services which were provided based on the orders made by this Court for the purpose of enabling the restructuring of the Company and in anticipation that these charges would be paid in a reasonable period of time. In all of the circumstances, it would be unfair not to pay out those charges at this time.

h) The Monitor's strong support for the proposed sale is a significant factor in my decision to grant the authorization. The Monitor, assisted by the Financial Advisor, is in the best position to assess whether the price offered is reasonable taking into account the market value of the Mactung property. I accept the Monitor's assessment of value and note that no evidence was offered to the Court which suggests a higher value. The difficulty, as I have outlined, is the depressed price of tungsten. While the Mactung property has value, the Cantung Mine is saddled with the reclamation obligation which is secured against Mactung. The Monitor is well aware of the issues which dictate the market value of the Company's assets.

i) The Monitor was not prepared to opine that the term in the APA which allowed the GNWT to be subrogated to the Interim Lender's Charge with an interest rate of 21% was commercially reasonable. As I will explain later, I was not prepared to authorize the sale with that term. The terms of the offer were thus revised to provide that the funds advanced by the GNWT, pending sale of the Cantung assets, will attract interest of 6.85%.

31 In summary, I am satisfied that the effort made to obtain the best price for the Mactung property was more than sufficient. The attempts to market the Company's assets were extensive and there is no basis to criticize the integrity of the process. The large shortfall in the recovery is unfortunate, but there is no undue prejudice to the parties in authorizing the sale. The consideration received is fair and reasonable, taking into account the market value of the Mactung property.

Payment of the *CCAA* Charge, Allocation and Subrogation

32 The parties recognize that there is a need to allocate the *CCAA* charges to the various assets and, in particular, to the Cantung assets and the Mactung property. Allocation of the restructuring costs must be done on a fair and even-handed basis amongst creditors, based on the particular circumstances of the case. Of course, allocation must be done equitably in a manner which does not re-adjust priorities: *Hunjan International Inc., Re* (2006), 21 C.B.R. (5th) 276 (Ont. S.C.J.). The parties agree that the allocation should be made by the Monitor.

33 The subrogation issue arose in this case because the terms of the APA required the GNWT to pay the *CCAA* charges. To the extent that those charges may be allocated to Cantung assets, the GNWT will be entitled to be repaid the amounts it advanced. Given these circumstances, the GNWT took the position it was entitled to be subrogated to the Interim Lender's Charge and to receive interest on the advance at the DIP loan rate of 21%. Callidus opposed this term in the agreement on two bases: the GNWT has no right to be subrogated in the circumstances of this case; and even if it is, the Court should exercise its discretion to set an interest rate which is more reflective of the loan risk.

34 I indicated to counsel that I was not inclined to authorize the sale with the subrogation term and certainly not at the interest rate of 21%. After some discussion between the parties, I was advised that the terms of the sale were revised

to provide that the GNWT will be paid interest on the funds it advances at the rate of 6.85%. This will be an allocation charge; the GNWT is not subrogated to the Interim Lender's Charge.

35 In summary, the sale of the Mactung property to the GNWT is approved as set out in the APA as modified in accordance with these reasons.

Application granted.

TAB 3

2012 ONSC 1750
Ontario Superior Court of Justice [Commercial List]

CCM Master Qualified Fund Ltd. v. blutip Power Technologies Ltd.

2012 CarswellOnt 3158, 2012 ONSC 1750, 213 A.C.W.S. (3d) 12, 90 C.B.R. (5th) 74

CCM Master Qualified Fund, Ltd. (Applicant) and blutip Power Technologies Ltd. (Respondent)

D.M. Brown J.

Heard: March 15, 2012
Judgment: March 15, 2012
Docket: CV-12-9622-00CL

Counsel: L. Rogers, C. Burr for Receiver, Duff & Phelps Canada Restructuring Inc.
A. Cobb, A. Lockhart for Applicant

Subject: Insolvency; Civil Practice and Procedure

Headnote

Bankruptcy and insolvency --- Receivers — Miscellaneous

Receiver was appointed over debtor company — Debtor was in development phase with no significant sources of revenue and was dependant on external sources of equity and debt funding to operate — Receiver brought motion for orders approving sales process and bidding procedures, including use of stalking horse credit bid; priority of Receiver's Charge and Receiver's Borrowings Charge; and activities reported in Receiver's First Report — Motion granted — Receiver lacked access to sufficient funding to support debtor's operations during lengthy sales process — Quick sales process was required — Marketing, bid solicitation and bidding procedures proposed by Receiver would result in fair, transparent and commercially efficacious process, and were approved — Stalking horse agreement was approved for purposes requested by Receiver — Receiver was granted priority over existing perfected security interests and statutory encumbrances — Debtor did not maintain any pension plans — Activities in Receiver's First Report were approved.

Table of Authorities

Cases considered by *D.M. Brown J.*:

Brainhunter Inc., Re (2009), 62 C.B.R. (5th) 41, 2009 CarswellOnt 8207 (Ont. S.C.J. [Commercial List]) — referred to

First Leaside Wealth Management Inc., Re (2012), 2012 CarswellOnt 2559, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]) — followed

Graceway Canada Co., Re (2011), 2011 ONSC 6403, 2011 CarswellOnt 11687, 85 C.B.R. (5th) 252 (Ont. S.C.J. [Commercial List]) — referred to

Indalex Ltd., Re (2009), 2009 CarswellOnt 4262, 79 C.C.P.B. 101 (Ont. S.C.J. [Commercial List]) — referred to

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

Nortel Networks Corp., Re (2009), 56 C.B.R. (5th) 74, 2009 CarswellOnt 4839 (Ont. S.C.J. [Commercial List]) — referred to

Parlay Entertainment Inc., Re (2011), 81 C.B.R. (5th) 58, 2011 ONSC 3492, 2011 CarswellOnt 5929 (Ont. S.C.J.) — referred to

Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205 (Ont. C.A.) — followed

White Birch Paper Holding Co., Re (2010), 2010 QCCS 4382, 2010 CarswellQue 9720 (C.S. Que.) — referred to

White Birch Paper Holding Co., Re (2010), 2010 CarswellQue 10954, 2010 QCCS 4915, 72 C.B.R. (5th) 49 (C.S. Que.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 243(6) — considered

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

Criminal Code, R.S.C. 1985, c. C-46
Generally — referred to

Personal Property Security Act, R.S.O. 1990, c. P.10
Generally — referred to

MOTION by receiver for orders approving sales process and bidding procedures, including use of stalking horse credit bid; priority of Receiver's Charge and Receiver's Borrowings Charge; and activities reported in its First Report.

***D.M. Brown J.*:**

I. Receiver's motion for directions: sales/auction process & priority of receiver's charges

1 By Appointment Order made February 28, 2012, Duff & Phelps Canada Restructuring Inc. ("D&P") was appointed receiver of blutip Power Technologies Ltd. ("Blutip"), a publicly listed technology company based in Mississauga which engages in the research, development and sale of hydrogen generating systems and combustion controls. Blutip employs 10 people and, as the Receiver stressed several times in its materials, the company does not maintain any pension plans.

2 D&P moves for orders approving (i) a sales process and bidding procedures, including the use of a stalking horse credit bid, (ii) the priority of a Receiver's Charge and Receiver's Borrowings Charge, and (iii) the activities reported in its First Report. Notice of this motion was given to affected persons. No one appeared to oppose the order sought. At the hearing today I granted the requested Bidding Procedures Order; these are my Reasons for so doing.

II. Background to this motion

3 The Applicant, CCM Master Qualified Fund, Ltd. ("CCM"), is the senior secured lender to Blutip. At present Blutip owes CCM approximately $3.7 million consisting of (i) two convertible senior secured promissory notes (October 21, 2011: $2.6 million and December 29, 2011: $800,000), (ii) $65,000 advanced last month pursuant to a Receiver's Certificate, and (iii) $47,500 on account of costs of appointing the Receiver (as per para. 30 of the Appointment Order). Receiver's counsel has opined that the security granted by Blutip in favour of CCM creates a valid and perfected security interest in the company's business and assets.

4 At the time of the appointment of the Receiver Blutip was in a development phase with no significant sources of revenue and was dependant on external sources of equity and debt funding to operate. As noted by Morawetz J. in his February 28, 2012 endorsement:

> In making this determination [to appoint a receiver] I have taken into account that there is no liquidity in the debtor and that it is unable to make payroll and it currently has no board. Stability in the circumstances is required and this can be accomplished by the appointment of a receiver.

5 As the Receiver reported, it does not have access to sufficient funding to support the company's operations during a lengthy sales process.

III. Sales process/bidding procedures

A. General principles

6 Although the decision to approve a particular form of sales process is distinct from the approval of a proposed sale, the reasonableness and adequacy of any sales process proposed by a court-appointed receiver must be assessed in light of the factors which a court will take into account when considering the approval of a proposed sale. Those factors were identified by the Court of Appeal in its decision in *Royal Bank v. Soundair Corp.*: (i) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; (ii) the efficacy and integrity of the process by which offers are obtained; (iii) whether there has been unfairness in the working out of the process; and, (iv) the interests of all parties. [1] Accordingly, when reviewing a sales and marketing process proposed by a receiver a court should assess:

> (i) the fairness, transparency and integrity of the proposed process;
>
> (ii) the commercial efficacy of the proposed process in light of the specific circumstances facing the receiver; and,
>
> (iii) whether the sales process will optimize the chances, in the particular circumstances, of securing the best possible price for the assets up for sale.

7 The use of stalking horse bids to set a baseline for the bidding process, including credit bid stalking horses, has been recognized by Canadian courts as a reasonable and useful element of a sales process. Stalking horse bids have been approved for use in other receivership proceedings, [2] *BIA* proposals, [3] and *CCAA* proceedings. [4]

8 Perhaps the most well-known recent example of the use of a stalking horse credit bid was that employed in the Canwest Publishing Corp. *CCAA* proceedings where, as part of a sale and investor solicitation process, Canwest's senior lenders put forward a stalking horse credit bid. Ultimately a superior offer was approved by the court. I accept, as an apt description of the considerations which a court should take into account when deciding whether to approve the use of a stalking horse credit bid, the following observations made by one set of commentators on the Canwest *CCAA* process:

> To be effective for such stakeholders, the credit bid had to be put forward in a process that would allow a sufficient opportunity for interested parties to come forward with a superior offer, recognizing that a timetable for the sale of a business in distress is a fast track ride that requires interested parties to move quickly or miss the opportunity.

> The court has to balance the need to move quickly, to address the real or perceived deterioration of value of the business during a sale process or the limited availability of restructuring financing, with a realistic timetable that encourages and does not chill the auction process. [5]

B. The proposed bidding process

B.1 The bid solicitation/auction process

9 The bidding process proposed by the Receiver would use a Stalking Horse Offer submitted by CCM to the Receiver, and subsequently amended pursuant to negotiations, as a baseline offer and a qualified bid in an auction process. D&P intends to distribute to prospective purchasers an interest solicitation letter, make available a confidential information memorandum to those who sign a confidentiality agreement, allow due diligence, and provide interested parties with a copy of the Stalking Horse Offer.

10 Bids filed by the April 16, 2012 deadline which meet certain qualifications stipulated by the Receiver may participate in an auction scheduled for April 20, 2012. One qualification is that the minimum consideration in a bid must be an overbid of $100,000 as compared to the Stalking Horse Offer. The proposed auction process is a standard, multi-round one designed to result in a Successful Bid and a Back-Up Bid. The rounds will be conducted using minimum incremental overbids of $100,000, subject to reduction at the discretion of the Receiver.

B.2 Stalking horse credit bid

11 The CCM Stalking Horse Offer, or Agreement, negotiated with the Receiver contemplates the acquisition of substantially all the company's business and assets on an "as is where is" basis. The purchase price is equal to: (i) Assumed Liabilities, as defined in the Stalking Horse Offer, plus (ii) a credit bid of CCM's secured debt outstanding under the two Notes, the Appointment Costs and the advance under the Receiver's Certificate. The purchase price is estimated to be approximately $3.744 million before the value of Assumed Liabilities which will include the continuation of the employment of employees, if the offer is accepted.

12 The Receiver reviewed at length, in its Report and in counsel's factum, the calculation of the value of the credit bid. Interest under both Notes was fixed at 15% per annum and was prepaid in full. The Receiver reported that if both Notes were repaid on May 3, 2012, the anticipated closing date, the effective annual rate of interest (taking into account all costs which could be categorized as "interest") would be significantly higher than 15% per annum - 57.6% on the October Note and 97.4% on the December Note. In order that the interest on the Notes considered for purposes of calculating the value of the credit bid complied with the interest rate provisions of the *Criminal Code*, the Receiver informed CCM that the amount of the secured indebtedness under the Notes eligible for the credit bid would have to be $103,500 less than the face value of the Notes. As explained in detail in paragraphs 32 through to 39 of its factum, the Receiver is of the view that such a reduction would result in a permissible effective annual interest rate under the December Note. The resulting Stalking Horse Agreement reflected such a reduction.

13 The Stalking Horse Offer does not contain a break-fee, but it does contain a term that in the event the credit bid is not the Successful Bid, then CCM will be entitled to reimbursement of its expenses up to a maximum of $75,000, or approximately 2% of the value of the estimated purchase price. Such an amount, according to the Receiver, would fall within the range of reasonable break fees and expense reimbursements approved in other cases, which have ranged from 1.8% to 5% of the value of the bid. [6]

C. Analysis

14 Given the financial circumstances of Blutip and the lack of funding available to the Receiver to support the company's operations during a lengthy sales process, I accept the Receiver's recommendation that a quick sales process is required in order to optimize the prospects of securing the best price for the assets. Accordingly, the timeframe proposed

by the Receiver for the submission of qualifying bids and the conduct of the auction is reasonable. The marketing, bid solicitation and bidding procedures proposed by the Receiver are likely to result in a fair, transparent and commercially efficacious process in the circumstances.

15 In light of the reduction in the face value of the Notes required by the Receiver for the purposes of calculating the value of the credit bid and the reasonable amount of the Expense Reimbursement, I approved the Stalking Horse Agreement for the purposes requested by the Receiver. I accept the Receiver's assessment that in the circumstances the terms of the Stalking Horse Offer, including the Expense Reimbursement, will not discourage a third party from submitting an offer superior to the Stalking Horse Offer.

16 Also, as made clear in paragraphs 7 and 8 of the Bidding Procedures Order, the Stalking Horse Agreement is deemed to be a Qualified Bid and is accepted solely for the purposes of CCM's right to participate in the auction. My order did not approve the sale of Blutip's assets on the terms set out in the Stalking Horse Agreement. As the Receiver indicated, the approval of the sale of Blutip's assets, whether to CCM or some other successful bidder, will be the subject of a future motion to this Court. Such an approach is consistent with the practice of this Court. [7]

17 For those reasons I approved the bidding procedures recommended by the Receiver.

IV. Priority of receiver's charges

18 Paragraphs 17 and 20 of the Appointment Order granted some priority for the Receiver's Charge and Receiver's Borrowings Charge. However, as noted by the Receiver in section 3.1 of its First Report, because that hearing was brought on an urgent, *ex parte* basis, priority over existing perfected security interests and statutory encumbrances was not sought at that time. The Receiver now seeks such priority.

19 As previously noted, the Receiver reported that Blutip does not maintain any pension plans. In section 3.1 of its Report the Receiver identified the persons served with notice of this motion: (i) parties with registered security interests pursuant to the *PPSA*; (ii) those who have commenced legal proceedings against the Company; (iii) those who have asserted claims in respect of intellectual property against the Company; (iv) the Company's landlord, and (v) standard government agencies. Proof of such service was filed with the motion record. No person appeared on the return of the motion to oppose the priority sought by the Receiver for its charges.

20 Although the Receiver gave notice to affected parties six days in advance of this motion, not seven days as specified in paragraph 31 of the Appointment Order, I was satisfied that secured creditors who would be materially affected by the order had been given reasonable notice and an opportunity to make representations, as required by section 243(6) of the *BIA*, that abridging the notice period by one day, as permitted by paragraph 31 of the Appointment Order, was appropriate and fair in the circumstances, and I granted the priority charges sought by the Receiver.

21 I should note that the Appointment Order contains a standard "come-back clause" (para. 31). Recently, in *First Leaside Wealth Management Inc., Re*, a proceeding under the *CCAA*, I wrote:

> [49] In his recent decision in *Timminco Limited (Re)* ("Timminco I") Morawetz J. described the commercial reality underpinning requests for Administration and D&O Charges in *CCAA* proceedings:
>
>> In my view, in the absence of the court granting the requested super priority and protection, the objectives of the CCAA would be frustrated. It is not reasonable to expect that professionals will take the risk of not being paid for their services, and that directors and officers will remain if placed in a compromised position should the Timminco Entities continue *CCAA* proceedings without the requested protection. The outcome of the failure to provide these respective groups with the requested protection would, in my view, result in the overwhelming likelihood that the *CCAA* proceedings would come to an abrupt halt, followed, in all likelihood, by bankruptcy proceedings.

> . . .
>
> [51] In my view, absent an express order to the contrary by the initial order applications judge, the issue of the priorities enjoyed by administration, D&O and DIP lending charges should be finalized at the commencement of a *CCAA* proceeding. Professional services are provided, and DIP funding is advanced, in reliance on super-priorities contained in initial orders. To ensure the integrity, predictability and fairness of the *CCAA* process, certainty must accompany the granting of such super-priority charges. When those important objectives of the *CCAA* process are coupled with the Court of Appeal's holding that parties affected by such priority orders be given an opportunity to raise any paramountcy issue, it strikes me that a judge hearing an initial order application should directly raise with the parties the issue of the priority of the charges sought, including any possible issue of paramountcy in respect of competing claims on the debtor's property based on provincial legislation. [8]

22 In my view those comments regarding the need for certainty about the priority of charges for professional fees or borrowings apply, with equal force, to priority charges sought by a receiver pursuant to section 243(6) of the *BIA*. Certainty regarding the priority of administrative and borrowing charges is required as much in a receivership as in proceedings under the *CCAA* or the proposal provisions of the *BIA*.

23 In the present case the issues of the priority of the Receiver's Charge and Receiver's Borrowings Charge were deferred from the return of the initial application until notice could be given to affected parties. I have noted that Blutip did not maintain pension plans. I have found that reasonable notice now has been given and no affected person appeared to oppose the granting of the priority charges. Consequently, it is my intention that the Bidding Procedures Order constitutes a final disposition of the issue of the priority of those charges (subject, of course, to any rights to appeal the Bidding Procedures Order). I do not regard the presence of a "come-back clause" in the Appointment Order as leaving the door open a crack for some subsequent challenge to the priorities granted by this order.

V. Approval of the Receiver's activities

24 The activities described by the Receiver in its First Report were reasonable and fell within its mandate, so I approved them.

25 May I conclude by thanking Receiver's counsel for a most helpful factum.

Motion granted.

Footnotes

1 (1991), 7 C.B.R. (3d) 1 (Ont. C.A.).

2 *Graceway Canada Co., Re*, 2011 ONSC 6403 (Ont. S.C.J. [Commercial List]), para. 2.

3 *Parlay Entertainment Inc., Re*, 2011 ONSC 3492 (Ont. S.C.J.), para. 15.

4 *Brainhunter Inc., Re* (2009), 62 C.B.R. (5th) 41 (Ont. S.C.J. [Commercial List]), para. 13; *White Birch Paper Holding Co., Re*, 2010 QCCS 4382 (C.S. Que.), para. 3; *Nortel Networks Corp., Re* (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]), para. 2, and *Nortel Networks Corp., Re* (2009), 56 C.B.R. (5th) 74 (Ont. S.C.J. [Commercial List]); *Indalex Ltd., Re*, 2009 CarswellOnt 4262 (Ont. S.C.J. [Commercial List]).

5 Pamela Huff, Linc Rogers, Douglas Bartner and Craig Culbert, "Credit Bidding — Recent Canadian and U.S. Themes", in Janis P. Sarra (ed.), *2010 Annual Review of Insolvency Law* (Toronto: Carswell, 2011), p. 16.

6 *Parlay Entertainment Inc., Re*, 2011 ONSC 3492 (Ont. S.C.J.), para. 12; *White Birch Paper Holding Co., Re*, 2010 QCCS 4915 (C.S. Que.), paras. 4 to 7; *Nortel Networks Corp., Re* (2009), 56 C.B.R. (5th) 74 (Ont. S.C.J. [Commercial List]), para. 12.

7 *Indalex Ltd., Re*, 2009 CarswellOnt 4262 (Ont. S.C.J. [Commercial List]), para. 7; *Graceway Canada Co., Re*, 2011 ONSC 6403 (Ont. S.C.J. [Commercial List]), para. 5; *Parlay Entertainment Inc., Re*, 2011 ONSC 3492 (Ont. S.C.J.), para. 58.

8 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]) (CanLII).

End of Document

TAB 4

2012 ONSC 2840
Ontario Superior Court of Justice [Commercial List]

PCAS Patient Care Automation Services Inc., Re

2012 CarswellOnt 5922, 2012 ONSC 2840, 216 A.C.W.S. (3d) 284, 94 C.B.R. (5th) 69

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 PCAS Patient Care Automation Services Inc. and 2163279 Ontario Inc., Applicants

D.M. Brown J.

Heard: May 14, 2012
Judgment: May 14, 2012
Docket: CV-12-9656-00CL

Counsel: S. Babe for Applicants
M. Wasserman for Monitor, Pricewaterhouse Coopers Inc.
R. Thornton, A. Shepherd for 2320714 Ontario Inc., the DIP Lender
D. Bulas for Castcan Investments
R. M. Slattery for Royal Bank of Canada

Subject: Insolvency

Headnote

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

Applicant companies obtained protection of Companies' Creditors Arrangement Act — Applicants brought motion for increase in DIP lending facility and approval of sales and investor solicitation process (SISP) which featured short time frame, primary control of SISP by applicants, not monitor; submission of stalking horse credit bid by DIP lender; and solicitation and consideration by applicants of any qualified bids in consultation with Monitor — Motion granted — Taking into account factors set out in s. 11.2(4) of Act, DIP lending facility increased to $6 million — SISP approved — Given extensive efforts by applicants' management to solicit interest in business and given liquidity problems facing applicants, proposed SISP would result, in circumstances of case, in fair, transparent and commercially efficacious process which should allow sufficient opportunity for interested parties to come forward with superior offer and thereby optimize chances of securing best possible price for assets or best possible investment in applicants' continuing operations.

Table of Authorities

Cases considered by *D.M. Brown J.*:

CCM Master Qualified Fund Ltd. v. blutip Power Technologies Ltd. (2012), 2012 CarswellOnt 3158, 2012 ONSC 1750 (Ont. S.C.J. [Commercial List]) — considered

PCAS Patient Care Automation Services Inc., Re (2012), 2012 CarswellOnt 4733, 2012 ONSC 2423 (Ont. S.C.J. [Commercial List]) — referred to

PCAS Patient Care Automation Services Inc., Re (2012), 2012 ONSC 2714 (Ont. S.C.J. [Commercial List]) — referred to

PCAS Patient Care Automation Services Inc., Re (2012), 2012 ONSC 2778, 2012 CarswellOnt 5675 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
s. 11.2(4) [en. 2005, c. 47, s. 128] — considered

MOTION by applicants under *Companies' Creditors Arrangement Act* for increase in DIP lending facility and approval of sale and investor solicitation process.

D.M. Brown J.:

I. Request for increase in DIP Lending Facility and approval of a Sale and Investor Solicitation Process

1 PCAS Patient Care Automation Services Inc. and 2163279 Ontario Inc. move under the *Companies' Creditors Arrangement Act* for an increase in the DIP Lending Facility and the approval of a Sale and Investor Solicitation Process ("SISP"). At the hearing I granted and signed the order sought, subject to a few modifications. These are my reasons for so doing.

II. Background to this motion

2 The history of this matter is set out my Reasons of April 20, 2012 (2012 ONSC 2423 (Ont. S.C.J. [Commercial List]))), May 5, 2012 (2012 ONSC 2714 (Ont. S.C.J. [Commercial List]))) and May 8, 2012 (2012 ONSC 2778 (Ont. S.C.J. [Commercial List]))).

III. Increase in DIP Lending Facility

3 At present the approved DIP Lending Facility stands at $5,350,000. The DIP Lender has received commitments to increase that facility by an additional $10,000. The DIP Lender, through the applicants, renews its request to increase the facility by further $640,000 to account for fees and expenses of counsel to the DIP Lender payable pursuant to the terms of the DIP Facility. Lender's Counsel has agreed to contribute the fees and expenses to the funding of the DIP Lender instead of requiring payment would could impact the applicants' cash flows. In total, the applicants seek an increase in the DIP Lending Facility to $6 million.

