Court File No.: CV-15-10936-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF CERTAIN PROCEEDINGS TAKEN IN THE UNITED STATES BANKRUPTCY COURT WITH RESPECT TO XINERGY LTD.

APPLICATION OF XINERGY LTD. UNDER SECTION 46 OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

BOOK OF AUTHORITIES OF THE MOVING PARTY JON NIX
(Returnable on May 28, 2015)

May 25, 2015

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TAB 1

2009 CarswellOnt 7007
Ontario Superior Court of Justice [Commercial List]

Tucker v. Aero Inventory (UK) Ltd.

2009 CarswellOnt 7007, 183 A.C.W.S. (3d) 443

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

JAMES ROBERT TUCKER, RICHARD HEIS, AND ALLAN WATSON GRAHAM OF KPMG LLP AS JOINT ADMINISTRATORS (Applicants) and AERO INVENTORY (UK) LIMITED and AERO INVENTORY PLC (Respondents)

Newbould J.

Heard: November 11, 2009
Judgment: November 12, 2009
Docket: 09-CL-8456-00CL

Counsel: Orestes Pasparakis, Virginie Gauthier for Applicants

Subject: Insolvency; International; Corporate and Commercial

Table of Authorities

Cases considered by *Newbould J.*:

Air Canada, Re (2003), 45 C.B.R. (4th) 13, 2003 CarswellOnt 4016, 39 B.L.R. (3d) 153 (Ont. S.C.J. [Commercial List]) — considered

Lear Canada, Re (2009), 2009 CarswellOnt 4232, 55 C.B.R. (5th) 57 (Ont. S.C.J. [Commercial List]) — considered

Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 1993 CarswellOnt 212, 20 C.B.R. (3d) 165 (Ont. Gen. Div.) — considered

United Air Lines Inc., Re (2