4 In its Fifth Report dated May 11, 2012, the Monitor, PricewaterhouseCoopers Inc., reported that it had reviewed and approved the fees submitted by Lender's Counsel. The Monitor concluded that the work performed by Lender's Counsel was "necessary to raise the required DIP financing in order to implement the expedited SISP". The Monitor stated:

> Given the challenges of raising a DIP Facility for a pre-commercialization technology company and the need of the Company to continually increase its DIP Facility in the weeks since March 23, 2012, the amount of time and effort expended by counsel to the DIP Lenders does not seem unreasonable in the circumstances.
>
> The Monitor will review the relevant invoices of the DIP Lender's counsel detailing the fees and expenses of the DIP Lender incurred after May 7, 2012 (which are included in the estimate of fees discussed above) prior to any such fees and expenses being added to the DIP Facility.

5 Pursuant to the Initial Order the DIP Lender's Charge ranked in priority to all other interests "with the exception of valid, enforceable and perfected Encumbrances existing as at the date of filing". The proposed increase in the amount of the DIP Lending Facility will not affect those priorities. The two general secured creditors, RBC and Castcan, did not oppose the increase in the DIP Lending Facility.

6 Taking into account the factors set out in *CCAA* s. 11.2(4), I approved an increase in the DIP Lending Facility to $6 million.

IV. Sales and Investor Solicitation Process

A. Overview of the proposed SISP

7 The applicants seek approval of a Sales and Investor Solicitation Process which has four main features:

(i) A short time frame — the deadline for bids will be May 24, 2012, a few days before the current Stay Period expiry date of May 28, 2012;

(ii) Primary control of the SISP by the applicants, not the Monitor;

(iii) The submission of a stalking horse credit bid by the DIP Lender; and,

(iv) The solicitation and consideration by the applicants of any Qualified Bids in consultation with the Monitor.

8 According to Mr. Loreto Grimaldi, the Chief Legal Officer of PCAS, the SISP has been developed by the applicants in conjunction with the Monitor. The SISP is intended to maximize stakeholder value through either a going-concern sale of the applicants' business or the attraction of new investment, with a plan of compromise or arrangement.

B. The solicitation and bidding process

9 The SISP will commence with the distribution of a "teaser" letter. Interested parties may sign a confidentiality agreement to secure access to an online data room and updated business plan. The proposed SISP stipulates the technical requirements for any bid to be considered a Qualified Bid. The terms of the SISP permit the applicants to waive compliance with the requirements for a Qualified Bid, but only with the consent of the Monitor.

10 Mr. Grimaldi deposed that given the efforts of the applicants over the past number of months to generate interest in the company by contacting a large number of potential investors, the applicants believe that the short SISP time frame — basically 10 days — is justified and practicable. The reality of the situation is that given the applicants' past marketing efforts, a number of potentially interested bidders will be much further along the due diligence and bid preparation curve than those who enter the process at this stage. Nonetheless, the liquidity problems facing the applicants necessitate this abbreviated SISP process.

C. The DIP Lender's stalking horse credit bid

11 The SISP terms which I approved described the stalking horse credit bid which the DIP Lender will submit as follows:

> 10. The Applicants have agreed with the DIP Lender that the DIP Lender shall submit a stalking horse bid for the purchase of substantially all of the property, assets and undertaking of the Applicants on an "as is, where is" basis (the "Stalking Horse Bid "). The Stalking Horse Bid will allow the DIP Lender to credit bid its debt in exchange for the purchase of the Applicants' Property. The Stalking Horse Bid will provide for a purchase price equal to the amount of outstanding secured liabilities owing by the Applicants to the DIP Lender (being the principal amount of the DIP Loan advances and all interest and all reasonable fees and expenses to the closing) plus the assumption of all senior secured indebtedness of the Applicants (the "Secured Indebtedness "), estimated to be approximately

CDN $7.9 million. The purchase price contained in the Stalking Horse Bid will be satisfied by the release of the liabilities owed to the DIP Lender by the Applicants plus the value of the assumed senior secured indebtedness. The Stalking Horse Bid shall not be permitted to be in an amount in excess of the Secured Indebtedness.

12 In the event that no Qualified Bid is received from another person, under the SISP the Stalking Horse Bid will be treated as the Successful Bid for which the applicants shall seek court approval.

13 Counsel for the applicants and the DIP Lender explained that this Stalking Horse Bid is designed to operate primarily to give an indicative price to other bidders for the company's business and assets. The terms and conditions of the actual Stalking Horse Bid will be available in the applicants' online due diligence room.

D. The treatment of Qualified Bids

14 In the event that the SISP results in the submission of one of more Qualified Bids, the following rules will apply:

> 15. If one or more Qualified Bids other than the Stalking Horse Bid are received in accordance with the Bidding Procedures, the Applicants, in consultation with the Monitor, may choose to:
>
> > (a) accept one Qualified Bid (the "Successful Bid" and the Qualified Bidder making the Successful Bid being the "Successful Bidder ") and take such steps as are necessary to finalize and complete an agreement for the Successful Bid with the selected bidder; or
> >
> > (b) continue negotiations with a selected number of Qualified Bidders (collectively, "Selected Bidders ") with a view to finalizing an agreement with one of the Selected Bidders.
>
> 16. The Applicants shall be under no obligation to accept the highest or best offer and the selection of the Selected Bids and the Successful Bid shall be entirely in the discretion of the Applicants, after consultation with the Monitor.

15 As can be seen, the contemplated SISP contains significant discretion and flexibility, as well as the risk that a successful transaction may not be negotiated prior to the expiry of the Stay Period. However, I accept the submission of counsel for the DIP Lender that the applicants anticipate a diversity of forms of bids and therefore require sufficient flexibility in the process in order to be able to compare "apples to oranges to fish".

16 The SISP provides that the applicants will apply to the court for approval of the Successful Bid.

E. Analysis

17 In *CCM Master Qualified Fund Ltd. v. blutip Power Technologies Ltd.*, 2012 ONSC 1750 (Ont. S.C.J. [Commercial List])), I attempted to summarize the jurisprudence on the approval of sales and investment solicitation processes as follows:

> [6] Although the decision to approve a particular form of sales process is distinct from the approval of a proposed sale, the reasonableness and adequacy of any sales process proposed by a court-appointed receiver must be assessed in light of the factors which a court will take into account when considering the approval of a proposed sale. Those factors were identified by the Court of Appeal in its decision in *Royal Bank v. Soundair*: (i) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; (ii) the efficacy and integrity of the process by which offers are obtained; (iii) whether there has been unfairness in the working out of the process; and, (iv) the interests of all parties. Accordingly, when reviewing a sales and marketing process proposed by a receiver a court should assess:
>
> > (i) the fairness, transparency and integrity of the proposed process;
> >
> > (ii) the commercial efficacy of the proposed process in light of the specific circumstances facing the receiver; and,

(iii) whether the sales process will optimize the chances, in the particular circumstances, of securing the best possible price for the assets up for sale.

[7] The use of stalking horse bids to set a baseline for the bidding process, including credit bid stalking horses, has been recognized by Canadian courts as a reasonable and useful element of a sales process. Stalking horse bids have been approved for use in other receivership proceedings, *BIA* proposals, and *CCAA* proceedings.

[8] Perhaps the most well-known recent example of the use of a stalking horse credit bid was that employed in the Canwest Publishing Corp. *CCAA* proceedings where, as part of a sale and investor solicitation process, Canwest's senior lenders put forward a stalking horse credit bid. Ultimately a superior offer was approved by the court. I accept, as an apt description of the considerations which a court should take into account when deciding whether to approve the use of a stalking horse credit bid, the following observations made by one set of commentators on the Canwest *CCAA* process:

> To be effective for such stakeholders, the credit bid had to be put forward in a process that would allow a sufficient opportunity for interested parties to come forward with a superior offer, recognizing that a timetable for the sale of a business in distress is a fast track ride that requires interested parties to move quickly or miss the opportunity. The court has to balance the need to move quickly, to address the real or perceived deterioration of value of the business during a sale process or the limited availability of restructuring financing, with a realistic timetable that encourages and does not chill the auction process.

18 In the present case two key factors have shaped the proposed SISP: (i) the liquidity problems facing the applicants, and (ii) the extensive efforts taken by the company prior to the *CCAA* process to market and solicit interest in the business of the applicants. I accept, as an accurate statement of the business reality facing the applicants, the following statements made by the Monitor in its Report:

> The proposed expedited SISP considers the urgent need of the Company to effect a transaction which will result in the sale of the Company's Property or an investment in the Company's business. The Company is in the midst of a liquidity crisis and will likely be unable to commercialize the MedCentres if the SISP is unsuccessful.
>
> Under the circumstances, the expedited SISP is likely the most viable process to maximize the value of the Company for the benefit of its stakeholders. In light of this situation, the Monitor supports the Company's request for approval of the proposed expedited SISP to permit interested parties with an opportunity to invest in the Company or make an offer to acquire the Company's assets.

19 Given the extensive efforts to date by management of the applicants to solicit interest in the business and given the liquidity crunch facing the applicants, I was satisfied that the proposed SISP would result, in the specific circumstances of this case, in a fair, transparent and commercially efficacious process which should allow a sufficient opportunity for interested parties to come forward with a superior offer and thereby optimize the chances of securing the best possible price for the assets up for sale or the best possible investment in the continuing operations of the applicants. For those reasons I approved the SISP.

20 Finally, the applicants did request, at the instance of the Monitor, amendments to the powers of the Monitor which I had granted in my May 7, 2012 order. As counsel explained to me during the hearing, the applicants, DIP Lender and Monitor concurred that the applicants, not the Monitor, should take the lead in soliciting Qualified Bids, in large part due to the past efforts by members of the Board to interest various investors in the business. In light of that "game plan", the Monitor concluded that it would not need to exercise some of the expanded marketing powers which I had approved on May 7. That order simply granted the Monitor expanded powers; it did not require the Monitor to exercise them. In the result, the Monitor has elected not to exercise those powers, I accepted the Monitor's explanation for its decision, and therefore saw no need to amend my May 7 order.

V. Summary

21 For those reasons I approved (i) an increase in the DIP Lending Facility to $6 million, (ii) the SISP, and (iii) the Fifth Report of the Monitor and the activities described therein.

Motion granted.

End of Document

TAB 5

2002 SCC 41, 2002 CSC 41
Supreme Court of Canada

Sierra Club of Canada v. Canada (Minister of Finance)

2002 CarswellNat 822, 2002 CarswellNat 823, 2002 SCC 41, 2002 CSC 41, [2002] 2 S.C.R. 522, [2002] S.C.J. No. 42, 113 A.C.W.S. (3d) 36, 18 C.P.R. (4th) 1, 20 C.P.C. (5th) 1, 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 287 N.R. 203, 40 Admin. L.R. (3d) 1, 44 C.E.L.R. (N.S.) 161, 93 C.R.R. (2d) 219, J.E. 2002-803, REJB 2002-30902

Atomic Energy of Canada Limited, Appellant v. Sierra Club of Canada, Respondent and The Minister of Finance of Canada, the Minister of Foreign Affairs of Canada, the Minister of International Trade of Canada and the Attorney General of Canada, Respondents

McLachlin C.J.C., Gonthier, Iacobucci, Bastarache, Binnie, Arbour, LeBel JJ.

Heard: November 6, 2001
Judgment: April 26, 2002
Docket: 28020

Proceedings: reversing (2000), 2000 CarswellNat 970, (sub nom. Atomic Energy of Canada Ltd. v. Sierra Club of Canada) 187 D.L.R. (4th) 231, 256 N.R. 1, 24 Admin. L.R. (3d) 1, [2000] 4 F.C. 426, 182 F.T.R. 284 (note), 2000 CarswellNat 3271, [2000] F.C.J. No. 732 (Fed. C.A.); affirming (1999), 1999 CarswellNat 2187, [2000] 2 F.C. 400, 1999 CarswellNat 3038, 179 F.T.R. 283, [1999] F.C.J. No. 1633 (Fed. T.D.)

Counsel: *J. Brett Ledger* and *Peter Chapin*, for appellant
Timothy J. Howard and *Franklin S. Gertler*, for respondent Sierra Club of Canada
Graham Garton, Q.C., and *J. Sanderson Graham*, for respondents Minister of Finance of Canada, Minister of Foreign Affairs of Canada, Minister of International Trade of Canada, and Attorney General of Canada

Subject: Intellectual Property; Property; Civil Practice and Procedure; Evidence; Environmental

Headnote

Evidence --- Documentary evidence — Privilege as to documents — Miscellaneous documents

Confidentiality order was necessary in this case because disclosure of confidential documents would impose serious risk on important commercial interest of Crown corporation and there were no reasonable alternative measures to granting of order — Confidentiality order would have substantial salutary effects on Crown corporation's right to fair trial and on freedom of expression — Deleterious effects of confidentiality order on open court principle and freedom of expression would be minimal — Salutary effects of order outweighed deleterious effects — Canadian Environmental Assessment Act, S.C. 1992, c. 37, s. 5(1)(b) — Federal Court Rules, 1998, SOR/98-106, R. 151, 312.

Practice --- Discovery — Discovery of documents — Privileged document — Miscellaneous privileges

Confidentiality order was necessary in this case because disclosure of confidential documents would impose serious risk on important commercial interest of Crown corporation and there were no reasonable alternative measures to granting of order — Confidentiality order would have substantial salutary effects on Crown corporation's right to fair trial and on freedom of expression — Deleterious effects of confidentiality order on open court principle and freedom of expression would be minimal — Salutary effects of order outweighed deleterious effects — Canadian Environmental Assessment Act, S.C. 1992, c. 37, s. 5(1)(b) — Federal Court Rules, 1998, SOR/98-106, R. 151, 312.

Practice --- Discovery — Examination for discovery — Range of examination — Privilege — Miscellaneous privileges

Confidentiality order was necessary in this case because disclosure of confidential documents would impose serious risk on important commercial interest of Crown corporation and there were no reasonable alternative measures to granting of order — Confidentiality order would have substantial salutary effects on Crown corporation's right to fair trial and on freedom of expression — Deleterious effects of confidentiality order on open court principle and freedom of expression would be minimal — Salutary effects of order outweighed deleterious effects — Canadian Environmental Assessment Act, S.C. 1992, c. 37, s. 5(1)(b) — Federal Court Rules, 1998, SOR/98-106, R. 151, 312.

Preuve --- Preuve documentaire — Confidentialité en ce qui concerne les documents — Documents divers

Ordonnance de confidentialité était nécessaire parce que la divulgation des documents confidentiels menacerait gravement l'intérêt commercial important de la société d'État et parce qu'il n'y avait aucune autre option raisonnable que celle d'accorder l'ordonnance — Ordonnance de confidentialité aurait des effets bénéfiques considérables sur le droit de la société d'État à un procès équitable et à la liberté d'expression — Ordonnance de confidentialité n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression — Effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables — Loi canadienne sur l'évaluation environnementale, L.C. 1992, c. 37, art. 5(1)b) — Règles de la Cour fédérale, 1998, DORS/98-106, r. 151, 312.

Procédure --- Communication de la preuve — Communication des documents — Documents confidentiels — Divers types de confidentialité

Ordonnance de confidentialité était nécessaire parce que la divulgation des documents confidentiels menacerait gravement l'intérêt commercial important de la société d'État et parce qu'il n'y avait aucune autre option raisonnable que celle d'accorder l'ordonnance — Ordonnance de confidentialité aurait des effets bénéfiques considérables sur le droit de la société d'État à un procès équitable et à la liberté d'expression — Ordonnance de confidentialité n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression — Effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables — Loi canadienne sur l'évaluation environnementale, L.C. 1992, c. 37, art. 5(1)b) — Règles de la Cour fédérale, 1998, DORS/98-106, r. 151, 312.

Procédure --- Communication de la preuve — Interrogatoire préalable — Étendue de l'interrogatoire — Confidentialité — Divers types de confidentialité

Ordonnance de confidentialité était nécessaire parce que la divulgation des documents confidentiels menacerait gravement l'intérêt commercial important de la société d'État et parce qu'il n'y avait aucune autre option raisonnable que celle d'accorder l'ordonnance — Ordonnance de confidentialité aurait des effets bénéfiques considérables sur le droit de la société d'État à un procès équitable et à la liberté d'expression — Ordonnance de confidentialité n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression — Effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables — Loi canadienne sur l'évaluation environnementale, L.C. 1992, c. 37, art. 5(1)b) — Règles de la Cour fédérale, 1998, DORS/98-106, r. 151, 312.

The federal government provided a Crown corporation with a $1.5 billion loan for the construction and sale of two CANDU nuclear reactors to China. An environmental organization sought judicial review of that decision, maintaining that the authorization of financial assistance triggered s. 5(1)(b) of the *Canadian Environmental Assessment Act*. The Crown corporation was an intervenor with the rights of a party in the application for judicial review. The Crown corporation filed an affidavit by a senior manager referring to and summarizing confidential documents. Before cross-examining the senior manager, the environmental organization applied for production of the documents. After receiving authorization from the Chinese authorities to disclose the documents on the condition that they be protected by a confidentiality order, the Crown corporation sought to introduce the documents under R. 312 of the *Federal Court Rules, 1998* and requested a confidentiality order. The confidentiality order would make the documents available only to the parties and the court but would not restrict public access to the proceedings.

The trial judge refused to grant the order and ordered the Crown corporation to file the documents in their current form, or in an edited version if it chose to do so. The Crown corporation appealed under R. 151 of the *Federal Court Rules, 1998* and the environmental organization cross-appealed under R. 312. The majority of the Federal Court of Appeal dismissed the appeal and the cross-appeal. The confidentiality order would have been granted by the dissenting judge. The Crown corporation appealed.

Held: The appeal was allowed.

Publication bans and confidentiality orders, in the context of judicial proceedings, are similar. The analytical approach to the exercise of discretion under R. 151 should echo the underlying principles set out in *Dagenais v. Canadian Broadcasting Corp.*, [1994] 3 S.C.R. 835 (S.C.C.). A confidentiality order under R. 151 should be granted in only two circumstances, when an order is needed to prevent serious risk to an important interest, including a commercial interest, in the context of litigation because reasonable alternative measures will not prevent the risk, and when the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh its deleterious effects, including the effects on the right to free expression, which includes public interest in open and accessible court proceedings.

The alternatives to the confidentiality order suggested by the Trial Division and Court of Appeal were problematic. Expunging the documents would be a virtually unworkable and ineffective solution. Providing summaries was not a reasonable alternative measure to having the underlying documents available to the parties. The confidentiality order was necessary in that disclosure of the documents would impose a serious risk on an important commercial interest of the Crown corporation, and there were no reasonable alternative measures to granting the order.

The confidentiality order would have substantial salutary effects on the Crown corporation's right to a fair trial and on freedom of expression. The deleterious effects of the confidentiality order on the open court principle and freedom of expression would be minimal. If the order was not granted and in the course of the judicial review application the Crown corporation was not required to mount a defence under the *Canadian Environmental Assessment Act*, it was possible that the Crown corporation would suffer the harm of having disclosed confidential information in breach of its obligations with no corresponding benefit to the right of the public to freedom of expression. The salutary effects of the order outweighed the deleterious effects.

Le gouvernement fédéral a fait un prêt de l'ordre de 1,5 milliards de dollar en rapport avec la construction et la vente par une société d'État de deux réacteurs nucléaires CANDU à la Chine. Un organisme environnemental a sollicité le contrôle judiciaire de cette décision, soutenant que cette autorisation d'aide financière avait déclenché l'application de l'art. 5(1)b) de la *Loi canadienne sur l'évaluation environnementale*. La société d'État était intervenante au débat et elle avait reçu les droits de partie dans la demande de contrôle judiciaire. Elle a déposé l'affidavit d'un cadre supérieur dans lequel ce dernier faisait référence à certains documents confidentiels et en faisait le résumé. L'organisme environnemental a demandé la production des documents avant de procéder au contre-interrogatoire du cadre supérieur. Après avoir obtenu l'autorisation des autorités chinoises de communiquer les documents à la condition qu'ils soient protégés par une ordonnance de confidentialité, la société d'État a cherché à les introduire en invoquant la r. 312 des *Règles de la Cour fédérale, 1998*, et elle a aussi demandé une ordonnance de confidentialité. Selon les termes de l'ordonnance de confidentialité, les documents seraient uniquement mis à la disposition des parties et du tribunal, mais l'accès du public aux débats ne serait pas interdit.

Le juge de première instance a refusé l'ordonnance de confidentialité et a ordonné à la société d'État de déposer les documents sous leur forme actuelle ou sous une forme révisée, à son gré. La société d'État a interjeté appel en vertu de la r. 151 des *Règles de la Cour fédérale, 1998*, et l'organisme environnemental a formé un appel incident en vertu de la r. 312. Les juges majoritaires de la Cour d'appel ont rejeté le pourvoi et le pourvoi incident. Le juge dissident aurait accordé l'ordonnance de confidentialité. La société d'État a interjeté appel.

Arrêt: Le pourvoi a été accueilli.

Il y a de grandes ressemblances entre l'ordonnance de non-publication et l'ordonnance de confidentialité dans le contexte des procédures judiciaires. L'analyse de l'exercice du pouvoir discrétionnaire sous le régime de la r. 151 devrait refléter les principes sous-jacents énoncés dans l'arrêt *Dagenais c. Société Radio-Canada*, [1994] 3 R.C.S. 835. Une ordonnance de confidentialité rendue en vertu de la r. 151 ne devrait l'être que lorsque: 1) une telle ordonnance est nécessaire pour écarter un risque sérieux pour un intérêt important, y compris un intérêt commercial, dans le cadre d'un litige, en l'absence d'autres solutions raisonnables pour écarter ce risque; et 2) les effets bénéfiques de l'ordonnance de confidentialité, y compris les effets sur les droits des justiciables civils à un procès équitable, l'emportent sur ses effets préjudiciables, y compris les effets sur le droit à la liberté d'expression, lequel droit comprend l'intérêt du public à l'accès aux débats judiciaires.

Les solutions proposées par la Division de première instance et par la Cour d'appel comportaient toutes deux des problèmes. Épurer les documents serait virtuellement impraticable et inefficace. Fournir des résumés des documents ne constituait pas une « autre option raisonnable » à la communication aux parties des documents de base. L'ordonnance de confidentialité était nécessaire parce que la communication des documents menacerait gravement un intérêt commercial important de la société d'État et parce qu'il n'existait aucune autre option raisonnable que celle d'accorder l'ordonnance.

L'ordonnance de confidentialité aurait d'importants effets bénéfiques sur le droit de la société d'État à un procès équitable et à la liberté d'expression. Elle n'aurait que des effets préjudiciables minimes sur le principe de la publicité des débats et sur la liberté d'expression. Advenant que l'ordonnance ne soit pas accordée et que, dans le cadre de la demande de contrôle judiciaire, la société d'État n'ait pas l'obligation de présenter une défense en vertu de la *Loi canadienne sur l'évaluation environnementale*, il se pouvait que la société d'État subisse un préjudice du fait d'avoir communiqué cette information confidentielle en violation de ses obligations, sans avoir pu profiter d'un avantage similaire à celui du droit du public à la liberté d'expression. Les effets bénéfiques de l'ordonnance l'emportaient sur ses effets préjudiciables.

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s. 5(1)(b) — referred to

s. 8 — referred to

s. 54 — referred to

s. 54(2)(b) — referred to

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s. 486(1) — referred to

Rules considered:

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R. 151 — considered

R. 312 — referred to

APPEAL from judgment reported at 2000 CarswellNat 970, 2000 CarswellNat 3271, [2000] F.C.J. No. 732, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 187 D.L.R. (4th) 231, 256 N.R. 1, 24 Admin. L.R. (3d) 1, [2000] 4 F.C. 426, 182 F.T.R. 284 (note) (Fed. C.A.), dismissing appeal from judgment reported at 1999 CarswellNat 2187, [2000] 2 F.C. 400, 1999 CarswellNat 3038, 179 F.T.R. 283 (Fed. T.D.), granting application in part.

POURVOI à l'encontre de l'arrêt publié à 2000 CarswellNat 970, 2000 CarswellNat 3271, [2000] F.C.J. No. 732, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada*) 187 D.L.R. (4th) 231, 256 N.R. 1, 24 Admin. L.R. (3d) 1, [2000] 4 F.C. 426, 182 F.T.R. 284 (note) (C.A. Féd.), qui a rejeté le pourvoi à l'encontre du jugement publié à 1999 CarswellNat 2187, [2000] 2 F.C. 400, 1999 CarswellNat 3038, 179 F.T.R. 283 (C.F. (1 re inst.)), qui avait accueilli en partie la demande.

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

I. Introduction

1 In our country, courts are the institutions generally chosen to resolve legal disputes as best they can through the application of legal principles to the facts of the case involved. One of the underlying principles of the judicial process is public openness, both in the proceedings of the dispute, and in the material that is relevant to its resolution. However, some material can be made the subject of a confidentiality order. This appeal raises the important issues of when, and under what circumstances, a confidentiality order should be granted.

2 For the following reasons, I would issue the confidentiality order sought and, accordingly, would allow the appeal.

II. Facts

3 The appellant, Atomic Energy of Canada Ltd. ("AECL"), is a Crown corporation that owns and markets CANDU nuclear technology, and is an intervener with the rights of a party in the application for judicial review by the respondent, the Sierra Club of Canada ("Sierra Club"). Sierra Club is an environmental organization seeking judicial review of the federal government's decision to provide financial assistance in the form of a $1.5 billion guaranteed loan relating to the construction and sale of two CANDU nuclear reactors to China by the appellant. The reactors are currently under construction in China, where the appellant is the main contractor and project manager.

4 The respondent maintains that the authorization of financial assistance by the government triggered s. 5(1)(b) of the *Canadian Environmental Assessment Act*, S.C. 1992, c. 37 ("CEAA"), which requires that an environmental assessment be undertaken before a federal authority grants financial assistance to a project. Failure to undertake such an assessment compels cancellation of the financial arrangements.

5 The appellant and the respondent Ministers argue that the CEAA does not apply to the loan transaction, and that if it does, the statutory defences available under ss. 8 and 54 apply. Section 8 describes the circumstances where Crown corporations are required to conduct environmental assessments. Section 54(2)(b) recognizes the validity of an environmental assessment carried out by a foreign authority provided that it is consistent with the provisions of the CEAA.

6 In the course of the application by Sierra Club to set aside the funding arrangements, the appellant filed an affidavit of Dr. Simon Pang, a senior manager of the appellant. In the affidavit, Dr. Pang referred to and summarized certain documents (the "Confidential Documents"). The Confidential Documents are also referred to in an affidavit prepared by Dr. Feng, one of AECL's experts. Prior to cross-examining Dr. Pang on his affidavit, Sierra Club made an application for the production of the Confidential Documents, arguing that it could not test Dr. Pang's evidence without access to the underlying documents. The appellant resisted production on various grounds, including the fact that the documents were the property of the Chinese authorities and that it did not have authority to disclose them. After receiving authorization by the Chinese authorities to disclose the documents on the condition that they be protected by a confidentiality order, the appellant sought to introduce the Confidential Documents under R. 312 of the *Federal Court Rules, 1998*, SOR/98-106, and requested a confidentiality order in respect of the documents.

7 Under the terms of the order requested, the Confidential Documents would only be made available to the parties and the court; however, there would be no restriction on public access to the proceedings. In essence, what is being sought is an order preventing the dissemination of the Confidential Documents to the public.

8 The Confidential Documents comprise two Environmental Impact Reports on Siting and Construction Design (the "EIRs"), a Preliminary Safety Analysis Report (the "PSAR"), and the supplementary affidavit of Dr. Pang, which summarizes the contents of the EIRs and the PSAR. If admitted, the EIRs and the PSAR would be attached as exhibits to the supplementary affidavit of Dr. Pang. The EIRs were prepared by the Chinese authorities in the Chinese language, and the PSAR was prepared by the appellant with assistance from the Chinese participants in the project. The documents contain a mass of technical information and comprise thousands of pages. They describe the ongoing environmental assessment of the construction site by the Chinese authorities under Chinese law.

9 As noted, the appellant argues that it cannot introduce the Confidential Documents into evidence without a confidentiality order; otherwise, it would be in breach of its obligations to the Chinese authorities. The respondent's position is that its right to cross-examine Dr. Pang and Dr. Feng on their affidavits would be effectively rendered nugatory in the absence of the supporting documents to which the affidavits referred. Sierra Club proposes to take the position that the affidavits should therefore be afforded very little weight by the judge hearing the application for judicial review.

10 The Federal Court of Canada, Trial Division, refused to grant the confidentiality order and the majority of the Federal Court of Appeal dismissed the appeal. In his dissenting opinion, Robertson J.A. would have granted the confidentiality order.

III. Relevant Statutory Provisions

11 *Federal Court Rules, 1998*, SOR/98-106

151.(1) On motion, the Court may order that material to be filed shall be treated as confidential.

(2) Before making an order under subsection (1), the Court must be satisfied that the material should be treated as confidential, notwithstanding the public interest in open and accessible court proceedings.

IV. Judgments below

A. Federal Court of Canada, Trial Division, [2000] 2 F.C. 400

12 Pelletier J. first considered whether leave should be granted pursuant to R. 312 to introduce the supplementary affidavit of Dr. Pang to which the Confidential Documents were filed as exhibits. In his view, the underlying question was that of relevance, and he concluded that the documents were relevant to the issue of the appropriate remedy. Thus, in the absence of prejudice to the respondent, the affidavit should be permitted to be served and filed. He noted that the respondents would be prejudiced by delay, but since both parties had brought interlocutory motions which had contributed to the delay, the desirability of having the entire record before the court outweighed the prejudice arising from the delay associated with the introduction of the documents.

13 On the issue of confidentiality, Pelletier J. concluded that he must be satisfied that the need for confidentiality was greater than the public interest in open court proceedings, and observed that the argument for open proceedings in this case was significant given the public interest in Canada's role as a vendor of nuclear technology. As well, he noted that a confidentiality order was an exception to the rule of open access to the courts, and that such an order should be granted only where absolutely necessary.

14 Pelletier J. applied the same test as that used in patent litigation for the issue of a protective order, which is essentially a confidentiality order. The granting of such an order requires the appellant to show a subjective belief that the information is confidential and that its interests would be harmed by disclosure. In addition, if the order is challenged, then the person claiming the benefit of the order must demonstrate objectively that the order is required. This objective element requires the party to show that the information has been treated as confidential, and that it is reasonable to believe that its proprietary, commercial and scientific interests could be harmed by the disclosure of the information.

15 Concluding that both the subjective part and both elements of the objective part of the test had been satisfied, he nevertheless stated: "However, I am also of the view that in public law cases, the objective test has, or should have, a third component which is whether the public interest in disclosure exceeds the risk of harm to a party arising from disclosure" (para. 23).

16 A very significant factor, in his view, was the fact that mandatory production of documents was not in issue here. The fact that the application involved a voluntary tendering of documents to advance the appellant's own cause as opposed to mandatory production weighed against granting the confidentiality order.

17 In weighing the public interest in disclosure against the risk of harm to AECL arising from disclosure, Pelletier J. noted that the documents the appellant wished to put before the court were prepared by others for other purposes, and recognized that the appellant was bound to protect the confidentiality of the information. At this stage, he again considered the issue of materiality. If the documents were shown to be very material to a critical issue, "the requirements of justice militate in favour of a confidentiality order. If the documents are marginally relevant, then the voluntary nature of the production argues against a confidentiality order" (para. 29). He then decided that the documents were material to a question of the appropriate remedy, a significant issue in the event that the appellant failed on the main issue.

18 Pelletier J. also considered the context of the case and held that since the issue of Canada's role as a vendor of nuclear technology was one of significant public interest, the burden of justifying a confidentiality order was very onerous. He found that AECL could expunge the sensitive material from the documents, or put the evidence before the court in some other form, and thus maintain its full right of defence while preserving the open access to court proceedings.

19 Pelletier J. observed that his order was being made without having perused the Confidential Documents because they had not been put before him. Although he noted the line of cases which holds that a judge ought not to deal with the issue of a confidentiality order without reviewing the documents themselves, in his view, given their voluminous nature and technical content as well as his lack of information as to what information was already in the public domain, he found that an examination of these documents would not have been useful.

20 Pelletier J. ordered that the appellant could file the documents in current form, or in an edited version if it chose to do so. He also granted leave to file material dealing with the Chinese regulatory process in general and as applied to this project, provided it did so within 60 days.

B. Federal Court of Appeal, [2000] 4 F.C. 426

(1) Evans J.A. (Sharlow J.A. concurring)

21 At the Federal Court of Appeal, AECL appealed the ruling under R. 151 of the *Federal Court Rules, 1998*, and Sierra Club cross-appealed the ruling under R. 312.

22 With respect to R. 312, Evans J.A. held that the documents were clearly relevant to a defence under s. 54(2)(b), which the appellant proposed to raise if s. 5(1)(b) of the CEAA was held to apply, and were also potentially relevant to the exercise of the court's discretion to refuse a remedy even if the Ministers were in breach of the CEAA. Evans J.A. agreed with Pelletier J. that the benefit to the appellant and the court of being granted leave to file the documents outweighed any prejudice to the respondent owing to delay and thus concluded that the motions judge was correct in granting leave under R. 312.

23 On the issue of the confidentiality order, Evans J.A. considered R. 151, and all the factors that the motions judge had weighed, including the commercial sensitivity of the documents, the fact that the appellant had received them in confidence from the Chinese authorities, and the appellant's argument that without the documents it could not mount a full answer and defence to the application. These factors had to be weighed against the principle of open access to court documents. Evans J.A. agreed with Pelletier J. that the weight to be attached to the public interest in open proceedings varied with context and held that, where a case raises issues of public significance, the principle of openness of judicial process carries greater weight as a factor in the balancing process. Evans J.A. noted the public interest in the subject matter of the litigation, as well as the considerable media attention it had attracted.

24 In support of his conclusion that the weight assigned to the principle of openness may vary with context, Evans J.A. relied upon the decisions in *AB Hassle v. Canada (Minister of National Health & Welfare)*, [2000] 3 F.C. 360 (Fed. C.A.), where the court took into consideration the relatively small public interest at stake, and *Ethyl Canada Inc. v. Canada (Attorney General)* (1998), 17 C.P.C. (4th) 278 (Ont. Gen. Div.), at p. 283, where the court ordered disclosure after determining that the case was a significant constitutional case where it was important for the public to understand the issues at stake. Evans J.A. observed that openness and public participation in the assessment process are fundamental to the CEAA, and concluded that the motions judge could not be said to have given the principle of openness undue weight even though confidentiality was claimed for a relatively small number of highly technical documents.

25 Evans J.A. held that the motions judge had placed undue emphasis on the fact that the introduction of the documents was voluntary; however, it did not follow that his decision on the confidentiality order must therefore be set aside. Evans J.A. was of the view that this error did not affect the ultimate conclusion for three reasons. First, like the motions judge, he attached great weight to the principle of openness. Secondly, he held that the inclusion in the affidavits of a summary of the reports could go a long way to compensate for the absence of the originals, should the appellant choose not to put them in without a confidentiality order. Finally, if AECL submitted the documents in an expunged fashion, the claim for confidentiality would rest upon a relatively unimportant factor, i.e., the appellant's claim that it would suffer a loss of business if it breached its undertaking with the Chinese authorities.

26 Evans J.A. rejected the argument that the motions judge had erred in deciding the motion without reference to the actual documents, stating that it was not necessary for him to inspect them, given that summaries were available and that the documents were highly technical and incompletely translated. Thus, the appeal and cross-appeal were both dismissed.

(2) Robertson J.A. (dissenting)

27 Robertson J.A. disagreed with the majority for three reasons. First, in his view, the level of public interest in the case, the degree of media coverage, and the identities of the parties should not be taken into consideration in assessing an application for a confidentiality order. Instead, he held that it was the nature of the evidence for which the order is sought that must be examined.

28 In addition, he found that without a confidentiality order, the appellant had to choose between two unacceptable options: either suffering irreparable financial harm if the confidential information was introduced into evidence or being denied the right to a fair trial because it could not mount a full defence if the evidence was not introduced.

29 Finally, he stated that the analytical framework employed by the majority in reaching its decision was fundamentally flawed as it was based largely on the subjective views of the motions judge. He rejected the contextual approach to the question of whether a confidentiality order should issue, emphasizing the need for an objective framework to combat the perception that justice is a relative concept, and to promote consistency and certainty in the law.

30 To establish this more objective framework for regulating the issuance of confidentiality orders pertaining to commercial and scientific information, he turned to the legal rationale underlying the commitment to the principle of open justice, referring to *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326 (S.C.C.). There, the Supreme Court of Canada held that open proceedings foster the search for the truth, and reflect the importance of public scrutiny of the courts.

31 Robertson J.A. stated that, although the principle of open justice is a reflection of the basic democratic value of accountability in the exercise of judicial power, in his view, the principle that justice itself must be secured is paramount. He concluded that justice as an overarching principle means that exceptions occasionally must be made to rules or principles.

32 He observed that, in the area of commercial law, when the information sought to be protected concerns "trade secrets," this information will not be disclosed during a trial if to do so would destroy the owner's proprietary rights and expose him or her to irreparable harm in the form of financial loss. Although the case before him did not involve a trade secret, he nevertheless held that the same treatment could be extended to commercial or scientific information which was acquired on a confidential basis and attached the following criteria as conditions precedent to the issuance of a confidentiality order (at para. 13):

> (1) the information is of a confidential nature as opposed to facts which one would like to keep confidential; (2) the information for which confidentiality is sought is not already in the public domain; (3) on a balance of probabilities the party seeking the confidentiality order would suffer irreparable harm if the information were made public; (4) the information is relevant to the legal issues raised in the case; (5) correlatively, the information is "necessary" to the resolution of those issues; (6) the granting of a confidentiality order does not unduly prejudice the opposing party; and (7) the public interest in open court proceedings does not override the private interests of the party seeking the confidentiality order. The onus in establishing that criteria one to six are met is on the party seeking the confidentiality order. Under the seventh criterion, it is for the opposing party to show that a *prima facie* right to a protective order has been overtaken by the need to preserve the openness of the court proceedings. In addressing these criteria one must bear in mind two of the threads woven into the fabric of the principle of open justice: the search for truth and the preservation of the rule of law. As stated at the outset, I do not believe that the perceived degree of public importance of a case is a relevant consideration.

33 In applying these criteria to the circumstances of the case, Robertson J.A. concluded that the confidentiality order should be granted. In his view, the public interest in open court proceedings did not override the interests of AECL in maintaining the confidentiality of these highly technical documents.

34 Robertson J.A. also considered the public interest in the need to ensure that site-plans for nuclear installations were not, for example, posted on a web-site. He concluded that a confidentiality order would not undermine the two primary objectives underlying the principle of open justice: truth and the rule of law. As such, he would have allowed the appeal and dismissed the cross-appeal.

V. Issues

35

> A. What is the proper analytical approach to be applied to the exercise of judicial discretion where a litigant seeks a confidentiality order under R. 151 of the *Federal Court Rules, 1998*?
>
> B. Should the confidentiality order be granted in this case?

VI. Analysis

A. The Analytical Approach to the Granting of a Confidentiality Order

(1) The General Framework: Herein the Dagenais Principles

36 The link between openness in judicial proceedings and freedom of expression has been firmly established by this Court. In *Canadian Broadcasting Corp. v. New Brunswick (Attorney General)*, [1996] 3 S.C.R. 480 (S.C.C.) [hereinafter *New Brunswick*], at para. 23, La Forest J. expressed the relationship as follows:

> The principle of open courts is inextricably tied to the rights guaranteed by s. 2(b). Openness permits public access to information about the courts, which in turn permits the public to discuss and put forward opinions and criticisms of court practices and proceedings. While the freedom to express ideas and opinions about the operation of the courts is clearly within the ambit of the freedom guaranteed by s. 2(b), so too is the right of members of the public to obtain information about the courts in the first place.

Under the order sought, public access and public scrutiny of the Confidential Documents would be restricted; this would clearly infringe the public's freedom of expression guarantee.

37 A discussion of the general approach to be taken in the exercise of judicial discretion to grant a confidentiality order should begin with the principles set out by this Court in *Dagenais v. Canadian Broadcasting Corp.*, [1994] 3 S.C.R. 835 (S.C.C.). Although that case dealt with the common law jurisdiction of the court to order a publication ban in the criminal law context, there are strong similarities between publication bans and confidentiality orders in the context of judicial proceedings. In both cases a restriction on freedom of expression is sought in order to preserve or promote an interest engaged by those proceedings. As such, the fundamental question for a court to consider in an application for a publication ban or a confidentiality order is whether, in the circumstances, the right to freedom of expression should be compromised.

38 Although in each case freedom of expression will be engaged in a different context, the *Dagenais* framework utilizes overarching *Canadian Charter of Rights and Freedoms* principles in order to balance freedom of expression with other rights and interests, and thus can be adapted and applied to various circumstances. As a result, the analytical approach to the exercise of discretion under R. 151 should echo the underlying principles laid out in *Dagenais*, *supra*, although it must be tailored to the specific rights and interests engaged in this case.

39 *Dagenais*, *supra*, dealt with an application by four accused persons under the court's common law jurisdiction requesting an order prohibiting the broadcast of a television programme dealing with the physical and sexual abuse of young boys at religious institutions. The applicants argued that because the factual circumstances of the programme were very similar to the facts at issue in their trials, the ban was necessary to preserve the accuseds' right to a fair trial.

40 Lamer C.J. found that the common law discretion to order a publication ban must be exercised within the boundaries set by the principles of the *Charter*. Since publication bans necessarily curtail the freedom of expression of third parties, he adapted the pre-*Charter* common law rule such that it balanced the right to freedom of expression with the right to a fair trial of the accused in a way which reflected the substance of the test from *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.). At p. 878 of *Dagenais*, Lamer C.J. set out his reformulated test:

> A publication ban should only be ordered when:
>
> > (a) Such a ban is *necessary* in order to prevent a real and substantial risk to the fairness of the trial, because reasonably available alternative measures will not prevent the risk; and
> >
> > (b) The salutary effects of the publication ban outweigh the deleterious effects to the free expression of those affected by the ban. [Emphasis in original.]

41 In *New Brunswick*, *supra*, this Court modified the *Dagenais* test in the context of the related issue of how the discretionary power under s. 486(1) of the *Criminal Code* to exclude the public from a trial should be exercised. That case dealt with an appeal from the trial judge's order excluding the public from the portion of a sentencing proceeding for sexual assault and sexual interference dealing with the specific acts committed by the accused on the basis that it would avoid "undue hardship" to both the victims and the accused.

42 La Forest J. found that s. 486(1) was a restriction on the s. 2(b) right to freedom of expression in that it provided a "discretionary bar on public and media access to the courts": *New Brunswick*, *supra*, at para. 33; however, he found this infringement to be justified under s. 1 provided that the discretion was exercised in accordance with the *Charter*. Thus, the approach taken by La Forest J. at para. 69 to the exercise of discretion under s. 486(1) of the *Criminal Code*, closely mirrors the *Dagenais* common law test:

> (a) the judge must consider the available options and consider whether there are any other reasonable and effective alternatives available;
>
> (b) the judge must consider whether the order is limited as much as possible; and
>
> (c) the judge must weigh the importance of the objectives of the particular order and its probable effects against the importance of openness and the particular expression that will be limited in order to ensure that the positive and negative effects of the order are proportionate.

In applying this test to the facts of the case, La Forest J. found that the evidence of the potential undue hardship consisted mainly in the Crown's submission that the evidence was of a "delicate nature" and that this was insufficient to override the infringement on freedom of expression.

43 This Court has recently revisited the granting of a publication ban under the court's common law jurisdiction in *R. v. Mentuck*, 2001 SCC 76 (S.C.C.), and its companion case *R. v. E. (O.N.)*, 2001 SCC 77 (S.C.C.). In *Mentuck*, the Crown moved for a publication ban to protect the identity of undercover police officers and operational methods employed by the officers in their investigation of the accused. The accused opposed the motion as an infringement of his right to a fair and public hearing under s. 11(d) of the *Charter*. The order was also opposed by two intervening newspapers as an infringement of their right to freedom of expression.

44 The Court noted that, while *Dagenais* dealt with the balancing of freedom of expression on the one hand, and the right to a fair trial of the accused on the other, in the case before it, both the right of the accused to a fair and public hearing, and freedom of expression weighed in favour of denying the publication ban. These rights were balanced against interests relating to the proper administration of justice, in particular, protecting the safety of police officers and preserving the efficacy of undercover police operations.

45 In spite of this distinction, the Court noted that underlying the approach taken in both *Dagenais* and *New Brunswick* was the goal of ensuring that the judicial discretion to order publication bans is subject to no lower a standard of compliance with the *Charter* than legislative enactment. This goal is furthered by incorporating the essence of s. 1 of the *Charter* and the *Oakes* test into the publication ban test. Since this same goal applied in the case before it, the Court adopted a similar approach to that taken in *Dagenais*, but broadened the *Dagenais* test (which dealt specifically with the right of an accused to a fair trial) such that it could guide the exercise of judicial discretion where a publication ban is requested in order to preserve *any* important aspect of the proper administration of justice. At para. 32, the Court reformulated the test as follows:

> A publication ban should only be ordered when:
>
> > (a) such an order is necessary in order to prevent a serious risk to the proper administration of justice because reasonably alternative measures will not prevent the risk; and
> >
> > (b) the salutary effects of the publication ban outweigh the deleterious effects on the rights and interests of the parties and the public, including the effects on the right to free expression, the right of the accused to a fair and public trial, and the efficacy of the administration of justice.

46 The Court emphasized that under the first branch of the test, three important elements were subsumed under the "necessity" branch. First, the risk in question must be a serious risk well-grounded in the evidence. Second, the phrase "proper administration of justice" must be carefully interpreted so as not to allow the concealment of an excessive amount of information. Third, the test requires the judge ordering the ban to consider not only whether reasonable alternatives are available, but also to restrict the ban as far as possible without sacrificing the prevention of the risk.

47 At para. 31, the Court also made the important observation that the proper administration of justice will not necessarily involve *Charter* rights, and that the ability to invoke the *Charter* is not a necessary condition for a publication ban to be granted:

> The [common law publication ban] rule can accommodate orders that must occasionally be made in the interests of the administration of justice, which encompass more than fair trial rights. As the test is intended to "reflect . . . the substance of the *Oakes* test", *we cannot require that Charter rights be the only legitimate objective of such orders any more than we require that government action or legislation in violation of the Charter be justified exclusively by the pursuit of another Charter right.* [Emphasis added.]

The Court also anticipated that, in appropriate circumstances, the *Dagenais* framework could be expanded even further in order to address requests for publication bans where interests other than the administration of justice were involved.

48 *Mentuck* is illustrative of the flexibility of the *Dagenais* approach. Since its basic purpose is to ensure that the judicial discretion to deny public access to the courts is exercised in accordance with *Charter* principles, in my view, the *Dagenais* model can and should be adapted to the situation in the case at bar where the central issue is whether judicial discretion should be exercised so as to exclude confidential information from a public proceeding. As in *Dagenais, New Brunswick* and *Mentuck*, granting the confidentiality order will have a negative effect on the *Charter* right to freedom of expression, as well as the principle of open and accessible court proceedings, and, as in those cases, courts must ensure that the discretion to grant the order is exercised in accordance with *Charter* principles. However, in order to adapt the test to the context of this case, it is first necessary to determine the particular rights and interests engaged by this application.

(2) The Rights and Interests of the Parties

49 The immediate purpose for AECL's confidentiality request relates to its commercial interests. The information in question is the property of the Chinese authorities. If the appellant were to disclose the Confidential Documents, it would be in breach of its contractual obligations and suffer a risk of harm to its competitive position. This is clear from the findings of fact of the motions judge that AECL was bound by its commercial interests and its customer's property rights not to disclose the information (para. 27), and that such disclosure could harm the appellant's commercial interests (para. 23).

50 Aside from this direct commercial interest, if the confidentiality order is denied, then in order to protect its commercial interests, the appellant will have to withhold the documents. This raises the important matter of the litigation context in which the order is sought. As both the motions judge and the Federal Court of Appeal found that the information contained in the Confidential Documents was relevant to defences available under the CEAA, the inability to present this information hinders the appellant's capacity to make full answer and defence or, expressed more generally, the appellant's right, as a civil litigant, to present its case. In that sense, preventing the appellant from disclosing these documents on a confidential basis infringes its right to a fair trial. Although in the context of a civil proceeding this does not engage a *Charter* right, the right to a fair trial generally can be viewed as a fundamental principle of justice: *M. (A.) v. Ryan*, [1997] 1 S.C.R. 157 (S.C.C.), at para. 84, *per* L'Heureux-Dubé J. (dissenting, but not on that point). Although this fair trial right is directly relevant to the appellant, there is also a general public interest in protecting the right to a fair trial. Indeed, as a general proposition, all disputes in the courts should be decided under a fair trial standard. The legitimacy of the judicial process alone demands as much. Similarly, courts have an interest in having all relevant evidence before them in order to ensure that justice is done.

51 Thus, the interests which would be promoted by a confidentiality order are the preservation of commercial and contractual relations, as well as the right of civil litigants to a fair trial. Related to the latter are the public and judicial interests in seeking the truth and achieving a just result in civil proceedings.

52 In opposition to the confidentiality order lies the fundamental principle of open and accessible court proceedings. This principle is inextricably tied to freedom of expression enshrined in s. 2(b) of the *Charter*: *New Brunswick*, *supra*, at para. 23. The importance of public and media access to the courts cannot be understated, as this access is the method by which the judicial process is scrutinized and criticized. Because it is essential to the administration of justice that justice is done and is *seen* to be done, such public scrutiny is fundamental. The open court principle has been described as "the very soul of justice," guaranteeing that justice is administered in a non-arbitrary manner: *New Brunswick*, *supra*, at para. 22.

(3) Adapting the Dagenais Test to the Rights and Interests of the Parties

53 Applying the rights and interests engaged in this case to the analytical framework of *Dagenais* and subsequent cases discussed above, the test for whether a confidentiality order ought to be granted in a case such as this one should be framed as follows:

> A confidentiality order under R. 151 should only be granted when:
>
> (a) such an order is necessary in order to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonably alternative measures will not prevent the risk; and
>
> (b) the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh its deleterious effects, including the effects on the right to free expression, which in this context includes the public interest in open and accessible court proceedings.

54 As in *Mentuck*, *supra*, I would add that three important elements are subsumed under the first branch of this test. First, the risk in question must be real and substantial, in that the risk is well-grounded in the evidence and poses a serious threat to the commercial interest in question.

55 In addition, the phrase "important commercial interest" is in need of some clarification. In order to qualify as an "important commercial interest," the interest in question cannot merely be specific to the party requesting the order; the interest must be one which can be expressed in terms of a public interest in confidentiality. For example, a private company could not argue simply that the existence of a particular contract should not be made public because to do so would cause the company to lose business, thus harming its commercial interests. However, if, as in this case, exposure of information would cause a breach of a confidentiality agreement, then the commercial interest affected can be characterized more broadly as the general commercial interest of preserving confidential information. Simply put, if there is no general principle at stake, there can be no "important commercial interest" for the purposes of this test. Or, in the words of Binnie J. in *Re N. (F.)*, [2000] 1 S.C.R. 880, 2000 SCC 35 (S.C.C.), at para. 10, the open court rule only yields" where the *public* interest in confidentiality outweighs the public interest in openness" (emphasis added).

56 In addition to the above requirement, courts must be cautious in determining what constitutes an "important commercial interest." It must be remembered that a confidentiality order involves an infringement on freedom of expression. Although the balancing of the commercial interest with freedom of expression takes place under the second branch of the test, courts must be alive to the fundamental importance of the open court rule. See generally Muldoon J. in *Eli Lilly & Co. v. Novopharm Ltd.* (1994), 56 C.P.R. (3d) 437 (Fed. T.D.), at p. 439.

57 Finally, the phrase "reasonably alternative measures" requires the judge to consider not only whether reasonable alternatives to a confidentiality order are available, but also to restrict the order as much as is reasonably possible while preserving the commercial interest in question.

B. Application of the Test to this Appeal

(1) Necessity

58 At this stage, it must be determined whether disclosure of the Confidential Documents would impose a serious risk on an important commercial interest of the appellant, and whether there are reasonable alternatives, either to the order itself or to its terms.

59 The commercial interest at stake here relates to the objective of preserving contractual obligations of confidentiality. The appellant argues that it will suffer irreparable harm to its commercial interests if the confidential documents are disclosed. In my view, the preservation of confidential information constitutes a sufficiently important commercial interest to pass the first branch of the test as long as certain criteria relating to the information are met.

60 Pelletier J. noted that the order sought in this case was similar in nature to an application for a protective order which arises in the context of patent litigation. Such an order requires the applicant to demonstrate that the information in question has been treated at all relevant times as confidential and that on a balance of probabilities its proprietary, commercial and scientific interests could reasonably be harmed by the disclosure of the information: *AB Hassle v. Canada (Minister of National Health & Welfare)* (1998), 83 C.P.R. (3d) 428 (Fed. T.D.), at p. 434. To this I would add the requirement proposed by Robertson J.A. that the information in question must be of a "confidential nature" in that it has been" accumulated with a reasonable expectation of it being kept confidential" (para. 14) as opposed to "facts which a litigant would like to keep confidential by having the courtroom doors closed" (para. 14).

61 Pelletier J. found as a fact that the *AB Hassle* test had been satisfied in that the information had clearly been treated as confidential both by the appellant and by the Chinese authorities, and that, on a balance of probabilities, disclosure of the information could harm the appellant's commercial interests (para. 23). As well, Robertson J.A. found that the information in question was clearly of a confidential nature as it was commercial information, consistently treated and

regarded as confidential, that would be of interest to AECL's competitors (para. 16). Thus, the order is sought to prevent a serious risk to an important commercial interest.

62 The first branch of the test also requires the consideration of alternative measures to the confidentiality order, as well as an examination of the scope of the order to ensure that it is not overly broad. Both courts below found that the information contained in the Confidential Documents was relevant to potential defences available to the appellant under the CEAA and this finding was not appealed at this Court. Further, I agree with the Court of Appeal's assertion (para. 99) that, given the importance of the documents to the right to make full answer and defence, the appellant is, practically speaking, compelled to produce the documents. Given that the information is necessary to the appellant's case, it remains only to determine whether there are reasonably alternative means by which the necessary information can be adduced without disclosing the confidential information.

63 Two alternatives to the confidentiality order were put forward by the courts below. The motions judge suggested that the Confidential Documents could be expunged of their commercially sensitive contents, and edited versions of the documents could be filed. As well, the majority of the Court of Appeal, in addition to accepting the possibility of expungement, was of the opinion that the summaries of the Confidential Documents included in the affidavits could go a long way to compensate for the absence of the originals. If either of these options is a reasonable alternative to submitting the Confidential Documents under a confidentiality order, then the order is not necessary, and the application does not pass the first branch of the test.

64 There are two possible options with respect to expungement, and, in my view, there are problems with both of these. The first option would be for AECL to expunge the confidential information without disclosing the expunged material to the parties and the court. However, in this situation the filed material would still differ from the material used by the affiants. It must not be forgotten that this motion arose as a result of Sierra Club's position that the summaries contained in the affidavits should be accorded little or no weight without the presence of the underlying documents. Even if the relevant information and the confidential information were mutually exclusive, which would allow for the disclosure of all the information relied on in the affidavits, this relevancy determination could not be tested on cross-examination because the expunged material would not be available. Thus, even in the best case scenario, where only irrelevant information needed to be expunged, the parties would be put in essentially the same position as that which initially generated this appeal in the sense that at least some of the material relied on to prepare the affidavits in question would not be available to Sierra Club.

65 Further, I agree with Robertson J.A. that this best case scenario, where the relevant and the confidential information do not overlap, is an untested assumption (para. 28). Although the documents themselves were not put before the courts on this motion, given that they comprise thousands of pages of detailed information, this assumption is at best optimistic. The expungement alternative would be further complicated by the fact that the Chinese authorities require prior approval for any request by AECL to disclose information.

66 The second option is that the expunged material be made available to the Court and the parties under a more narrowly drawn confidentiality order. Although this option would allow for slightly broader public access than the current confidentiality request, in my view, this minor restriction to the current confidentiality request is not a viable alternative given the difficulties associated with expungement in these circumstances. The test asks whether there are *reasonably* alternative measures; it does not require the adoption of the absolutely least restrictive option. With respect, in my view, expungement of the Confidential Documents would be a virtually unworkable and ineffective solution that is not reasonable in the circumstances.

67 A second alternative to a confidentiality order was Evans J.A.'s suggestion that the summaries of the Confidential Documents included in the affidavits" may well go a long way to compensate for the absence of the originals" (para. 103). However, he appeared to take this fact into account merely as a factor to be considered when balancing the various interests at stake. I would agree that at this threshold stage to rely on the summaries alone, in light of the intention of

Sierra Club to argue that they should be accorded little or no weight, does not appear to be a "reasonably alternative measure" to having the underlying documents available to the parties.

68 With the above considerations in mind, I find the confidentiality order necessary in that disclosure of the Confidential Documents would impose a serious risk on an important commercial interest of the appellant, and that there are no reasonably alternative measures to granting the order.

(2) The Proportionality Stage

69 As stated above, at this stage, the salutary effects of the confidentiality order, including the effects on the appellant's right to a fair trial, must be weighed against the deleterious effects of the confidentiality order, including the effects on the right to free expression, which, in turn, is connected to the principle of open and accessible court proceedings. This balancing will ultimately determine whether the confidentiality order ought to be granted.

(a) Salutary Effects of the Confidentiality Order

70 As discussed above, the primary interest that would be promoted by the confidentiality order is the public interest in the right of a civil litigant to present its case or, more generally, the fair trial right. Because the fair trial right is being invoked in this case in order to protect commercial, not liberty, interests of the appellant, the right to a fair trial in this context is not a *Charter* right; however, a fair trial for all litigants has been recognized as a fundamental principle of justice: *Ryan*, *supra*, at para. 84. It bears repeating that there are circumstances where, in the absence of an affected *Charter* right, the proper administration of justice calls for a confidentiality order: *Mentuck*, *supra*, at para. 31. In this case, the salutary effects that such an order would have on the administration of justice relate to the ability of the appellant to present its case, as encompassed by the broader fair trial right.

71 The Confidential Documents have been found to be relevant to defences that will be available to the appellant in the event that the CEAA is found to apply to the impugned transaction and, as discussed above, the appellant cannot disclose the documents without putting its commercial interests at serious risk of harm. As such, there is a very real risk that, without the confidentiality order, the ability of the appellant to mount a successful defence will be seriously curtailed. I conclude, therefore, that the confidentiality order would have significant salutary effects on the appellant's right to a fair trial.

72 Aside from the salutary effects on the fair trial interest, the confidentiality order would also have a beneficial impact on other important rights and interests. First, as I discuss in more detail below, the confidentiality order would allow all parties and the court access to the Confidential Documents, and permit cross-examination based on their contents. By facilitating access to relevant documents in a judicial proceeding, the order sought would assist in the search for truth, a core value underlying freedom of expression.

73 Second, I agree with the observation of Robertson J.A. that, as the Confidential Documents contain detailed technical information pertaining to the construction and design of a nuclear installation, it may be in keeping with the public interest to prevent this information from entering the public domain (para. 44). Although the exact contents of the documents remain a mystery, it is apparent that they contain technical details of a nuclear installation, and there may well be a substantial public security interest in maintaining the confidentiality of such information.

(b) Deleterious Effects of the Confidentiality Order

74 Granting the confidentiality order would have a negative effect on the open court principle, as the public would be denied access to the contents of the Confidential Documents. As stated above, the principle of open courts is inextricably tied to the s. 2(b) *Charter* right to freedom of expression, and public scrutiny of the courts is a fundamental aspect of the administration of justice: *New Brunswick*, *supra*, at paras. 22-23. Although as a *general* principle, the importance of open courts cannot be overstated, it is necessary to examine, in the context of this case, the *particular* deleterious effects on freedom of expression that the confidentiality order would have.

75 Underlying freedom of expression are the core values of (1) seeking the truth and the common good, (2) promoting self-fulfilment of individuals by allowing them to develop thoughts and ideas as they see fit, and (3) ensuring that participation in the political process is open to all persons: *Irwin Toy Ltd. c. Québec (Procureur général)*, [1989] 1 S.C.R. 927 (S.C.C.), at p. 976, *R. v. Keegstra*, [1990] 3 S.C.R. 697 (S.C.C.), *per* Dickson C.J., at pp. 762-764. *Charter* jurisprudence has established that the closer the speech in question lies to these core values, the harder it will be to justify a s. 2(b) infringement of that speech under s. 1 of the *Charter*: *Keegstra*, *supra*, at pp. 760-761. Since the main goal in this case is to exercise judicial discretion in a way which conforms to *Charter* principles, a discussion of the deleterious effects of the confidentiality order on freedom of expression should include an assessment of the effects such an order would have on the three core values. The more detrimental the order would be to these values, the more difficult it will be to justify the confidentiality order. Similarly, minor effects of the order on the core values will make the confidentiality order easier to justify.

76 Seeking the truth is not only at the core of freedom of expression, but it has also been recognized as a fundamental purpose behind the open court rule, as the open examination of witnesses promotes an effective evidentiary process: *Edmonton Journal*, *supra*, *per* Wilson J., at pp. 1357-1358. Clearly, the confidentiality order, by denying public and media access to documents relied on in the proceedings, would impede the search for truth to some extent. Although the order would not exclude the public from the courtroom, the public and the media would be denied access to documents relevant to the evidentiary process.

77 However, as mentioned above, to some extent the search for truth may actually be *promoted* by the confidentiality order. This motion arises as a result of Sierra Club's argument that it must have access to the Confidential Documents in order to test the accuracy of Dr. Pang's evidence. If the order is denied, then the most likely scenario is that the appellant will not submit the documents, with the unfortunate result that evidence which may be relevant to the proceedings will not be available to Sierra Club or the court. As a result, Sierra Club will not be able to fully test the accuracy of Dr. Pang's evidence on cross-examination. In addition, the court will not have the benefit of this cross-examination or documentary evidence, and will be required to draw conclusions based on an incomplete evidentiary record. This would clearly impede the search for truth in this case.

78 As well, it is important to remember that the confidentiality order would restrict access to a relatively small number of highly technical documents. The nature of these documents is such that the general public would be unlikely to understand their contents, and thus they would contribute little to the public interest in the search for truth in this case. However, in the hands of the parties and their respective experts, the documents may be of great assistance in probing the truth of the Chinese environmental assessment process, which would, in turn, assist the court in reaching accurate factual conclusions. Given the nature of the documents, in my view, the important value of the search for truth which underlies both freedom of expression and open justice would be promoted to a greater extent by submitting the Confidential Documents under the order sought than it would by denying the order, and thereby preventing the parties and the court from relying on the documents in the course of the litigation.

79 In addition, under the terms of the order sought, the only restrictions on these documents relate to their public distribution. The Confidential Documents would be available to the court and the parties, and public access to the proceedings would not be impeded. As such, the order represents a fairly minimal intrusion into the open court rule, and thus would not have significant deleterious effects on this principle.

80 The second core value underlying freedom of speech, namely, the promotion of individual self-fulfilment by allowing open development of thoughts and ideas, focuses on individual expression, and thus does not closely relate to the open court principle which involves institutional expression. Although the confidentiality order would restrict individual access to certain information which may be of interest to that individual, I find that this value would not be significantly affected by the confidentiality order.

81 The third core value, open participation in the political process, figures prominently in this appeal, as open justice is a fundamental aspect of a democratic society. This connection was pointed out by Cory J. in *Edmonton Journal*, *supra*, at p. 1339:

> It can be seen that freedom of expression is of fundamental importance to a democratic society. It is also essential to a democracy and crucial to the rule of law that the courts are seen to function openly. The press must be free to comment upon court proceedings to ensure that the courts are, in fact, seen by all to operate openly in the penetrating light of public scrutiny.

Although there is no doubt as to the importance of open judicial proceedings to a democratic society, there was disagreement in the courts below as to whether the weight to be assigned to the open court principle should vary depending on the nature of the proceeding.

82 On this issue, Robertson J.A. was of the view that the nature of the case and the level of media interest were irrelevant considerations. On the other hand, Evans J.A. held that the motions judge was correct in taking into account that this judicial review application was one of significant public and media interest. In my view, although the public nature of the case may be a factor which strengthens the importance of open justice in a particular case, the level of media interest should not be taken into account as an independent consideration.

83 Since cases involving public institutions will generally relate more closely to the core value of public participation in the political process, the public nature of a proceeding should be taken into consideration when assessing the merits of a confidentiality order. It is important to note that this core value will *always* be engaged where the open court principle is engaged owing to the importance of open justice to a democratic society. However, where the political process is also engaged by the *substance* of the proceedings, the connection between open proceedings and public participation in the political process will increase. As such, I agree with Evans J.A. in the court below, where he stated, at para. 87:

> While all litigation is important to the parties, and there is a public interest in ensuring the fair and appropriate adjudication of all litigation that comes before the courts, some cases raise issues that transcend the immediate interests of the parties and the general public interest in the due administration of justice, and have a much wider public interest significance.

84 This motion relates to an application for judicial review of a decision by the government to fund a nuclear energy project. Such an application is clearly of a public nature, as it relates to the distribution of public funds in relation to an issue of demonstrated public interest. Moreover, as pointed out by Evans J.A., openness and public participation are of fundamental importance under the CEAA. Indeed, by their very nature, environmental matters carry significant public import, and openness in judicial proceedings involving environmental issues will generally attract a high degree of protection. In this regard, I agree with Evans J.A. that the public interest is engaged here more than it would be if this were an action between private parties relating to purely private interests.

85 However, with respect, to the extent that Evans J.A. relied on media interest as an indicium of public interest, this was an error. In my view, it is important to distinguish *public* interest from *media* interest, and I agree with Robertson J.A. that media exposure cannot be viewed as an impartial measure of public interest. It is the public *nature* of the proceedings which increases the need for openness, and this public nature is not necessarily reflected by the media desire to probe the facts of the case. I reiterate the caution given by Dickson C.J. in *Keegstra*, *supra*, at p. 760, where he stated that, while the speech in question must be examined in light of its relation to the core values," we must guard carefully against judging expression according to its popularity."

86 Although the public interest in open access to the judicial review application *as a whole* is substantial, in my view, it is also important to bear in mind the nature and scope of the information for which the order is sought in assigning weight to the public interest. With respect, the motions judge erred in failing to consider the narrow scope of the order

when he considered the public interest in disclosure, and consequently attached excessive weight to this factor. In this connection, I respectfully disagree with the following conclusion of Evans J.A., at para. 97:

> Thus, having considered the nature of this litigation, and having assessed the extent of public interest in the openness of the proceedings in the case before him, the Motions Judge cannot be said in all the circumstances to have given this factor undue weight, even though confidentiality is claimed for only three documents among the small mountain of paper filed in this case, and their content is likely to be beyond the comprehension of all but those equipped with the necessary technical expertise.

Open justice is a fundamentally important principle, particularly when the substance of the proceedings is public in nature. However, this does not detract from the duty to attach weight to this principle in accordance with the specific limitations on openness that the confidentiality order would have. As Wilson J. observed in *Edmonton Journal*, *supra*, at pp. 1353-1354:

> One thing seems clear and that is that one should not balance one value at large and the conflicting value in its context. To do so could well be to pre-judge the issue by placing more weight on the value developed at large than is appropriate in the context of the case.

87 In my view, it is important that, although there is significant public interest in these proceedings, open access to the judicial review application would be only slightly impeded by the order sought. The narrow scope of the order coupled with the highly technical nature of the Confidential Documents significantly temper the deleterious effects the confidentiality order would have on the public interest in open courts.

88 In addressing the effects that the confidentiality order would have on freedom of expression, it should also be borne in mind that the appellant may not have to raise defences under the CEAA, in which case the Confidential Documents would be irrelevant to the proceedings, with the result that freedom of expression would be unaffected by the order. However, since the necessity of the Confidential Documents will not be determined for some time, in the absence of a confidentiality order, the appellant would be left with the choice of either submitting the documents in breach of its obligations or withholding the documents in the hopes that either it will not have to present a defence under the CEAA or that it will be able to mount a successful defence in the absence of these relevant documents. If it chooses the former option, and the defences under the CEAA are later found not to apply, then the appellant will have suffered the prejudice of having its confidential and sensitive information released into the public domain with no corresponding benefit to the public. Although this scenario is far from certain, the possibility of such an occurrence also weighs in favour of granting the order sought.

89 In coming to this conclusion, I note that if the appellant is not required to invoke the relevant defences under the CEAA, it is also true that the appellant's fair trial right will not be impeded, even if the confidentiality order is not granted. However, I do not take this into account as a factor which weighs in favour of denying the order because, if the order is granted and the Confidential Documents are not required, there will be no deleterious effects on *either* the public interest in freedom of expression *or* the appellant's commercial interests or fair trial right. This neutral result is in contrast with the scenario discussed above where the order is denied and the possibility arises that the appellant's commercial interests will be prejudiced with no corresponding public benefit. As a result, the fact that the Confidential Documents may not be required is a factor which weighs in favour of granting the confidentiality order.

90 In summary, the core freedom of expression values of seeking the truth and promoting an open political process are most closely linked to the principle of open courts, and most affected by an order restricting that openness. However, in the context of this case, the confidentiality order would only marginally impede, and in some respects would even promote, the pursuit of these values. As such, the order would not have significant deleterious effects on freedom of expression.

VII. Conclusion

91 In balancing the various rights and interests engaged, I note that the confidentiality order would have substantial salutary effects on the appellant's right to a fair trial, and freedom of expression. On the other hand, the deleterious effects of the confidentiality order on the principle of open courts and freedom of expression would be minimal. In addition, if the order is not granted and in the course of the judicial review application the appellant is not required to mount a defence under the CEAA, there is a possibility that the appellant will have suffered the harm of having disclosed confidential information in breach of its obligations with no corresponding benefit to the right of the public to freedom of expression. As a result, I find that the salutary effects of the order outweigh its deleterious effects, and the order should be granted.

92 Consequently, I would allow the appeal with costs throughout, set aside the judgment of the Federal Court of Appeal, and grant the confidentiality order on the terms requested by the appellant under R. 151 of the *Federal Court Rules, 1998*.

Appeal allowed.

Pourvoi accueilli.

End of Document

TAB 6

(a) the netting or setting off or compensation of obligations between the company and the other parties to the eligible financial contract; and

(b) any dealing with financial collateral including

(i) the sale or foreclosure or, in the Province of Quebec, the surrender of financial collateral, and

(ii) the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.

Restriction

(9) No order may be made under this Act if the order would have the effect of staying or restraining the actions permitted under subsection (8).

Net termination values

(10) If net termination values determined in accordance with an eligible financial contract referred to in subsection (8) 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 those net termination values.

Priority

(11) No order may be made under this Act if the order would have the effect of subordinating financial collateral.

2005, c. 47, s. 131; 2007, c. 29, s. 109, c. 36, ss. 77, 112; 2012, c. 31, s. 421.

Obligations and Prohibitions

Obligation to provide assistance

35 (1) A debtor company shall provide to the monitor the assistance that is necessary to enable the monitor to adequately carry out the monitor's functions.

Obligation to duties set out in section 158 of the *Bankruptcy and Insolvency Act*

(2) A debtor company shall perform the duties set out in section 158 of the *Bankruptcy and Insolvency Act* that are appropriate and applicable in the circumstances.

2005, c. 47, s. 131.

Restriction on disposition of business assets

36 (1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale

a) la compensation des obligations entre la compagnie et les autres parties au contrat;

b) toute opération à l'égard de la garantie financière afférente, notamment :

(i) la vente, la demande en forclusion ou, dans la province de Québec, la demande en délaissement,

(ii) la compensation, ou l'affectation de son produit ou de sa valeur.

Restriction

(9) Aucune ordonnance rendue au titre de la présente loi ne peut avoir pour effet de suspendre ou de restreindre le droit d'effectuer les opérations visées au paragraphe (8).

Valeurs nettes dues à la date de résiliation

(10) Si, aux termes du contrat financier admissible visé au paragraphe (8), des sommes sont dues par la compagnie à une autre partie au contrat au titre de valeurs nettes dues à la date de résiliation, cette autre partie est réputée être un créancier de la compagnie relativement à ces sommes.

Rang

(11) Il ne peut être rendu, au titre de la présente loi, aucune ordonnance dont l'effet serait d'assigner un rang inférieur à toute garantie financière.

2005, ch. 47, art. 131; 2007, ch. 29, art. 109, ch. 36, art. 77 et 112; 2012, ch. 31, art. 421.

Obligations et interdiction

Assistance

35 (1) La compagnie débitrice est tenue d'aider le contrôleur à remplir adéquatement ses fonctions.

Obligations visées à l'article 158 de la *Loi sur la faillite et l'insolvabilité*

(2) Elle est également tenue de satisfaire aux obligations visées à l'article 158 de la *Loi sur la faillite et l'insolvabilité* selon ce qui est indiqué et applicable dans les circonstances.

2005, ch. 47, art. 131.

Restriction à la disposition d'actifs

36 (1) Il est interdit à la compagnie débitrice à l'égard de laquelle une ordonnance a été rendue sous le régime de la présente loi de disposer, notamment par vente, d'actifs hors du cours ordinaire de ses affaires sans l'autorisation du tribunal. Le tribunal peut accorder l'autorisation sans qu'il soit nécessaire d'obtenir l'acquiescement or disposition even if shareholder approval was not obtained.

Notice to creditors

(2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.

Factors to be considered

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Additional factors — related persons

(4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that

(a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and

(b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

Related persons

(5) For the purpose of subsection (4), a person who is related to the company includes

des actionnaires, et ce malgré toute exigence à cet effet, notamment en vertu d'une règle de droit fédérale ou provinciale.

Avis aux créanciers

(2) La compagnie qui demande l'autorisation au tribunal en avise les créanciers garantis qui peuvent vraisemblablement être touchés par le projet de disposition.

Facteurs à prendre en considération

(3) Pour décider s'il accorde l'autorisation, le tribunal prend en considération, entre autres, les facteurs suivants :

a) la justification des circonstances ayant mené au projet de disposition;

b) l'acquiescement du contrôleur au processus ayant mené au projet de disposition, le cas échéant;

c) le dépôt par celui-ci d'un rapport précisant que, à son avis, la disposition sera plus avantageuse pour les créanciers que si elle était faite dans le cadre de la faillite;

d) la suffisance des consultations menées auprès des créanciers;

e) les effets du projet de disposition sur les droits de tout intéressé, notamment les créanciers;

f) le caractère juste et raisonnable de la contrepartie reçue pour les actifs compte tenu de leur valeur marchande.

Autres facteurs

(4) Si la compagnie projette de disposer d'actifs en faveur d'une personne à laquelle elle est liée, le tribunal, après avoir pris ces facteurs en considération, ne peut accorder l'autorisation que s'il est convaincu :

a) d'une part, que les efforts voulus ont été faits pour disposer des actifs en faveur d'une personne qui n'est pas liée à la compagnie;

b) d'autre part, que la contrepartie offerte pour les actifs est plus avantageuse que celle qui découlerait de toute autre offre reçue dans le cadre du projet de disposition.

Personnes liées

(5) Pour l'application du paragraphe (4), les personnes ci-après sont considérées comme liées à la compagnie :

TAB 7

2012 ABQB 59
Alberta Court of Queen's Bench

Royal Bank v. Cow Harbour Construction Ltd.

2012 CarswellAlta 198, 2012 ABQB 59, [2012] 8 W.W.R. 209, [2012] A.W.L.D. 1380, [2012] A.W.L.D. 1381, 19 P.P.S.A.C. (3d) 31, 211 A.C.W.S. (3d) 265, 529 A.R. 147, 59 Alta. L.R. (5th) 215, 75 C.B.R. (5th) 99, 98 B.L.R. (4th) 236

Royal Bank of Canada (Plaintiff) and Cow Harbour Construction Ltd. and 1134252 Alberta Ltd. (Defendants)

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended

In the Matter of the Companies' Creditors Arrangement Act, RSC 1985, c C-36, as amended

In the Matter of a Plan of Arrangement of Cow Harbour Construction Ltd.

K.D. Yamauchi J.

Heard: November 2-3, 2011
Judgment: January 23, 2012
Docket: Edmonton 1003-11241, 1003-05560, BKCY 24-115359

Counsel: Walker W. MacLeod for GE
Joseph J.Bellissimo for Scott Capital
Kentigern A. Rowan, Q.C., Stephanie A. Wanke for Wajax
Ryan Zahara, for Caterpillar Financial
Jeremy H. Hockin for Kempenfelt Vehicle Leasing (a Division of Equirex Vehicle Leasing 2007 Inc.), Alter Moneta Corporation, Concentra Financial, Key Equipment

Subject: Insolvency; Estates and Trusts; Civil Practice and Procedure; Contracts; Corporate and Commercial

Headnote

Bankruptcy and insolvency --- Administration of estate — Trustee's possession of assets — Particular assets — Leasehold assets

True leases and financing leases — Debtor entered protection under of Companies' Creditors Arrangement Act, and was later subject of asset sale — Company was lessee of several pieces of equipment — Funds regarding leases were transferred to receiver — Lessor's brought application regarding entitlement to funds — Certain lessors had entered into agreements subject to true lease, and could claim recovery — True leases but not financing leases are subject to s. 11.01(a) of Companies' Creditors Arrangement Act, which allows for payment for leased property — SC Inc. leased eight pieces of equipment under five leases — SC Inc. leases were true leases — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — Debtor paid taxes related to equipment and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment was selected by lessee and purchased by lessor for specific lease — Substantial security deposit required — Aggregate rentals approximated purchase price — Lease had warranties of fitness — Lease was reflective of financing transaction as true lease — Parties intent was to have option to buy at full market value, based on knowledge and experience of SC Inc. — End of lease was not end of equipment's useful life, and SC Inc. retained surplus value unless purchased by debtor — Debtor was paying for use of equipment, although hypothetical situations could exist where equity could be built up and only residual amount paid, as if financing agreement were in effect — Equipment lease for C Ltd. was true lease — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — C Ltd. acted as financing agency and leasing company — Debtor paid taxes related to equipment, and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment selected by lessee and purchased by lessor for specific lease — Debtor not required to pay substantial security deposit — Aggregate rental payments approximated value of purchase price, if interest considered — If purchase option exercised amount would be significant — Equipment lease for W was true lease — Option to purchase reflected fair purchase price — W did not act as financing agency — Debtor was responsible for insurance, license fees and risk of loss — Security deposit not paid but payment was required before equipment delivered — Agreement had liquidated damages clause but default provisions were not inordinately favourable to lessee — Default clause was only for portion of rental charges on unexpired period — Purchase option had expired — K Inc. leases were financing leases — Lease referred to security deposit but deposit was not identified unless amount was first payment, which was five times normal monthly payment and approximately 10 percent of value of equipment — Aggregate rental payments were more than cost of equipment and purchase option available at 60 months was approximately same as remaining monthly payments — Equipment lease for CF was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar, and could be exercised well before useful life of equipment expired — AM Corp. lease was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar — KEFC Ltd. lease was financing lease — Purchase option was for ten percent of value, which was not nominal — However, debtor was required to exercise option.

Bankruptcy and insolvency --- Practice and procedure in courts — Stay of proceedings

True leases and financing leases — Debtor entered protection under Companies' Creditors Arrangement Act, and was later subject of asset sale — Company was lessee of several pieces of equipment — Funds regarding leases were transferred to receiver — Lessor's brought application regarding entitlement to funds — Certain lessors had entered into agreements subject to true lease, and could claim recovery — True leases but not financing leases are subject to s. 11.01(a) of Companies' Creditors Arrangement Act, which allows for payment for leased property — SC Inc. leased eight pieces of equipment under five leases — SC Inc. leases were true leases — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — Debtor paid taxes related to equipment and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment was selected by lessee and purchased by lessor for specific lease — Substantial security deposit required — Aggregate rentals approximated purchase price — Lease had warranties of fitness — Lease was reflective of financing transaction as true lease — Parties intent was to have option to buy at full market value, based on knowledge and experience of SC Inc. — End of lease was not end of equipment's useful life, and SC Inc. retained surplus value unless purchased by debtor — Debtor was paying for use of equipment, although hypothetical situations could exist where equity could be built up and only residual amount paid, as if financing agreement were in effect — Equipment lease for C Ltd. was true lease — Option to purchase reflected fair purchase price — Lease did not grant lessee interest in equipment — C Ltd. acted as financing agency and leasing company — Debtor paid taxes related to equipment, and was responsible for insurance, license fees and risk of loss — Lease had acceleration clause and mortgage-like remedies which were inordinately favourable to lessor, including liquidated damages — Equipment selected by lessee and purchased by lessor for specific lease — Debtor not required to pay substantial security deposit — Aggregate rental payments approximated value of purchase price, if interest considered — If purchase option exercised amount would be significant — Equipment lease for W was true lease — Option to purchase reflected fair purchase price — W did not act as financing agency — Debtor was responsible for insurance, license fees and risk of loss — Security deposit not paid but payment was required before equipment delivered — Agreement had liquidated damages clause but default provisions were not inordinately favourable to lessee — Default clause was only for portion of rental charges on unexpired period — Purchase option had expired — K Inc. leases were financing leases — Lease referred to security deposit but deposit was not identified unless amount was first payment, which was five times normal monthly payment and approximately 10 percent of value of equipment — Aggregate rental payments were more than cost of equipment and purchase option available at 60 months was approximately same as remaining monthly payments — Equipment lease for CF was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar, and could be exercised well before useful life of equipment expired — AM Corp. lease was financing lease — Aggregate rents were greater than net price of equipment — Option to purchase was only one dollar — KEFC Ltd. lease was financing lease — Purchase option was for ten percent of value, which was not nominal — However, debtor was required to exercise option.

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s. 11.01(a) [en. 2005, c. 47, s. 128] — considered

s. 11.02 [en. 2005, c. 47, s. 128] — considered

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Words and phrases considered:

true lease

A true lease, in essence, is a bailment contract such that ownership of the leased goods remains with the bailor/lessor and the bailee/lessee pays for "use" of those goods.

APPLICATION by lessors regarding disposition of funds held by receiver of debtor.

K.D. Yamauchi J.:

I. Nature of the Matter

1 Various equipment lessors (collectively, the Applicants) have applied for what they claim to be their proportionate share of funds that PricewaterhouseCoopers Inc. (PWC) currently holds, pending this Court's determination of whether their leases were subject to section 11.01(a) of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (*CCAA*). PWC is the court-appointed receiver and manager of the assets, property and undertaking of Cow Harbour Construction Ltd. (Cow Harbour).

II. Procedural History

2 On April 7, 2010, Cow Harbour obtained a stay of proceedings against it (Initial Order) under *CCAA* s. 11.02. This Court extended the Initial Order from time to time by a number of subsequent court orders. Pursuant to the Initial Order, this Court appointed Deloitte LLP as monitor under the *CCAA* (Monitor).

3 Cow Harbour's primary business consisted of overburden removal and general contracting services for oil extraction companies in Fort McMurray, Alberta. Its assets consisted mainly of earth moving and hauling equipment. Much of the equipment that Cow Harbour used in its operations was leased from various parties.

4 On May 21, 2010, this Court directed the Monitor to provide all interested parties with a list of those leases which it had classified as ones entitling the respective lessors to receive ongoing monthly payments pursuant to *CCAA* s. 11.01. This Court gave any party who claimed to have such a lease, but whose claim was not included in the Monitor's list, until June 2, 2010 to advise the Monitor that it was disputing the classification, failing which it was barred from subsequently asserting that its lease entitled it to those ongoing monthly payments.

5 Disputes were registered in relation to a total of 58 leases (Disputed Leases).

6 Also on May 21, 2010, this Court directed Cow Harbour to pay over to the Monitor's counsel monies representing all monthly payments from April 1, 2010, that Cow Harbour would have paid to lessors under the Disputed Leases, or leases which had not yet been categorized (Disputed Lease Funds). This Court directed the Monitor's counsel to hold the Disputed Lease Funds pending resolution of disputes pertaining to categorization of the Disputed Leases.

7 It became clear as matters progressed that Cow Harbour was not going to be able to restructure it affairs through refinancing, compromise or an equity restructuring. Rather, the proceedings evolved into a liquidation. PWC was appointed as transaction facilitator to assist the various parties in their negotiations. Acting in that capacity, PWC negotiated a potential sale of certain of Cow Harbour's assets to Aecon Group Inc. (Aecon). On August 10, 2010, PWC's acceptance of Aecon's letter of intent received this Court's endorsement, subject to the parties later applying for court approval of an asset purchase agreement and vesting order.

8 On August 25, 2010, the Royal Bank of Canada (RBC) successfully applied for a receivership order, pursuant to which this Court appointed PWC as receiver and manager of the assets, property and undertaking of Cow Harbour (Receiver). This Court then approved the asset purchase agreement and granted a vesting order in Aecon's favour. The transaction contemplated by the asset purchase agreement closed on August 26, 2010.

9 The Disputed Lease Funds were transferred to the Receiver pending resolution of the disputes over classification of the Disputed Leases.

10 RBC was paid out in full through the *CCAA* and receivership proceedings. The secured creditor holding the next general security over Cow Harbour's assets, property and undertaking is GE Capital Equipment Financing G.P. (GE).

11 The Receiver has settled many of the issues between Cow Harbour and various third parties, including many of the lessors under the Disputed Leases. However, it continues to hold back a portion of the Disputed Lease Funds until this Court's determination of entitlement to those funds.

III. Issue

12 The Applicants ask this Court to determine which of the remaining Disputed Leases fall within *CCAA* s. 11.01(a). This, in turn, will determine which party or parties are entitled to a portion of the Disputed Lease Funds.

IV. Law

A. Legislation

13 Section 11.01(a) of the *CCAA* provides:

> 11.01 No order made under section 11 or 11.02 has the effect of
>
> > (A) prohibiting a person from requiring immediate payment for ... use of leased ... property or other valuable consideration provided after the order is made.

14 Section 11.02 of the *CCAA* provides for a stay of proceedings. It states:

> 11.02(1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,
>
> > (a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;
> >
> > (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
> >
> > (c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

B. General Legal Principles

15 Section 11.02 of the *CCAA* allows a court to order a stay of proceedings on an initial application under the *CCAA* in respect of a debtor company. This is in keeping with the general policy underlying the *CCAA*, which is to allow a debtor corporation to restructure its corporate or financial affairs in a way that will permit it to continue on as a going concern, without being hampered by those who wish to enforce their previously bargained for rights. As the Ontario Court of Appeal commented in *Nortel Networks Corp., Re*, 2009 ONCA 833 (Ont. C.A.) at para 16, (2009), 59 C.B.R. (5th) 23 (Ont. C.A.) [*Nortel*], "[t]he primary instrument provided by the *CCAA* to achieve its purpose is the power of the court to issue a broad stay of proceedings under s. 11. That power includes the power to stay the *debt obligations* of the company" (emphasis added). Courts have given the *CCAA* a wide and liberal construction to facilitate this policy objective (see *e.g. Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.)).

16 While a debtor corporation is proceeding through the *CCAA* restructuring process, it must still carry on its business. It hardly seems fair to require a person to continue to supply the debtor corporation with goods or services, or to allow the debtor corporation to continue to use leased property, without that person being compensated for those goods, services or use. Section 11.01(a) of the *CCAA* allows for that compensation.

17 As noted in *Smith Brothers Contracting Ltd., Re* (1998), 53 B.C.L.R. (3d) 264 (B.C. S.C.) at para 3 (SC) [*Smith Brothers*], Parliament added what is now s. 11.01 to the *CCAA* as part of a set of amendments proclaimed in force on

September 30, 1997. Suche J. in *Winnipeg Motor Express Inc., Re*, 2009 MBQB 204, 243 Man. R. (2d) 31 (Man. Q.B.) [*Re Winnipeg*], leave to appeal to CA refused, 2009 MBCA 110, [2009] 12 W.W.R. 224 (Man. C.A. [In Chambers]), suggested that Parliament may have added this provision to clarify the point made in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (B.C. C.A.) [*Quintette*], that a stay would never be used to enforce the continuous supply of goods or services without payment for current deliveries. She also commented that the amendment brought the *CCAA* in line with the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*], which contains a similar provision relating to proposals.

18 To further facilitate the policy objective of the *CCAA*, courts have given *CCAA* s. 11.01(a), which is an exception to the stay provision, a narrow construction (*Nortel* at para 17). They have differentiated between a "true lease," in which the debtors' corporation is paying for use of the property, and a debt obligation clothed in the guise of a lease, i.e., a financing lease in which the debtors' corporation is "earning equity" in the property. Courts and writers have used the term "financing lease," "security lease," "financial leasing arrangement" or similar terms to describe the latter type of arrangement (referred to here as a financing lease). It is only the debtor corporation's obligations under a true lease that courts have excepted from the stay of proceedings, not its obligations under a financing lease (*Smith Brothers* at para 61).

19 Canadian courts have accepted the conclusion of Bauman J. (as he then was) in *Smith Brothers* that a true lease, being a bailment of property, falls within the *CCAA* s. 11.01(a) exception, while a financing lease does not. They also have endorsed his approach to distinguishing between the two types of arrangements (see *e.g. International Wallcoverings Ltd., Re* (1999), 28 C.B.R. (4th) 48 (Ont. Gen. Div. [Commercial List])) [*International Wallcoverings*]; *Sharp-Rite Technologies Ltd., Re*, 2000 BCSC 122 (B.C. S.C.). In *PSINET Ltd., Re* (2001), 26 C.B.R. (4th) 288 (Ont. S.C.J.) at para 19 [*PSINET*], Swinton J. stated:

> In my view, ***Smith Brothers Contracting Ltd.*** was correct in determining that [*CCAA* s. 11.01(a)] is to apply to payments for the use of property provided after the stay order — that is, where a party provides new credit to the debtor following the stay. The payments under the leases here are not that type of payment. These leases are clearly financing arrangements, whose purpose is to secure a loan which was provided before the stay order was made, and the payments owing are repayments for that loan. Therefore, the leases here do not fall within [*CCAA* s. 11.01(a)] of the Act, and the order of Farley J. which prohibits the company from making payments under them is consistent with the purpose of the Act. Any other determination would give the RBC an unfair advantage when compared to other creditors of the applicants, who are bound by the stay.

20 While initially having questioned in oral reasons on August 25, 2010, whether it might be worthwhile to re-examine the approach that Bauman J. took in *Smith Brothers*, this Court concluded the approach was sound, given that *CCAA* s. 11.01(a) is to be narrowly construed. The substance and not the form of the arrangement between the debtor corporation and the other contracting party is of importance and, unless there is a sound policy reason for doing so, the court should not give an advantage to one creditor over another.

21 Why did this Court initially question the reasoning in *Smith Brothers*?

22 Bauman J. relied heavily on Professor Ronald CC Cuming's article, "True Leases and Security Leases Under Canadian Personal Property Security Acts" (1983) 7 Can Bus LJ 251, in arriving at his conclusions. As is apparent from the title, Professor Cuming's article dealt with differentiating leases for purposes of personal property security legislation, not insolvency legislation.

23 The *CCAA* does not expressly incorporate personal property security legislation concepts. Unlike such legislation, the *CCAA* does not distinguish between a true lease and a financing lease.

24 The way in which courts have used personal property security legislation concepts when they are dealing with *CCAA* proceedings, and the tension that this approach creates, was discussed by Professor Roderick J. Wood in his article, "The Definition of Secured Creditor in Insolvency Law" (2010) 25 BFLR 341.

25 Professor Wood recognized that the *CCAA* does not expressly deem a lessor in a financing lease transaction to be a "secured creditor" rather than an owner of the goods. He remarked that the definitions of "secured creditor" and "security interest" in insolvency law (the *CCAA* and *BIA*) do not adopt personal property security legislation terminology (at p 347). He noted that courts have held that the broader definition of the term "secured creditor" in the *Income Tax Act*, RSC 1985, c one (5th Supp.) (*ITA*) does not encompass lessors under a financing lease. Professor Wood recognized the difficulty in interpreting the definition of "a secured creditor" in the *CCAA* as including a lessor under a title retention device such as a financing lease, given that courts have not done so in the context of the broader definition in the *ITA*. He expressed the view that the best way to resolve this tension would be for Parliament to clarify federal insolvency legislation, suggesting at p. 356 that:

> It would also produce a proper dovetailing of the federal insolvency provisions. For example, the insolvency statutes provide that a stay of proceedings does not prevent a lessor from requiring immediate payment for use of the leased property. This gives the lessor the ability to collect post-commencement lease payments. Courts have held that this provision only applies to true leases and not to security leases. The latter are treated in the same manner as other security interests and the debtor is able to retain possession of the goods without the need to satisfy the post commencement payments. This further demonstrates that the division between true leases and security leases that is produced by the application of the substance test of the *PPSA* is being recognized in insolvency law, and that an amendment of the definition of secured creditor to reflect this fact is the most sensible solution.

26 When examining *Smith Brothers* closely, it appears that Bauman J. was simply saying that the logic that Professor Cuming applied when differentiating between true leases and financing leases in the context of personal property security legislation applies equally to *CCAA* proceedings. Said differently, *CCAA* s. 11.01(a) protects parties who provide goods and services to the debtor corporation after a court grants an initial order, but not "creditors" to whom the debtor corporation has "debt obligations." This would put the latter in a better position *vis-a-vis* the debtor corporation than the debtor corporation's other creditors.

27 As previously stated, this Court is of the view that Bauman J's decision with respect to this issue is in keeping with the *CCAA*'s underlying policy objectives.

28 It is arguable, however, that Blair J. in *International Wallcoverings* left the door open for a court to find that a financing lease could fall within *CCAA* s. 11.01(a), when he said at para 4:

> While I would not go so far as to say, [*CCAA* s. 11.01(a)] requires payment under all leasing arrangements, or (on the other hand) that it could never encompass a financial leasing arrangement, I am satisfied that in the particular circumstances of this case the reasoning of ***Smith Brothers*** is applicable and that the arrangements in question are more akin to equipment purchase financing arrangements ...

29 He used the *Smith Brothers* true lease/financing lease analysis in reaching his conclusion. He did not speculate as to the type of situation where *CCAA* s. 11.01(a) might encompass a financing lease arrangement.

30 *Winnipeg Motor* could be considered one such case, and, as the result, is contrary to what might be expected when using the *Smith Brothers* analysis.

31 *Winnipeg Motor* dealt with the proper distribution of interim financing and administrative charges incurred after the court granted an initial order under the *CCAA*. The monitor recommended that the charges be distributed among the secured creditors based on a *pro rata* recovery. Two parties claimed to be true lessors. The court referred to the distinction made in *Smith Brothers* between true leases and financing leases. It commented that the exclusion of financing leases from *CCAA* s. 11.01(a) makes perfect sense based on the notion of ownership, as a financing lessor cannot seek the benefits of ownership when it has given it away (assuming the lessee has been acquiring equity in the leased goods). It also suggested that the narrow construction of *CCAA* s. 11.01(a) as limiting the obligation of the debtor to make payments for "use" is consistent with the idea that a supplier cannot be expected to continue to provide its product without payment.

32 The court in *Winnipeg Motor* noted the financing lessors' complaint that they had been unduly prejudiced by the stay of proceedings. They argued that not only were they not being paid while the debtor corporation was using their assets for the benefit of the other stakeholders, but the debtor corporation was deteriorating their underlying security in the process. They maintained that this violated one of the fundamental objectives of the stay of proceedings: preventing one creditor from obtaining an advantage over other creditors during the stay period. The court at paras 60-62 suggested that the fact true lessors were entitled to be paid aggravated the problem, stating:

> It is difficult to know how this situation can be remedied, given that the whole point of the *CCAA* is to relieve a company of ongoing financial burden to allow it the opportunity to restructure. In this case, for example, [the debtor corporation] would not have succeeded had it been obliged to pay for its equipment during the entirety of the restructuring.
>
> On the particular facts of this case, this issue became somewhat easier to address given the nature of [the debtor corporation's] business. Equipment to a transportation company is akin to raw goods to a manufacturer, and I was of the opinion that if [the debtor corporation] was going to be viable, at a certain point it would have to demonstrate it could pay for the essential means of production.
>
> Otherwise, there would be no purpose to continue the stay. Accordingly, I ordered that financing leases would be paid as of August 1, 2008.
>
> I say all this not to justify or revisit the basis for my earlier decision, but to get to the point that in considering what is equitable, undue prejudice is a reason to adjust what would otherwise be a uniform approach. I am satisfied that equipment lessors in a business operation such as [the debtor corporation's] do suffer undue prejudice. In this case, however, the equipment lessors were paid as of August 1. Being financing leases, those payments were not just for use, but included some amount on account of equity. I conclude, then, that the undue prejudice suffered has been recognized, *albeit* not totally, perfectly or precisely, but, in my view, in an amount sufficient amount to justify the uniform application of the methodology proposed by the monitor.

33 Of interest, the court in *Winnipeg Motor* required one of the debtor corporation's true lessors to contribute to the court-ordered charges, as it had derived the same benefit from the *CCAA* proceedings as the financing lessors.

34 In *Clayton Construction Co., Re*, 2009 SKQB 397, 59 C.B.R. (5th) 213 (Sask. Q.B.) [*Clayton Construction*], the debtor corporation sought an extension of a *CCAA* stay of proceedings. Rothery J. granted the extension, but also allowed the payment of interest that the debtor corporation owed to nine of its equipment lessors as a means of compensating them for the use and depreciation of their equipment. The debtor corporation required the equipment to complete its contracts. The court determined that the monthly interest payments to the equipment lessors would not prejudice the other creditors. The major secured creditor had benefited from the accounts receivable generated by the debtor's use of the equipment and the unsecured creditors likely would not have received any benefit, had the equipment lessors withdrawn their support for the restructuring process.

35 *Winnipeg Motor* and *Clayton Construction* might be responses to the non-peer reviewed journal articles that criticize the *Smith Brothers* approach that courts have taken to the issue before this Court (see *e.g.* Steven J. Weisz, Linc A. Rogers & Stacy McLean, "Striking an Imbalance: The Treatment of Equipment Lessors Under Section 11.3 of the *CCAA*" (2003) 20:5 Nat'l Insolv Rev 45 at 48-49; Jeffrey C. Cahart, "Should There be Special Rules in Commercial Reorganizations for Equipment Lessors?" (2002) 15:2 Comm Insol R 13; Harvey G. Chaiton and John R. Hutchins, "Equipment Lessors in Restructurings: Hostage Lenders" (2009) 21 Comm Insol R 3).

36 One of the themes that runs through these articles is that it is unfair for courts to allow creditors that hold general security to gain a benefit from the debtor corporation's use of the leased equipment during the stay period. Cahart commented at p. 15:

> ... it is simply unfair to allow a debtor to continue to use (and to depreciate) a piece of (perhaps essential) equipment which the debtor only has because of the equipment lessor's financing while the debtor pursues a reorganization and/or a sale as a going concern (as has happened in so many *CCAA* cases) possibly over a very extended period. Again, unlike lenders with more general security, equipment lessors (usually) only have recourse to a specific asset. Is it fair to allow, for instance, a mining company under *CCAA* protection to continue to use a specialized leased truck, continue to wear it down and to diminish its value, for 11 months for free, while the company pursues sale as a going concern and/or reorganization based on the company's going concern value? Among other things, the availability of the truck to the company over time: (i) contributes to the going concern value of the company (and the preservation of which is at the heart of what the *CCAA* is trying to achieve); and (ii) allows the company to produce product which is turned into cash and which goes to pay down an operating lender. Yet under the current jurisprudence, the relevant equipment lessor probably receives nothing during the stay period — not even its regular monthly payments, let alone any kind of "premium" for its contribution to the going concern value or to the ability of the company to generate cash.

37 The problem, however, is that one creditor should not receive "an unfair advantage when compared to other creditors of the applicants, who are bound by the stay" (*PSINET* at para 19). If some creditors are to be bound by the stay of proceedings, all creditors must be bound. Any contrary approach invariably would lead to every creditor attempting to argue that its interests are being prejudiced by the stay of proceedings in one way or another, with the end result that the stay of proceedings would prove meaningless.

38 *Smith Brothers* concluded that courts must differentiate between true leases and financing leases. Is this what the legislation says?

39 If certain portions of *CCAA* s. 11.01(a) are emphasized, the legislation could be read differently. For example, *CCAA* s. 11.01(a) might be read as stating that: "No order made under section 11 or 11.02 has the effect of prohibiting a person from requiring immediate *payment for* ... use of *leased ... property ... provided after the order is made*" (emphasis added). In other words, the phrase "provided after the order is made" might refer to "leased property." In that case, lessors of pre-stay leases, whether true or financing, would be subject to the stay of proceedings. Only lessors of property leased post-stay could demand that the debtor corporation make its lease payments. This would be in keeping with judicial interpretation of the balance of *CCAA* s. 11.01(a). For example, a supplier may provide goods or services to the debtor corporation post-stay on the basis of "cash on delivery."

40 This type of interpretation would not be unusual, as Canadian courts, including the Alberta Court of Appeal, have taken such a grammatical-interpretative approach when they have considered, for example, *BIA* s. 178(1)(d). That section provides:

> 178(1) An order of discharge does not release the bankrupt from ...
>
>> (d) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity ...

41 The question has arisen whether the words "while acting in a fiduciary capacity" qualify only the word "defalcation" or whether they qualify all of the listed factors, including fraud, embezzlement, misappropriation and defalcation. Courts have held that the latter is the proper interpretation (see *e.g. Confederation Life Insurance Co. v. Waselenak* (1997), [1998] 5 W.W.R. 712, 57 Alta. L.R. (3d) 38 (Alta. Q.B.), affd 2000 ABCA 136 (Alta. C.A.); *166404 Canada Inc. v. Coulter* (1998), 4 C.B.R. (4th) 1 (Ont. C.A.), leave to appeal to SCC refused (1998), 233 N.R. 395 (note) (S.C.C.); *Ross & Associates v. Palmer*, 2001 MBCA 17, 22 C.B.R. (4th) 140 (Man. C.A.); *Brant, Re* (1984), 52 C.B.R. (N.S.) 317 (Ont. S.C.)).

42 Including all pre-stay leases in the stay of proceedings would be in keeping with the broad and liberal interpretation that courts have given to the *CCAA*, which is to provide the debtor corporation with "breathing space" in which to determine whether it is in a position to restructure its affairs and to facilitate its survival. Including only post-stay leases

under *CCAA* s. 11.01(a) also would be in keeping with the narrow interpretation of transactions that are excepted from the stay of proceedings. It would simplify *CCAA* proceedings involving equipment leases.

43 This interpretation, however, does not give weight to the word "use" in *CCAA* s. 11.01(a). In making the true lease/financing lease distinction, Bauman J. in *Smith Brothers* and courts in subsequent cases have sought to do just that. They have read the section as stating, "No order made under section 11 or 11.02 has the effect of prohibiting a person from requiring immediate *payment for ... use* of leased ... property ... *provided after the order is made*" (emphasis added). In other words, it is "use" of the leased property which is provided after a court makes the initial order.

44 A true lease, in essence, is a bailment contract such that ownership of the leased goods remains with the bailor/lessor and the bailee/lessee pays for "use" of those goods. In *Punch v. Savoy's Jewellers Ltd.* (1986), 54 O.R. (2d) 383 (Ont. C.A.) at para 17, the court defined bailment as follows:

> ... Bailment has been defined as the delivery of personal chattels on trust, usually on a contract, express or implied, that the trust shall be executed and the chattels be delivered in either their original or an altered form as soon as the time for which they were bailed has elapsed. It is to be noted that the legal relationship of bailor and bailee can exist independently of a contract. It is created by the voluntary taking into custody of goods which are the property of another.

(See also *Visscher v. Triple Broek Holdings Ltd.*, 2006 ABQB 259, 399 A.R. 184 (Alta. Q.B.) at paras 27-28; *Letourneau v. Otto Mobiles Edmonton (1984) Ltd.*, 2002 ABQB 609, 315 A.R. 232 (Alta. Q.B.) at para 23).

45 The central character of a true lease is "payment for use." Bauman J. in *Smith Brothers* at para 48 adopted the following statement in Professor Cuming's above-referenced article to expand on this principle:

> Under a true lease, the lessor surrenders his possessory right in chattels to the lessee in return for an undertaking by the lessee to perform certain acts which usually involve the payment of money to the lessor. The lessee has obligations, but the transaction cannot be characterized as a security agreement because the interest of the lessor is not related to those obligations. In other words, the lessor does not remain owner merely to ensure or to induce performance of the lessee's obligations. He remains owner because a bailment contract does not involve the transfer of ownership to the bailee.

46 Bauman J. concluded in *Smith Brothers* at para 61:

> It is only payments for the use of leased property that are excepted from a s. 11 stay order under [*CCAA* s. 11.01(a)]. Payments for use and equity are not. Similarly payments for use and equity and an option to purchase are not. This is another reason to conclude ... [*CCAA* s. 11.01(a)] is not inclusive of all forms of lease.

47 This is a curious statement inasmuch as it might be seen as suggesting that a court should identify what portion of the lease payments made under the instrument is for use rather than for acquisition of equity (and, perhaps, of the option to purchase). This approach is not in keeping with other statements that Bauman J. made in *Smith Brothers*. In this Court's view, the instrument is either a financing lease or a true lease. There is no room for finding the instrument to be a hybrid of the two, as this unnecessarily confuses the issue.

48 As acknowledged by Suche J. in *Winnipeg Motor* at para 31, "... the true nature of arrangements involving the supply of equipment can be very difficult to peg." There can be a fine line between what is considered a true lease and a financing lease.

49 The determination of whether an arrangement is a true lease for purposes of *CCAA* s. 11.01(a) involves a functional analysis of the relationship between the parties based on substance as opposed to form (*Smith Brothers* at para 26; *Philip Services Corp., Re* (1999), 15 C.B.R. (4th) 107 (Ont. S.C.J. [Commercial List]) at para 2 [*Philip Services*]).

50 Professors Ronald CC Cuming and Roderick J. Wood in their *Alberta Personal Property Security Act Handbook*, 4th ed (Toronto: Carswell, 1998) at 53 [*Handbook*] emphasized the need to examine the relationship between the lessor and lessee to determine if it reflects indicia of a financing arrangement. They noted, however, that they were not referring to the traditional indicia prescribed by the common law, but rather those which would be relevant to someone examining the economic realities of the transaction.

51 In *Smith Brothers* at para 67, Bauman J. referred to the following non-exhaustive list of considerations mentioned by Master Powers sitting as a Registrar in Bankruptcy in *Bronson, Re* (1995), 34 C.B.R. (3d) 255 (B.C. Master) [*Bronson*], aff'd (1996), 39 C.B.R. (3d) 33 (B.C. S.C.). This list includes factors considered by American courts in determining whether a document is a true lease or a security agreement, as summarized in *Teaching Material for Personal Property Security Transactions Governed by Personal Property Security Acts* by Professor Cuming in September 1991:

> 1. Whether there was an option to purchase for a nominal sum;
>
> 2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment;
>
> 3. Whether the nature of the lessor's business was to act as a financing agency;
>
> 4. Whether the lessee paid a sales tax incident to acquisition of the equipment;
>
> 5. Whether the lessee paid all other taxes incident to ownership of the equipment;
>
> 6. Whether the lessee was responsible for comprehensive insurance on the equipment;
>
> 7. Whether the lessee was required to pay any and all licence fees for operation of the equipment and to maintain the equipment at his expense;
>
> 8. Whether the agreement placed the entire risk of loss upon the lessee;
>
> 9. Whether the agreement included a clause permitting the lessor to accelerate the payment of rent upon default of the lessee and granted remedies similar to those of a mortgagee;
>
> 10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease;
>
> 11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment;
>
> 12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement;
>
> 13. Whether there was a default provision in the lease inordinately favourable to the lessor;
>
> 14. Whether there was a provision in the lease for liquidated damages;
>
> 15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor;
>
> 16. Whether the aggregate rental approximated the value of purchase price of the equipment. [See also *PSINET* at para 12.]

52 Other courts have added that the right of the lessee to an "option to purchase" can be established through the course of conduct between the parties, if not expressly provided for in the document itself (*Philip Services* at paras 4-5). As well, leases that are "bundled together" for financing purposes may be construed as financing transactions and not

as true leases, because the transactions really involve payment for financing the acquisition of the assets rather than payment for use (*Philip Services* at para 9).

53 Neither Professor Cuming nor the court in *Smith Brothers* said that a lease must contain all of the foregoing indicia to be classified as a financing lease. Indeed, the main factor on which Bauman J. relied in deciding that the arrangement before him was a financing lease was the default clause.

54 A court may use some or all of the *Smith Brothers* factors when assessing whether a particular transaction is a true lease or a financing arrangement. It is the substance of the transaction that is determinative.

55 Michael E Burke, in his article "Ontario *Personal Property Security Act* Reform: Significant Policy Changes" (2009) 48 Can Bus LJ 289 at 291-97, undertook an empirical review of the authorities and discussed the relative weight courts have placed on these factors. He stated at 291-92:

> First, from the universe of factors or indicia that have been mentioned in the jurisprudence, some factors or indicia (referred to in this paper as "primary factors") are clearly more important than other factors or indicia (referred to in this paper as "secondary factors"). Second, the presence of a primary factor in a lease will often be determinative of the characterization of the agreement. Third, secondary factors generally have a corroborative value and are not in and of themselves determinative of the characterization. Accordingly, the presence of a number of secondary factors that are indicative of a characterization that is contrary to the characterization indicated by the primary factor will not be sufficient to overturn the weighting given by a court to the primary factor. Fourth, in those situations where the primary factor is ambiguous or absent, then the relative weighting given by a court to the secondary factors will be relevant in determining the characterization of the lease in question.

56 Topolniski J. in *843504 Alberta Ltd., Re*, 2011 ABQB 448, 80 C.B.R. (5th) 177 (Alta. Q.B.) [*843504*] identified what Burke at 292-94 referred to as "primary factors:"

> (a) Relevance of the purchase option price - whether the purchase option price is nominal or reflective of fair market value.
>
> (b) Mandatory purchase options - whether there is a mandatory purchase option that obligates the lessee to purchase the equipment at the end of the term.
>
> (c) Open-end leases/guaranteed residual clauses - whether the lessee is liable for any deficiency in the sale of the equipment at the end of the term.
>
> (d) Sale-leaseback transactions - whether the transaction is structured as a sale and leaseback.

57 Topolniski J. then identified (at para 65) what Burke (at 295-98) referred to as "secondary factors":

> (a) The ability to replace/exchange leased equipment is indicative of a true lease.
>
> (b) The lessor's ability to accelerate payments and the residual value are generally inconsistent with a true lease. However, it is equally consistent with a true lease if the acceleration clause limits the lessor's damages to the present value of the remaining rents, plus the present value of the residual value at the end of the term, minus the value of net proceeds from a sale of the assets. If the acceleration clause is more narrowly crafted, it favours a security lease.
>
> (c) A full payment lease may be indicative of either form of lease, depending on the language of the provision.
>
> (d) A security deposit is indicative of a security lease.
>
> (e) A substantial down payment is indicative of a security lease.

(f) Covenants relating to maintenance, insurance and risk of loss can be indicators of either type of lease. They are weak evidence of a security lease.

(g) Whether the lessor uses different forms for different types of transactions may be some evidence of intention.

58 Burke also identified (at 297) some factors, such as the exclusion of warranties on the lessor's part, as "red herrings" because their presence (or lack of presence) in a lease is equivocal: see also Weisz, Rogers & McLean at 48-49.

59 On an application for leave to appeal this Court's assessment that a particular agreement at issue in these proceedings was a financing lease, the Alberta Court of Appeal in *De Lage Landen Financial Services Canada Inc. v. Royal Bank*, 2010 ABCA 394 (Alta. C.A.) at para 60 [*De Lage Landen (CA)*], refusing leave to appeal 2010 ABQB 637, 37 Alta. L.R. (5th) 82 (Alta. Q.B.) [*De Lage Landen (QB)*] expressly rejected the suggestion that there should be a hierarchy of factors that a court should use to determine if a lease is a true lease or a financing lease. In denying the leave application, Ritter J.A. stated at para 15:

> The applicant points to a British Columbia decision which suggests in *obiter* that there should be a hierarchy of factors used to determine if a lease is a true lease or a financing lease. In my view, this *obiter* runs contrary to current trends about how to weigh the factors in a legal test and about the deference afforded to courts of first instance in this respect. <u>If one factor trumps the others, there is simply no point in including the others in the test</u>. [Emphasis added].

60 During the present hearing before this Court, counsel spent a significant amount of time attempting to rationalize *843504* and *De Lage Landen (CA)*. In this Court's view, there is no conflict between the two. Topolniski J. in *843504* cited the Court of Appeal's decision in *De Lage Landen (CA)* and quoted (at para 60) this Court's observation in *De Lage Landen (QB)* at para 32 that:

> ... no one factor "is the *sine qua non* for determining whether a document is a true lease or a financing lease. One must look at the whole document to get a flavour of the [parties'] intentions ..."

While Topolniski J. referred to Burke's discussion of how courts weigh certain factors and outlined the results in her case of applying his "primary" and "secondary" factors, she did not necessarily endorse the view that there is a "hierarchy" of factors in every case.

61 Topolniski J. considered (at para 64) a provision in the lease before her which provided that:

- the lessee could return the vehicle at the end of the six-month minimum lease term;
- once the lessee returned the vehicle, the lessor would sell the vehicle;
- the lessee would keep the surplus if the sale proceeds exceeded the termination book value; and
- if the sale proceeds did not exceed the termination book value, the lessee would be liable for the shortfall.

She found this provision was indicative of a security lease since it rendered the lessee liable for a deficiency on the vehicle's sale at the end of the term.

62 Topolniski J. also applied Burke's "secondary" factors to the lease that was before her. There would have been no point in her doing so had she accepted that the lessee's liability for the deficiency trumped any and all secondary factors. She concluded that the secondary factors were not determinative of the proper characterization of the lease (at para 67). The presence of some secondary factors was insufficient to outweigh the clear effect of the primary factors in her case.

63 GE suggests that Topolniski J. acknowledged that the presence of a primary factor often can be determinative of the characterization, while absence or ambiguity in respect of the primary factors can make weighing of the secondary

factors more relevant. In fact, Topolniski J. did not make such a statement. She simply quoted the Burke article where Burke made that argument.

64 GE argues that while the presence of one of Burke's "primary" factors is significant, absence or ambiguity in respect of a primary factor is not determinative. It simply means that other factors will be more important in the analysis. For example, GE submits that the presence of an option to purchase at nominal value is a primary factor, and while its presence likely will result in the agreement being characterized as a financing lease, the absence of such an option or, indeed, the presence of an option to purchase at fair market value, means that focus must be directed to the other factors. GE suggests that this approach is consistent with authorities which hold that agreements without an option to purchase may still be classified as financing leases when the other indicia of financing leases are present.

65 The proper approach is more holistic than the one advocated by GE. While the presence or absence of one or more factors may loom larger than others, in all instances the inquiry remains focussed on determining the intention of the parties and is based on an interpretation of the entire agreement. As stated by the Alberta Court of Appeal in *De Lage Landen (CA)*, one factor cannot trump others in terms of the legal test. Courts must review the entire agreement and they must consider all factors. That is not to say, however, that certain factors may not have greater probative value than others in terms of the particular agreement before the court. In such a case, the court might give those factors greater weight. In all cases, the court must examine the various *Smith Brothers* factors and any other factors it considers material and relevant, balance those factors in the context of the entire agreement, and make a determination as to whether the agreement before it as a financing lease or a true lease. This is not a scientific exercise.

66 Counsel for several of the Applicants argue that payments that Cow Harbour made under leases containing an option to purchase were payments for "use," as the "purchase price" was not due and payable until Cow Harbour exercised the option to purchase or the lease came to an end and the lessee chose to pay the purchase price at a nominal sum. They cite *Ed Miller Sales & Rentals Ltd. v. R.* (1982), 42 A.R. 350 (Alta. Q.B.) [*Ed Miller*] in support of this position. Purvis J, in that case, relied in turn on *Ramsay v. Pioneer Machinery Co.* (1981), 28 A.R. 429 (Alta. C.A.) [*Ramsay*].

67 The issues in *Ramsay* were whether a transaction fell within the *Conditional Sales Act*, RSA 1970, c 61 and, if it did, whether the conditional seller could recover the purchase price through the sale of the equipment or by suing the conditional buyer. This was called the "seize or sue" provision. The Alberta Court of Appeal stated at para 20:

> ... Until the option is exercised the lessor is not pursuing his "right to recover the purchase price". If he chooses to recover the chattel he is exercising his right of possession on default, which is a right independent of any money claim. I have no hesitation in saying that [the seize or sue provision] is not applicable unless the lessor is seeking to recover the purchase money and he cannot seek to recover the purchase money until the option is exercised. It may be that a "lessor" who is found to be, in substance, a "conditional sales vendor" should be treated as a vendor claiming his purchase price within the section, but that is not this case.

68 In *Ed Miller*, the court considered whether lessors holding leases with options to purchase could maintain a priority claim to a builders' lien fund. The court applied the analysis in *Ramsay* in finding that until the lessees exercised the options to purchase, the lessors were not "sellers" under the *Conditional Sales Act* and, "... [t]hey are not attempting to recover a purchase price, but are attempting to establish priority against a lien fund for rental for equipment" (at para 49). As a result, the court held that the lessors' claims were not for payment of purchase moneys but for rental and, as a result, they were entitled to advance a claim for a lien for a reasonable and just rental of the equipment while used on the contract site (at para 50).

69 The now repealed *Conditional Sales Act* contained specific provisions concerning registration and remedies available to conditional sellers. The courts, when considering that statute, were more interested in the structure of the transaction than the parties' intention. In fact, the court in *Ed Miller* commented, "Stevenson J.A. [in *Ramsay*] found that it was sufficient to bring the transaction within the relevant sections of the *Conditional Sales Act* if it was established that the lessee merely had it within his power to acquire ownership. It was not necessary to establish intention" (at para 43).

70 When a court undertakes the true lease/financing lease analysis under the *CCAA*, substance, including the parties' intention, is one of the paramount considerations. The form the transaction takes is not. The "all or nothing" argument advanced by certain of the Applicants could just as easily result in all lessors of true and financing leases being precluded from receiving anything during the stay of proceedings.

71 Accordingly, it is of the utmost importance that this Court examine each lease individually to determine whether it falls within the category of a true lease or a financing lease.

72 Finally, it is a fundamental principle of contractual interpretation that a court must interpret an agreement as at the date it was made, as the exercise is intended to discern the intention of the parties at the time the contract was formed (*McDonald Crawford v. Morrow*, 2004 ABCA 150, 348 A.R. 118 (Alta. C.A.)).

V. Specific Leases

A. Scott Capital Group Inc. (Scott Capital) Leases

1. The leases

73 Five of the Disputed Leases are between Cow Harbour and Scott Capital. The lease details are as follows:

Lease number	*Date day/month/year*	*Term (months)*	*Capital Cost of Items*	*Monthly Rental*	*Option Price*	*Security Deposit*
6049520 Schedule 001	1/10/2009	60	$559,951	$10,469	25% of original capital cost	$55,995 = 10% of original capital cost
6049520 Schedule 002	30/10/2009	48	$801,250	$18,184	20% of original capital cost	$160,250 = 20% of original capital cost
6049520 Schedule 003	18/12/2009	48	$234,000	$5,295	Fair market value	$46,800 = 20% of original capital cost
6049520 Schedule 004	4/2/2010	48	$664,832	$16,717	Fair market value	$132,966 = 20% of original capital cost
6049520 Schedule 005	5/2/2010	48	$286,020	$7,190	Fair market value	$57,204 = 20% of original capital cost

74 All of the Scott Capital leases are subject to the terms of the Scott Capital Master Equipment Lease that the parties entered into on October 1, 2009 (Scott Master Lease). Scott Capital's affiant deposed that the Scott Master Lease had been in effect for 30 years, with the last revision having been made about ten years ago. He confirmed that Scott Capital used the same form for what Scott Capital intended to be true leases and financing leases. The number 6049520 refers to the Scott Master Lease to which all of the Scott Capital leases being considered are subject. This Court will refer to each lease by its Schedule number.

75 Scott Capital leased eight pieces of heavy equipment or vehicles to Cow Harbour under these five leases. It entered into all of these leases with Cow Harbour within six months prior to Cow Harbour's *CCAA* filing. In the case of the Schedule 001 lease, the equipment was only commissioned for use by Cow Harbour in July 2010, which was well into the *CCAA* proceedings.

76 The evidence of Scott Capital's affiant was that Cow Harbour sourced the equipment, negotiated the sale price and approached a broker to seek assistance with acquisition of the assets. The broker then contacted Scott Capital and the equipment went straight from the third party vendor to Cow Harbour.

77 Scott Capital's affiant deposed that Scott Capital generally structured its leases as true leases. His due diligence on Cow Harbour suggested that Cow Harbour might be in a precarious financial position. As a result, Scott Capital had no intention of providing "financing leases" to Cow Harbour. He deposed that Scott Capital made it clear to Cow Harbour, and Cow Harbour accepted and acknowledged at the time they negotiated the leases, that the lease options to purchase were to be at fair market value.

78 All of the leases identify the option price as being fair market value. In three of the leases, that value is not specified. In the other two, the fair market value of the equipment is pre-estimated and agreed by the parties to be a particular percentage of the original capital cost of the equipment (25 percent in the Schedule 001 lease and 20 percent in the Schedule 002 lease).

79 The security deposits that Scott Capital required Cow Harbour to pay under the leases amounted to 10 percent of the capital cost of the equipment in the case of the Schedule 001 lease and 20 percent of the capital cost of the equipment in the other four leases.

2. Lease-specific arguments of the parties

(a) Scott Capital

80 Scott Capital asserts that it did not structure its leases in such a way that Cow Harbour was financing its purchase of the equipment or accruing equity in the equipment over the lease term. Rather, Scott Capital structured the leases to ensure that the use, condition and value of the equipment were being controlled and maintained, as Scott Capital expected that Cow Harbour would return the equipment to it at the end of the lease terms. As the affiant stated on cross-examination:

> A. You will see that the terms on these leases are different. And part of that is because we feel that certain equipment may be perhaps more abused. Certain equipment naturally has a different life than other equipment.
>
> But that type of an analysis is factored into whether or not we will enter into a 48-month lease or perhaps a 60-month lease. If we think that equipment will be used gingerly, then we will perhaps enter into a longer-term lease. If we think that equipment will be used harshly in harsh conditions, we want to put it on a shorter-term lease. There always has to be value on that equipment in the event that it's returned.
>
> [Transcript of the cross-examination of Brian Jagt, 26 October 2010, p. 20, ll 21-34.]

81 The Schedule 003, Schedule 004 and Schedule 005 leases, in addition to other detailed terms concerning the maintenance and condition of the equipment, specified usage maximums in the return provisions of the lease. Scott Capital did this with specific care and concern for the equipment's condition, having regard to how Cow Harbour intended to use the equipment. The affiant explained that Scott Capital was concerned about the number of hours that Cow Harbour intended to use the equipment, rather than the number of kilometres of recorded use, as Scott Capital anticipated that the buses and trucks would be running constantly but not travelling great distances.

82 The purchase option prices set out in the Schedule 001 and the Schedule 002 leases (25 and 20 percent, respectively, of the original capital cost of the equipment) were not arbitrary figures. Rather, Scott Capital determined those prices and Cow Harbour agreed to those prices as a reasonable pre-estimate of the equipment's fair market value at the end of the lease term, based on Cow Harbour's anticipated use and the nature of the use.

83 Scott Capital points out that the present value of the rentals under each lease was less than 90 percent of the original equipment cost.

(b) Monitor

84 The Monitor suggests that the Schedule 001 and Schedule 002 leases are best characterized as financing leases because, among other factors, the end of term purchase option price appears to be arbitrary and bears no direct connection to the actual value of the leased equipment at the time Cow Harbour was to exercise the option. In other words, Cow Harbour appears to have acquired equity in the leased equipment because the fair market value of the leased equipment at the time Cow Harbour was to exercise the option may exceed the purchase option price.

85 In addition, the Schedule 001 and Schedule 002 leases overwhelmingly exhibit other indicia of a financing lease, as discussed in *Smith Brothers*, which militates against them being considered true leases. Specifically, the leases contain the *Smith Brothers* financing lease factors 3 to 10 and 13 to 16.

86 The Monitor points out that the aggregate rental under the Schedule 001 and Schedule 002 leases approximated the value of the purchase price of the equipment, factoring in interest and carrying costs (*Smith Brothers* factor 16), as the equipment in the Schedule 001 lease originally was valued at $559,951 plus applicable tax, while the total amount to be paid by Cow Harbour during the course of the term was $628,140 plus applicable tax. In the Schedule 002 lease, the equipment originally was valued at $801,249.96 plus applicable tax, while the total amount to be paid by Cow Harbour over the course of the term was $1,033,079.83 plus applicable tax.

87 In the Schedule 003, Schedule 004 and Schedule 005 leases, the end of term purchase option was referred to as "fair market value" (with no approximated value of what that value might be). While this factor militates in favour of each such lease being characterized as a true lease, the Monitor notes that, as in *Bronson*, these leases contained default provisions which guaranteed to Scott Capital the residual value of the equipment. These three leases contained financing lease *Smith Brothers* factors 3 to 10 and 13 to 15.

(c) GE

88 GE takes the position that the Scott Master Lease bears the indicia of a financing lease as *Smith Brothers* factors 4 to 11 and 13 to 15 are present.

89 It says the present value of the rental payments is irrelevant. The more important factor is that the aggregate cost of the rental payments exceeded the value of the equipment at the commencement of the lease.

90 GE points to the evidence of Scott Capital's affiant that the amount of the security deposit that Cow Harbour paid at the outset of the Schedule 002 lease was equal to the amount of the purchase option at the conclusion of the term. It contends this was equivalent to a nominal purchase option price and suggestive of a financing lease as Cow Harbour, at the outset of the lease, paid the amount of the purchase price due at the conclusion of the lease.

91 GE maintains that, if this Court accepts Scott Capital's assertion that the purchase price options in the Schedule 003, Schedule 004 and Schedule 005 leases were for fair market value, it would be accepting form over substance. Scott Capital's affiant confirmed that the amount of the security deposit that Cow Harbour paid in respect of each of these three leases at the outset of the leases was equal to Scott Capital's internal estimate of the remaining value of the equipment at the conclusion of the leases. Said differently, Cow Harbour, at the outset of the lease, paid what was estimated to be the equipment's remaining value at the conclusion of the lease, leaving Cow Harbour with a nominal purchase option.

3. Decision

92 Applying the *Smith Brothers* criteria to the five Scott Capital leases reveals the following:

1. Whether there was an option to purchase for a nominal sum - No, the purchase price was reflective of fair market value (see discussion below).

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - The affiant acknowledged financing leases are a small portion of its business.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - Yes.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

93 What do these results establish?

94 Scott Capital's affiant conceded that Cow Harbour sourced the equipment and then approached a broker to seek assistance with acquisition of the assets. The broker would then contact Scott Capital. The way in which the leases came about is more reflective of a financing lease transaction than a true lease situation. However, it is important for this Court to examine the structure of each transaction to characterize properly the agreement.

95 All of the leases had purchase options. This Court must attempt to value the purchase price option as at the date Cow Harbour and Scott Capital executed the lease agreements. As stated in the *Handbook* at 55:

> A clause in a lease giving the option to purchase the goods at less than their expected market value (as determined at the date of execution) indicates that the lessee has acquired an equity in the goods not unlike that which he would have acquired under an instalment purchase contract.
>
> [Emphasis added.]

96 In *Ontario Equipment (1976) Ltd., Re* (1981), 33 O.R. (2d) 648 (Ont. Bktcy.) at para 9, aff'd (1982), 35 O.R. (2d) 194 (Ont. C.A.), Henry J. considered the nature of the option to purchase to be a critical factor in distinguishing between true leases and financing leases in personal property security legislation cases, stating:

> The test in determining whether an agreement is a true lease or a conditional sale is whether the option to purchase at the end of the lease term is for a substantial sum or a nominal amount ... If the purchase price bears a resemblance to the fair market price of the property, then the rental payments were in fact designated to be in compensation for the use of the property and the option is recognized as a real one. On the other hand, where the price of the option to purchase is substantially less than the fair market value of the leased equipment, the lease will be construed as a mere cover for an agreement of conditional sale.

97 Whether a purchase option price is nominal is fact-specific. A purchase option for a nominal sum is indicative of a financing lease. On the other hand, a purchase option at fair market value is highly suggestive of a true lease. The rationale, according to Burke, is that, "[i]f the lessee is required to pay the actual value of the property at the end of the lease at a time when the property still has value, then the lease payments cannot reasonably be said to have been payments towards an equity interest in the property" (at 293).

98 However, as noted by the Master in *Bronson* at para 55 and confirmed by the British Columbia Supreme Court in that case (at para 7), the mere existence of a fair market value purchase option price in the agreement is not necessarily determinative of whether the agreement is a true lease or a financing transaction.

99 In *Smith Brothers*, Bauman J. commented that simply because the lessee can purchase the equipment at its fair market value at the end of the lease does not prevent a court from characterizing the transaction as a financing transaction if the end of the lease term is roughly equivalent to the end of the equipment's useful life (at para 76).

100 Professors Cuming and Wood explained in their *Handbook* at 55 that:

> A clause in a lease giving the lessee the option to purchase the goods at less than their expected market value (as determined at the date of execution) indicates that the lessee has acquired an equity in the goods not unlike that which he would have acquired under an instalment purchase contract. The economic reality is that it is quite predictable the lessee will pay this amount to the lessor. Consequently, the transaction is likely to be characterized as a security agreement. However, the fact that at the end of a lease term roughly equivalent to the useful life of the goods the lessee can purchase the goods at their then market value does not prevent characterization of the transaction as a security agreement. If one or more of the major indicia of a security agreement are present, the transaction may be a security agreement. Accordingly, if the lease is for all or the greater part of the useful life of the leased equipment and the lessee is obligated to pay rental equivalent to the capital cost of the goods and an appropriate credit charge, the fact that the lessee is given the right to buy the goods at the end of the term for their then small market price should play no role in the characterization process. A consideration of the option price is relevant to the characterization of the transaction only if the option can be exercised at a time when the goods have significant commercial value. It may be possible to show that the option price was not designed to ensure that the lessor is fairly compensated for his interest in the goods, but was included for some other purpose (such as satisfying income tax authorities). This provides strong evidence that the parties recognize that by the time the option is exercised the lessor has been fully compensated through rental payments and that it matters little to either the lessor or the lessee that the option is or is not exercised.

101 In the Schedule 001 and Schedule 002 leases, the purchase option price was expressed to be the "fair market value" of the equipment, pre-estimated and agreed by the parties to be 25 percent and 20 percent, respectively, of its original capital cost. These percentages equated to purchase prices of $139,987.75 (Schedule 001 lease) and $160,249.99 (Schedule 002 lease). These are not nominal amounts.

102 Scott Capital's affiant deposed that Scott Capital used a "combination of past experience, extensive equipment knowledge, market knowledge and the application or intended use of the equipment to determine the value of any purchase option at lease end such that it is a reasonable estimate of fair market value."

103 The Schedule 003, Schedule 004 and Schedule 005 leases all stated that the purchase option price was "fair market value." There is no evidence to suggest that the parties meant or intended otherwise.

104 This Court finds that the options were for fair market value or a reasonable pre-estimate of such.

105 There was no evidence that 60 months in the case of the Schedule 001 lease or 48 months in the case of the Schedule 002, Schedule 003, Schedule 004 and Schedule 005 leases was roughly equivalent to the end of the useful life of the equipment involved in those leases. In fact, Scott Capital's affiant stated that Scott Capital structured the leases to ensure there was value in the equipment at the end of the lease term.

106 These leases did not contain any mechanism, either in a default situation or at full term, whereby the surplus value of the equipment would go to Cow Harbour. If, at the end of the term of each lease, Cow Harbour did not exercise the purchase option to acquire the equipment, Cow Harbour had to return the equipment to Scott Capital. Scott Capital could then deal with the equipment as it saw fit for its own benefit and account. Cow Harbour was not responsible under any of these leases for any deficiency or shortfall on the sale of the equipment at the end of the term.

107 The Scott Master Lease s 13(f) contained a default clause allowing for liquidated damages to consist of the present value of rents owing to the end of the term, plus the present value of the residual value of the equipment "which Lessor expected to receive at the expiry of the term of the lease, which is equal to the Fair Market Value of the Equipment as set out in the Equipment Schedule ...," minus the net proceeds from a sale or lease of the equipment. The lease schedules stated that if Cow Harbour defaulted in its obligations under the lease, Scott Capital would retain the security deposit as liquidated damages.

108 The default provisions in *Daimler Chrysler Services Canada Inc. v. Cameron*, 2007 BCCA 144 (B.C. C.A.) [*DaimlerChrysler*], rev'g 2006 BCSC 1992, 32 C.B.R. (5th) 188 (B.C. S.C.) were similar (other than retention of the security deposit). The court found that the lease secured the payment of the residual value by the lessee in the contingency of default (at para 28). The court went on at para 37 to say:

> ... the basis for calculating damages does not distinguish a true lease from a security lease. The ability to claim accelerated damages in *Langille* was not a consequence of the character of the lease, i.e., a true lease or a security lease. Rather, it was simply the proper measure of damages for breach of a chattel lease. Generally, the basis for calculating damages can provide only some insight as to whether an impugned lease secures payment or performance of an obligation. I emphasize that it cannot serve as a decisive factor.

109 The Chambers Judge had concluded in *Daimler Chrysler* that the transaction was a security lease, following *Bronson*, which found that the default clause secured payment of both the lease payments and the option price. On appeal, the court determined that the chambers judge had placed undue weight on the default provision as it can have only corroborative effect (at para 46).

110 According to Burke at 294:

> If, however, the lessee's residual value guarantee only applies in the case of an early termination of the lease, whether voluntarily by the lessee or by the lessor as a result of the occurrence of a default, but not at the end of the scheduled lease term, then such a residual value guarantee will not constitute a primary factor that is indicative of a security lease.

111 In the case before this Court, the default provisions contained in the Scott Capital leases are equivocal.

112 The aggregate of rental payments for each of these leases is greater than the original capital cost of the equipment. Professors Cuming and Wood expressed their view in the *Handbook* that if the lessee must pay the equivalent of the lessor's capital investment plus a credit charge at the rate existing at the date of the agreement, there is strong but not conclusive evidence of a secured sale (at 54). However, Burke commented at 296:

> If a lessee is required to pay what is the equivalent of the original cost of the leased property (i.e., the lessor's capital investment), plus a finance charge based on the rate existing at the date of the lease agreement, it does not necessarily follow that such an agreement is a security lease, especially if the lease contains a true fair market value purchase option.
>
> In such a lease, it is possible that the lessee has simply agreed to pay a premium for the use of the leased property.

113 The Schedule 003, Schedule 004 and Schedule 005 leases contain specific use limitations with corresponding excess use charges. In *Daimler Chrysler*, the Chambers Judge found that excess kilometre charges and maintenance obligations were indicative of a true lease as they protected the lessor against reduction of market value on expiry of the lease term due to excess "wear and tear" (at para 25). Burke, however, considered such provisions equally consistent with a financing lease, as they suggest that the lessee bears some risks of ownership (at 296). This Court finds that those provisions are equivocal in the case of the Scott Capital leases.

114 All five Scott Capital leases required substantial security deposits. The evidence of Scott Capital's affiant on cross-examination was that for four of the five Scott Capital leases, the amount of the security deposit was equivalent to the purchase option price in the lease or the anticipated purchase option price (transcript of the cross-examination of Brian Jagt, 26 October 2010, pp 43-45). He explained that in terms of the Schedule 003, Schedule 004 and Schedule 005 leases (which have purchase options simply stated to be at "fair market value"), the security deposit was based on the "estimated" fair market value of the equipment, but that this was just Scott Capital's internal estimate (transcript of the cross-examination of Brian Jagt, 26 October 2010, pp 39-42). Scott Capital did not provide this information to Cow Harbour. Cow Harbour had the ability to purchase the equipment at the end of the term of the lease for the "fair market value," irrespective of whether that amount turned out to be less than, equal to, or greater than the amount of the security deposit.

115 During cross-examination, the Scott Capital affiant gave the following evidence:

> Q. And would I be correct in stating as well that typically if a purchaser or if a lessee does exercise an option to purchase the equipment at the end of the lease, the deposit will be utilized in some fashion to acquire the equipment?
>
> A. It depends on the customer. Some customers want us to reimburse in the form of a cheque their security deposit, and then they pay us a separate cheque for the full amount if they purchase it. And other customers just tell us to net it against their purchase option, making sure that the bill of sale records the correct gross purchase price and then with the reflection that the other amount has been applied.
>
> Q. And was there any discussion with Cow Harbour at any point in time with respect to how the deposit, whether the deposit would be utilized for the purchase price of the asset if Cow Harbour did exercise an option to purchase?
>
> A. There was no discussion with Cow Harbour.

[Transcripts of the cross-examination of Brian Jagt, 26 October 2010, p 25, ll 8-26.]

116 This Court finds that Scott Capital's estimated fair market value at the end of the lease term was a reasonable "security deposit" amount to protect against its risk that Cow Harbour might not return the equipment to it when the lease ended because of some total loss event or that Cow Harbour would return the equipment to Scott Capital in such

poor condition that the equipment no longer had value. In such cases, the security deposit would have served its stated purpose of being a recourse for Scott Capital's damages under the lease.

117 There are certainly indicia of a financing arrangement. There are hypothetical situations under which Cow Harbour could indeed have built up equity and paid only the residual amount of the equipment's capital cost plus a financing charge; *e.g.* if it defaulted in its obligations under the leases. Those hypothetical situations did not occur, however, and based on the wording of the leases, Cow Harbour was paying for use of the equipment.

118 Although the security deposits are relatively substantial, there was no obligation on Cow Harbour's part to forfeit the security deposits at the end of the lease term. It could simply return the equipment and demand the security deposits (less any additional charges that it had incurred in the meantime). This is especially so with respect to the Schedule 001 lease, where the purchase option price was 25 percent of the equipment's original capital cost, while the security deposit was ten percent. Although Burke suggested (at 296) that a substantial security deposit is indicative of a financing lease in that the lessee is required to post collateral to obtain the equipment, considering the whole of the Scott Capital lease agreements, this factor is not determinative and, in fact, it assists Scott Capital in its position.

119 For the foregoing reasons, this Court concludes that the Scott Capital leases are true leases.

B. Caterpillar Financial Services Limited (CFSL) Lease

1. The Lease

120 Cow Harbour leased a Caterpillar off-highway truck from CFSL pursuant to a lease dated March 27, 2006. According to CFSL's affiant, the original cost of the truck was $2,235,456. The amount shown in the floating rate addendum was $500 more, which CFSL's affiant explained was a fee payable by Cow Harbour (transcript of the cross examination of Renee Bertha Fournier, 21 October 2011, p. 7, ll 32-41). The lease term was 60 months. The lease required Cow Harbour to pay irregular monthly payments pursuant to the terms of the irregular payment schedule attached to the CFSL lease (6 months at $100,000 and 54 months at $28,397.86). The aggregate amount of those rents was about $2,133,485.

121 If Cow Harbour exceeded the maximum hours of use of the equipment, it was to pay an excess hour charge.

122 The CFSL lease contained an end of term purchase option price of $524,535.

2. Lease-specific arguments of the parties

(a) CFSL

123 CFSL argues that the most probative factor is that the purchase option price was neither a nominal sum nor arbitrarily selected. Rather, it calculated the purchase option price after considering factors such as depreciation, historic resale market for like equipment, application, exchange rate and annual hours of usage. The purchase option price represented 102 percent of the standard residual amount, which CFSL calculated to be $514,250, and was more than 15 percent of the value of the truck at the commencement of the term.

124 According to CFSL, the purchase option price was an amount intended to represent a reasonable pre-estimate of the fair market value of the truck at the end of the lease term. It relies on the statement by Burke (at 293) that, "[i]f the lessee is required to pay the actual value of the property at the end of the lease at a time when the property still has value, then the lease payments cannot reasonably be said to have been payments towards an equity interest in the property." CFSL says that the term of the lease did not exceed 75 percent of the economic useful life of the truck, which it estimated to be 120 months.

125 The net present value of the rental payments is $1,865,621.73, which is less than 90 percent of the equipment's value at the beginning of the term. CFSL points out that the rental payments could not be applied in satisfaction of the purchase option price.

126 CFSL maintains that other factors point to this being a true lease, including:

- the lack of any requirement for a security deposit or down payment

- Cow Harbour was not required to pay the equivalent of the original cost of the truck, plus a financing charge based on a rate existing at the date of the CFSL lease

- Cow Harbour was required to maintain certain minimum standards of repair with respect to the truck.

CFSL submits that the latter factor is consistent with it attempting to protect its interest in the residual value of the truck on its return at the end of the lease.

127 Cow Harbour was not required to make a residual payment at the end of the lease term or to guarantee residual value. Cow Harbour could exercise the option or return the truck to CFSL.

128 CFSL asserts that the presence of other factors, such as the inability of Cow Harbour to exchange or replace the truck; a default provision favourable to CFSL; and the inclusion of the floating rate addendum, should be given less weight in comparison with the fair market value option to purchase. Equipment lessors are in the business of making money and the floating rate addendum simply reflects its cost of capital or a return of investment.

129 CFSL relies on *Daimler Chrysler* in arguing that the acceleration of rent on default is equivocal.

130 CFSL submits that given Cow Harbour's operations, the specialized equipment it was leasing and the relatively remote location of the oil sands site where it was working, it was only logical that CFSL would impose the obligation for insurance, maintenance and the risk of loss on Cow Harbour. Accordingly, these are neutral factors.

(b) Monitor

131 The Monitor contends that the CFSL lease is best characterized as a financing lease because, among other factors, the end of term purchase option price (approximately 23 percent of the original value of the equipment) appears to be arbitrary and bears no direct connection to the actual value of the leased equipment at the time Cow Harbour exercises the option. In other words, Cow Harbour appears to have acquired equity in the leased equipment because the fair market value of the leased equipment at the time when the option could be exercised might exceed the purchase option price. This leads to the conclusion that the lease is a financing agreement and/or a lease pursuant to which payments are made for "use and equity."

132 The Monitor suggests that the CFSL lease exhibits other indicia of a financing lease, as discussed in *Smith Brothers*, which militates against it being considered a true lease. Specifically, *Smith Brothers* factors 4 to 6, 8, 9 and 13 to 16 are present in the CFSL lease. The Monitor notes that the equipment originally was valued at $2,235,956 plus applicable tax, while the total amount that Cow Harbour was to pay during the course of the term was $2,658,019.44 plus applicable tax. Therefore, the aggregate rentals approximated the value of the purchase price of the equipment factoring in interest and carrying costs.

(c) GE

133 GE focuses on the floating rate addendum, which provided that the rental payments were subject to an interest rate adjustment. It says this resulted in the lease operating like a credit or loan agreement. GE notes that:

- CFSL charged interest to Cow Harbour equivalent to its cost of acquiring the truck;

• the interest rate that CFSL charged fluctuated over the term of the lease, according to the cross-examination of CFSL's affiant (transcript of the cross-examination of Renee Bertha Fournier, 21 October 2011, p.6, ll 5-8);

• Cow Harbour had the option, at any time over the term of the lease, to lock into a fixed interest rate equal to the rate of interest charged to CFSL on fixed rate loans (transcript of the cross-examination of Renee Bertha Fournier, 21 October 2011, p.8, ll 30-41; p.9, ll 1-4);

• at the end of the lease, Cow Harbour's final rent payment was subject to a credit or debit adjustment on the interest rate fluctuation over the term of the lease.

GE suggests that this is the most significant evidence the lease was a financing arrangement.

3. Decision

134 The following results from applying the *Smith Brothers* criteria to the CFSL lease:

1. Whether there was an option to purchase for a nominal sum - No, the purchase price was reflective of fair market value.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - It acted as both a financing and a leasing company, according to its affiant.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - The lessee was to pay any taxes due on its exercise of the sale option.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Not specifically in the lease agreement

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - No.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes, if interest payments are added to the rent.

135 Cow Harbour selected the truck and CFSL acquired the truck to lease to Cow Harbour.

136 This Court finds that the purchase option price for the CFSL equipment was a reasonable pre-estimate of the truck's fair market value at the end of the 60-month lease term. It was approximately 23 percent of the truck's original price. Based on CFSL's estimate that the truck had an economic useful life of 120 months, it was reasonable for CFSL to believe that the truck would still have value at the end of the lease term. No evidence was led which would suggest otherwise.

137 The lease did not require Cow Harbour to pay a security deposit or down payment. While CFSL was entitled to accelerate rental payments on default, Cow Harbour was not responsible for the residual value, if any, of the truck.

138 The aggregate rent was about five percent less than the truck's original value. However, as is apparent from the floating rate amortization schedule attached to the lease, the rent payments and option purchase price together amounted to the capital cost of the truck, plus a seven percent interest rate (Toronto Dominion prime plus 1.50 percent).

139 GE argues that a "payment for use" contract will not impose an obligation on the lessee to pay interest on the funds that the lessor uses to acquire the leased equipment. However, in this Court's view, it is just as likely that such a charge will be included in a true lease, *albeit* it may be incorporated in the overall rental amount rather than being identified as interest or a financing charge.

140 Some of the terminology that CFSL used in the floating rate addendum suggests that it is an addendum to a financing lease agreement. The terminology includes "principal balance," which is defined as "equal to the amount of *credit extended* of $2,235,956.00, as adjusted by amortization during the term of the Contract" (emphasis added). Also, "gross lease" was defined as meaning "the total *Amount of Credit Extended and Aggregate Finance Charge(s)* payable hereunder" (emphasis added). These definitions, however, are not definitive and this Court must look at the lease as a whole.

141 Cow Harbour was not obliged to exercise the purchase option. If it did, the purchase option price was a significant amount and CFSL was not guaranteed the residual value of the truck unless Cow Harbour exercised the option. This Court finds that Cow Harbour simply agreed to pay a premium for the use of the leased property.

142 In looking at the CFSL lease as a whole, this Court holds that it was a true lease.

C. Wajax Industries (Wajax) Leases

1. The Leases

143 Wajax had three leases with Cow Harbour, as set out below:

Lease number (Monitor's Report)	*Date day/ month /year*	*Initial Term (months)*	*Original Cost of Equipment*	*Monthly Rental*	*Option Price*	*Assessed Value June 2010*
196	12/11/2008	6	$439,810	$16,500	$439,810, less a % of rent payments	$130,000
198	8/4/2009	6	$1,681,500	$40,000	$1,681,500, less a % rent payments	$450,000
197	8/4/2009	6	$991,860	$30,000	$991,860, less a % of rent payments	$175,000

144 The leases were for a maximum six-month initial term, with month-to-month extensions allowed after the initial term. Cow Harbour could exercise the option to purchase at any time during the initial term of the lease, or within 6 months after that, if CFSL extended the term of the lease.

145 Cow Harbour was responsible to pay the specified monthly rental, unless it used the equipment for more than 200 hours in a month, in which case it was required to pay overtime charges.

146 The option to purchase was for the original cost of the equipment, but if Cow Harbour exercised it during the initial six-month term, 85 percent of the rental payments that Cow Harbour had made was to be credited towards the purchase price. Wajax had the sole option to extend the option to purchase for a further six-month term. If Cow Harbour exercised the option during the second six-month term, Wajax was to credit towards the purchase price 85 percent of the rental payments that Cow Harbour had made during the first six month term and 50 percent of the rental payments that Cow Harbour had made during the second six-month term.

147 Cow Harbour did not exercise the option to purchase during the initial six-month term and Wajax did not extend the option to purchase beyond that term. At the date this Court granted the Initial Order, Cow Harbour no longer had an option to purchase the equipment.

2. Lease specific arguments of the parties

(a) Wajax

148 Wajax's affiant deposed that Wajax is not in the business of providing equipment financing. He stated that, in this case, Wajax entered into short-term rental agreements with Cow Harbour to accommodate Cow Harbour's need for the equipment and to permit Cow Harbour time to find third party financing for payment of the purchase price.

149 The affiant stated that Wajax set the rental rate with a view to covering the equipment's depreciation during the rental period, as Cow Harbour could have returned the equipment after the initial six-month term without incurring any further obligation to Wajax.

150 Wajax emphasizes that the focus on this application should be on whether the lease agreements secured payment of the purchase price for the equipment. Wajax suggests that this Court should bear in mind the distinctions between leasing consumer goods to an individual versus leasing a large piece of equipment that generates revenue for a business.

151 Wajax submits that the percentage of the rental payments credit that Cow Harbour would have received had it elected to exercise the option to purchase the equipment was minimal when compared to the purchase price for the equipment. It asserts this credit was not "equity" given the equipment's depreciation, as demonstrated by the Ritchie Brothers valuations that were undertaken in these proceedings and the evidence of Wajax's affiant.

152 Wajax notes that there was no mandatory purchase option and no liability for any deficiency on the sale of the equipment following the expiry of the lease. It says these were not sale-leaseback transactions. Under the leases, Wajax could replace the equipment with a comparable piece of equipment if Cow Harbour did not exercise the purchase option during the first six months. Further, if Cow Harbour defaulted, Wajax was entitled only to the amounts that Cow Harbour owed to it under the agreement plus 30 percent of the aggregate rental charges for the unexpired portion of the term as a pre-estimate of liquidated damages. Wajax maintains this was a weak default clause.

153 Wajax points out that the assessed fair market value of the equipment in June of 2010 was significantly less than the purchase option price, even after the second term. As a result, Cow Harbour had not built up equity in the equipment through the lease agreements.

(b) Monitor

154 The Monitor acknowledges that the Wajax leases could be characterized as financing leases or true leases, depending on the approach used in performing the characterization analysis.

155 The Monitor says the Wajax leases were not security agreements under a personal property security analysis. However, it maintains that Cow Harbour made payments for use of and earned equity in the equipment during the first six months of the leases. This militates in favour of the leases being considered financing leases.

156 The Monitor notes that the six-month purchase option period had expired under each of the leases, and Wajax had not given any indication of its election to extend the purchase option period. Therefore, it would appear that Cow Harbour no longer had any equity in the leased equipment, which would militate in favour of each lease being considered a true lease.

(c) GE

157 GE contends that the Wajax leases bear several indicia of financing leases, including Cow Harbour's:

- obligation to pay all taxes incidental to ownership;
- responsibility for insuring the equipment;
- responsibility for payment of license fees for maintenance of the equipment;
- bearing the entire risk of loss

As well, it asserts that the default provisions were inordinately favourable to Wajax, and the leases contained a provision providing for liquidated damages.

158 GE contends that the rental payments earned Cow Harbour a significant equity interest in the equipment over the term of the leases. It says that the most significant factor is that Wajax intended to sell the equipment to Cow Harbour pursuant to the leases, as confirmed by Wajax's affiant. As well, Cow Harbour previously had purchased a number of pieces of the same type of equipment from Wajax.

3. Decision

159 Application of the *Smith Brothers* criteria to the Wajax leases reveals the following:

1. Whether there was an option to purchase for a nominal sum - No, the option purchase price was reflective of fair market value.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - Yes, but contingent on the option to purchase being exercised.

3. Whether the nature of the lessor's business was to act as a financing agency - No.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes, but only 30 percent of the aggregate rental charges for the unexpired portion of the term, as a pre-estimate of liquidated damages.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Wajax is the exclusive dealer for Hitachi equipment in Canada. The equipment was new when it provided the equipment to Cow Harbour.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - No. However, rent for the minimum rental period was payable before delivery of the equipment.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - No (see discussion below).

14. Whether there was a provision in the lease for liquidated damages - Yes (see discussion below).

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - No.

160 The parties' intent in this case was that Cow Harbour would purchase the equipment, which was the subject of these leases, if it could find a third party to finance its purchase of the equipment.

161 If Cow Harbour exercised the option to purchase within the first six-month term of the leases, it would be credited with 85 percent of the rental payments made. Professors Cuming and Wood commented in the *Handbook* at 56 on this type of situation:

> Some leases provide that rental payments made up to the point when the option is exercised are to be "credited" to the lessee and deducted from the amount payable under the option. Under an economic realities test, the amount "credited" to the lessee has little significance; it remains necessary to determine if the amount of new money to be paid by the lessee represents the reasonably expected fair market value of the goods at the time of exercise of the option. If the new money is equal to or near the market value of the goods, the "credit" is of no significance. If the amount of new money is significantly less than the market value of the goods, the term providing for the credit is an overt recognition that the debtor has purchased an "equity" in the goods through his lease payments. It is inevitable that, as a rational person, the lessee will exercise the option in order to realize that equity.

162 This Court finds that the purchase option price or "new money" in this case was a reasonable pre-estimate of what the market value of the equipment would be if and when Cow Harbour exercised the option, taking into account depreciation, which was reflected by the rental "credit." These were relatively short term leases. In any event, the six-month option had expired for each lease and Wajax did not extend them for a second term.

163 While there was a default clause in each case which allowed for acceleration of rents, it was only for 30 percent of the aggregate rental charges for the unexpired portion of the term. Further, Cow Harbour had no liability for deficiency on sale of the leased property at the end of the term.

164 Accordingly, this Court finds that the Wajax leases were true leases.

D. Kempenfelt Vehicle Leasing (a Division of Equirex Vehicle Leasing 2007 Inc.) (Kempenfelt) Leases

1. The Leases

165 Kempenfelt had four leases with Cow Harbour, as described below:

Lease number	*Date day/month/ year*	*Initial Term (months)*	*Original Cost of Equipment*	*Monthly Rental*	*Option Price*
ZNCS1001	2/2/2010	66	$202,738.90	$4,122.95 (plus one initial payment of $20,468)	$20,268 at 60 months, FMV at 66 months
ZNEW1002	10/2/2010	66	$145,000.00	$2,979.99 (plus one initial payment of $14,700)	$14,500 at 60 months, FMV at 66 months
ZEX1002	2/2/2010	66	$101,369.00	$2,061.48 (plus one initial payment of $10,334)	$10,134 at 60 months, FMV at 66 months
ZNEY1002	10/2/2010	66	$101,369.00	$2,061.48 (plus one initial payment of $10,334)	$10,134 at 60 months, FMV at 66 months

166 All the leases required Cow Harbour to make an initial payment, roughly equivalent to 10 percent of the original cost of the equipment, and approximately the same amount as the purchase option price. These payments are not identified as security deposits. However, clause 20 of each lease makes reference to a security deposit, which is refundable at the termination date of the lease, provided Cow Harbour has not defaulted under the lease.

2. Lease-specific arguments of the parties

(a) Kempenfelt

167 Kempenfelt takes the position that all of these leases fall within C*CAA* s. 11.01(a). In the alternative, Burke's primary/secondary factor approach applies, as the *Smith Brothers* factors are not equally probative of the issue as to whether the leases are true leases or financing leases.

168 Kempenfelt points out that under each lease, Cow Harbour was entitled to purchase the leased equipment for approximately 10 percent of its original value at the end of 60 months, or at fair market value at the end of the 66-month term. Kempenfelt's affiant deposed that the purchase option price was the estimated fair market value of the equipment at the conclusion of the lease term. She did not specify how Kempenfelt arrived at, or calculated, that value.

169 Kempenfelt notes that the leases contained a guaranteed residual clause, but only if Cow Harbour defaulted or on early termination of the leases. Kempenfelt contends that the acceleration of rents on default is typical of both true leases and financing leases. It says the leases were not full payment leases. Cow Harbour was not required to pay a security deposit or down payment. All payments were described in the leases as "rent."

(b) Monitor

170 The Monitor submits that the leases are best characterized as financing leases because the 60-month purchase option price (approximately 10 percent of the original value of the equipment) appears to be arbitrary and bears no direct connection to what the actual value of the leased equipment might be at the time Cow Harbour exercised the option.

171 The Monitor says the leases overwhelmingly exhibit other *Smith Brothers* indicia of a financing lease. Specifically, *Smith Brothers* financing lease factors 3 to 7, 9, 10 and 13 to 15 are present in the Kempenfelt leases. The Monitor

asserts that the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs. It points out that under the terms of lease ZNCS1001, the equipment originally was valued at $202,738 plus applicable tax, while the total amount Cow Harbour was to pay during the lease term, including the initial payment, was $288,459.95 plus applicable tax. In both leases ZEX1002 and ZNEY1002, the equipment originally was valued at $101,369 plus applicable tax, while the total amount Cow Harbour was to pay during the lease term of each lease, including the initial payment, was $144,330.30 plus applicable tax. In lease ZNEW1002, the equipment originally was valued at $145,000 plus applicable tax, while the total amount Cow Harbour was to pay during the lease term, including the initial payment, was $208,399.35 plus applicable tax.

(c) GE

172 GE contends that the Kempenfelt leases are full payment leases. GE notes that the aggregate cost of the rental payments exceeded the equipment's original cost in each case.

173 GE notes that the purchase option price exercisable after 60 payments was less than the remaining payments due under the leases. Therefore, the economic reality was that Cow Harbour would be inclined to purchase the equipment for that lower price.

3. Decision

174 The following are the results of applying the *Smith Brothers* criteria to the Kempenfelt leases:

1. Whether there was an option to purchase for a nominal sum - See discussion below.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - The leases refer to a security deposit in clause 20.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Kempenfelt was permitted to accelerate rent on default.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

175 Each lease referred to a security deposit and stated that Cow Harbour would not earn any interest on the deposit. Kempenfelt was to return the security deposit to Cow Harbour on the termination of the lease. The leases, however, did not identify any security deposit, unless it was meant to be the first payment, which in each case was approximately 10 percent of the original value of the equipment, or five times the other monthly rental payments.

176 The aggregate of the rental payments, not including the initial payment, was more than the original cost of the equipment in each case. The purchase option price available at 60 months was approximately the same as the remaining five monthly rental payments, less interest.

177 At the end of the term of each lease, the lessee could return the equipment to Kempenfelt or exercise the option to purchase the equipment at fair market value.

178 This Court finds that the option served merely as window dressing. The economic reality was that Cow Harbour would have exercised the 60-month option, whether the first payment was considered a security deposit or actual rent.

179 Considering all of the *Smith Brothers* factors, this Court concludes that the Kempenfelt leases were financing leases.

E. Concentra Financial (Concentra) Lease

1. The Leases

180 Concentra's lease 7958-1, dated February 24, 2006, was for a new off-highway mining truck. The original cost of the truck was $2,335,456, according to the Monitor's brief. The vendor was shown as Finning (Canada). The initial term of the lease was 60 months. The lease required one payment of $100,000 and 59 monthly payments of $35,224.79. The end of term resale value was identified as $415,000.

181 Under clause 10 of lease 7958-1, Cow Harbour unconditionally guaranteed the end of term minimum resale value of the equipment, on or at expiry of the lease or any renewal term.

182 Attached as part of an appendix to the Monitor's 13th Report was a Concentra lease credit approval relating to this equipment. Concentra approved a "loan" of $2,075,000, with an "origination fee" of $21,000 and contract initiation fee of $5,188. Monthly rental was shown as $35,224.78, with the term being 60 months. Approval was said to be subject to a "rental" payment in advance of $100,000. Also attached was a Capital City Savings amortization schedule for a $2,075,000 loan, at a nominal annual rate of 8.321 percent, compounded monthly, showing the payments noted above in the lease document, plus a $415,000 payment on February 20, 2011. The copies of these document that this Court reviewed were not signed and Concentra's affiant was not cross-examined on them.

183 The other lease is referred to as "Alter Moneta Equipment Schedule Number 2 to Master Lease No. CCB5314A." It is dated April 18, 2007 and was assigned to Concentra by Alter Moneta Corporation on September 27, 2007. The subject of the lease was a new CAT off-highway truck and accessories, the net price of which was shown as $2,558,295. The term of the lease was 60 months. The payment schedule addendum provided for an initial payment of $683,295 and 59 monthly payments of $40,372.39 each. The lease contained an option to purchase for $1 at the end of the initial lease term or end of any renewal period

2. Lease-specific arguments of the parties

(a) Concentra

184 Concentra notes that under clause 9 of lease 7958-1, if either party elected not to renew the lease or elected to cancel it during the renewal period, the lessee could return the equipment to Concentra.

185 Concentra suggests the default clause is typical, presumably meaning it is equivocal.

186 Lease 7958-1 did not have an option to purchase. Nor was there a mandatory option requirement. There was no ability for the lessee to exchange equipment. Concentra concedes the $100,000 payment was a down payment.

187 In terms of the Alter Moneta Corporation assigned lease, Concentra argues that even an option at a nominal purchase price is irrelevant until such time as Cow Harbour exercises the option (*Ed Miller*; see this Court's discussion above). Concentra notes that the option did not state that it was mandatory. As well, there was a guaranteed residual clause. Concentra contends that it is a matter of interpretation whether the termination options or the end of term options make the lease open-ended. The lease was not stated to be a full payment lease and there was no security deposit. The down payment was only about 20 to 25 percent of the equipment's initial acquisition cost.

(b) Monitor

188 The Monitor says that lease 7958-1 is best characterized as a financing lease because, among other things, it contained a "guaranteed residual clause" in clause 10, thereby constituting it a security agreement under a personal property security analysis. The Monitor asserts that because it is a security agreement under a personal property security analysis, it falls outside of the scope of *CCAA* s. 11.01(a).

189 As well, the Monitor submits that lease 7958-1 overwhelmingly exhibits the *Smith Brothers* indicia of a financing lease. Specifically, *Smith Brothers* factors 3 to 10 and 13 to 16 are present. It notes that the equipment originally was valued at $2,335,456 plus applicable tax, while the total amount that Cow Harbour was to pay during the course of the lease term was $2,593,261.84 plus applicable tax. Therefore, the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs.

(c) GE

190 GE takes the position that both leases have indicia of financing leases. Under lease 7958-1, Cow Harbour guaranteed the end of term resale value of the equipment ($415,000) to Concentra, which suggests this is financing lease.

191 GE says the Alter Moneta Corporation assigned lease was substantively identical to the Alter Moneta Corporation lease (discussed below) in having a mandatory end of term purchase obligation for $1. This also points to it being a financing lease.

3. Decision

192 The following are the results of applying the *Smith Brothers* criteria to the Concentra leases:

1. Whether there was an option to purchase for a nominal sum - No option to purchase in lease 7958-1, but end of term resale value guaranteed; nominal option price for the Alter Moneta Corporation assigned lease.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There was a down payment for both leases.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes, in terms of lease 7958-1, but the aggregate would not account for financing charges on the full amount. However, the aggregate was equal to a lesser amount with monthly compounded interest. Yes, in terms of the Alter Moneta Corporation assigned lease.

193 Lease 7958-1 did not contain an option to purchase. At the end of the term, end of any renewal period, or on default, Cow Harbour was required to pay the residual value of the equipment. Cow Harbour, however, also was required to return the equipment to Concentra. If Concentra sold the equipment and the sale yielded an amount less than the end of term minimum resale value, Cow Harbour was responsible for the deficiency (at Concentra's option), but was not entitled to any surplus.

194 Burke stated at 294 that:

> Where the lessee is liable under an open-end lease for any deficiency in the sale of the leased property following its return at the end of the scheduled lease term, the current line of authority is to treat such a lease as a security lease, because a lessor is "guaranteed" to receive a minimum return on the transaction.

195 Burke cited *Crop & Soil Service Inc. v. Oxford Leaseway Ltd.* (2000), 48 O.R. (3d) 291 (Ont. C.A.) as authority for this proposition. That case, however, and those referred to in it, involved situations where the lessee was entitled, as well, to any surplus on the sale of the equipment.

196 Burke suggested (at 296) that a substantial down payment is indicative of a financing lease in that the lessee may be viewed as acquiring an equity interest in the leased property.

197 The parties presented no evidence that 60 months was the anticipated useful life of the truck. There was no purchase option. Even though Concentra had a residual value guarantee and Cow Harbour made a substantial down payment, Cow Harbour was required to return the truck at the end of the lease term or renewal period, and it was not entitled to any surplus above the end of term minimum resale value, this Court finds that the Concentra lease was a true lease.

198 The aggregate of rents for the Alter Moneta Corporation assigned lease was approximately $3,065,266, which was greater than the $2,558,295 net price. A substantial down payment was required. The assigned lease contained an option to purchase for $1. The economic reality is that Cow Harbour would have exercised that option. The lease contained other lesser indicia of a financing lease. This Court concludes that the Alter Moneta assigned lease was a financing lease.

F. Alter Moneta Corporation (Alter Moneta) Lease

1. The Lease

199 The lease dated January 21, 2008 between Alter Moneta and Cow Harbour was Equipment Schedule No. 003 to Master Lease No. CCB5314A.

200 The net price of the leased equipment, a new 2008 Caterpillar off-highway truck, was shown as $2,737,433. The lease term was 60 months. Addendum 4 to the lease called for an initial payment of $273,743.30 and 59 monthly payments of $53,116.94.

201 At the end of the initial term or renewal period, Cow Harbour, if not in default, had the option to purchase the lessor's interest and title in the equipment for $1 or to renew the lease for a further 12 months for the same monthly lease payment.

2. Lease-specific arguments of the parties

(a) Alter Moneta

202 Alter Moneta advanced the same arguments as those advanced in relation to the Alter Moneta lease that Alter Moneta assigned to Concentra. In particular, it argued that the nominal purchase option price was irrelevant until such time as Cow Harbour exercised the option.

203 Alter Moneta notes that the option to purchase was not mandatory, there was no residual guarantee clause and the document did not relate the amount of payments to the purchase price. Alter Moneta says that the document refers to all payments as rent, but the initial payment is different from the others.

(b) GE

204 GE notes that the aggregate value of the rental payments over the term of the lease ($3,407,643) exceeded the cost of the leased equipment ($2,737,433).

205 GE asserts that, inasmuch as the option to purchase was for $1, the economic reality is that Cow Harbour would have bought the leased equipment.

3. Decision

206 The following results from application of the *Smith Brothers* criteria to the Alter Moneta lease:

1. Whether there was an option to purchase for a nominal sum - Yes, the option purchase price was $1 at the end of the term.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There is a large down payment required, although it is referred to as "rent."

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

207 The aggregate of the lease payments was greater than the net price of the equipment. Cow Harbour was required to make a substantial down payment. The lease contained an option to purchase for $1. Alter Moneta's affiant deposed that the option was for the estimated fair market value of the equipment at the end of the lease term. If it is seen as a nominal purchase option price, the economic reality is that Cow Harbour would have exercised that option. If it is a reflection that the equipment was expected to be at the end of its useful life at the conclusion of the lease, Alter Moneta, in essence, was giving credit to Cow Harbour for its purchase of the equipment. The lease contained other *Smith Brothers* indicia of a financing lease.

208 As with the Alter Moneta lease that Alter Moneta assigned to Concentra, this Court concludes that this lease was a financing lease.

G. Key Equipment Finance Canada Ltd. (Key Equipment) Lease

1. The Lease

209 Key Equipment was the assignee of a lease agreement dated November 15, 2006 between Alter Moneta and Cow Harbour (assigned June 27, 2008) relating to a hydraulic excavator. The agreement was described as Equipment Schedule No. 001 to Master Lease No. CCB5314A

210 The equipment's value at the time of the lease agreement was stated to be $1,484,277.99. The lease term was 60 months. Addendum 4 to the lease agreement called for an initial payment of $148,429.80, with 59 monthly payments of $26,777.34.

211 Addendum 3 to the lease provided that if the lease had not been terminated earlier and if the lessee was not in default, the "Lessee *shall*... elect for one of the following options" (emphasis added). The three options were to: (1) purchase the equipment on November 15, 2011 (the option date) for $148,429.80 plus taxes (the purchase option price),

which was said to be the estimated fair market value of the equipment at that date; (2) find a third party to purchase the equipment on the option date for the purchase option price; or (3) rent the equipment for a further period and periodic rent to be established by the lessor acting reasonably.

212 Clause 27 of the Master Lease provided that if there was a substantial adverse change in Cow Harbour's financial circumstances, the lessor could terminate the lease, at the lessor's sole option.

2. Lease-specific arguments of the parties

(a) Key Equipment

213 Key Equipment argues that the purchase option price was not nominal. Instead, it was an amount to which the parties agreed at the outset to be the estimated fair market value of the equipment at the end of the lease term. Key Equipment takes no position on whether the option can be characterized as mandatory.

214 Key Equipment points out that the termination provision in clause 27 of the Master Lease is common to all Alter Moneta leases (including this one and the one Alter Moneta assigned to Concentra). Key Equipment says that the lease agreement did not contain a guaranteed residual clause and it is a matter of interpretation whether the renewal provision made this an open-ended lease. The lease did not state that it is a full payment lease. Key Equipment submits that all payments under the lease were rent.

(b) Monitor

215 The Monitor submits that this lease was a financing lease since the end of term purchase option price (approximately 10 percent of the original value of the equipment) appears to be arbitrary, rather than bearing some connection to what the actual value of the equipment might be at the time Cow Harbour could exercise the option.

216 The Monitor maintains that the lease overwhelmingly exhibits other *Smith Brothers* indicia of a financing lease, which militates against it being considered a true lease. Specifically, *Smith Brothers* factors 3 to 10 and 13 to 16 are present, indicating a financing lease. The Monitor points out that the equipment originally was valued at $1,484,297.99 plus applicable tax while the total amount Cow Harbour was to pay during the course of the term was $1,728,292.86 plus applicable tax. Therefore, the aggregate rental approximated the value of the purchase price of the equipment, factoring in interest and carrying costs.

(c) GE

217 GE notes that the aggregate of rental payments exceeded the cost of the equipment, which suggests that this lease agreement was a financing lease. It points out that Cow Harbour was required to purchase the equipment at an option purchase price of $148,429.80 plus tax, find a purchaser for it at the purchase option price, or renew the lease. Cow Harbour could not return the equipment to Key Equipment.

3. Decision

218 Application of the *Smith Brothers*factors to the Key Equipment lease produces the following results:

1. Whether there was an option to purchase for a nominal sum - There was an option, but it was not for a nominal sum.

2. Whether there was a provision in the lease granting the lessee an equity or property interest in the equipment - No.

3. Whether the nature of the lessor's business was to act as a financing agency - Yes.

4. Whether the lessee paid sales tax incidental to acquisition of the equipment - Yes.

5. Whether the lessee paid all other taxes incidental to ownership of the equipment - Yes.

6. Whether the lessee was responsible for comprehensive insurance on the equipment - Yes.

7. Whether the lessee was required to pay any licence fees for operation of the equipment at its expense - Yes.

8. Whether the agreement placed the entire risk of loss on the lessee - Yes.

9. Whether the agreement included a clause permitting the lessor to accelerate payment of rent on default by the lessee and granted remedies similar to those of a mortgage - Yes.

10. Whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lease - Yes.

11. Whether the lessee was required to pay a substantial security deposit in order to obtain the equipment - There was a substantial down payment.

12. Whether the agreement required the lessee to join the lessor or permit the lessor by himself to execute a UCC financing statement - Not applicable.

13. Whether there was a default provision in the lease inordinately favourable to lessor - Yes.

14. Whether there was a provision in the lease for liquidated damages - Yes.

15. Whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor - Yes.

16. Whether the aggregate rentals approximated the value of the purchase price of the equipment - Yes.

219 The purchase option price in this case was approximately 10 percent of the original cost of the equipment, which is not a nominal amount. The parties agreed that this was a pre-estimate of the market value of the equipment at the end of the lease term. Ordinarily, a fair market value option would be highly suggestive of a true lease. In this case, however, Key Equipment was guaranteed the option price, as Cow Harbour was required to exercise the option, find a third party who would pay the option price, or renew the lease for a term and at a rate selected at the sole option of Key Equipment. This was equivalent to a mandatory purchase option. Cow Harbour could not return the equipment to Key Equipment. As Burke stated (at 294):

> ... leases that do not provide the lessee with the option to return the equipment (i.e., the only available options to a lessee at the end of the scheduled term of the lease are either to purchase the leased property or to renew the lease) can be expected to be construed as conditional sales, because the inability of the lessee to return the leased property at the end of the term will likely be construed as effectively requiring the lessee to acquire the leased property.

220 The Key Equipment lease also contained other indicia of a financing lease. This Court concludes that it was a financing lease.

VI. Conclusions

221 This Court categorizes the Disputed Leases as follows:

A. Scott Capital's leases were true leases.

B. CFSL's lease was a true lease.

C. Wajax's leases were true leases.

D. Kempenfelt's leases were financing leases.

E. Concentra's lease was a true lease. The Alter Moneta lease assigned to Concentra was a financing lease.

F. Alter Moneta lease was a financing lease.

G. The Alter Moneta lease assigned to Key Equipment was a financing lease.

222 The true leases are subject to *CCAA* s. 11.01(a).

Order accordingly.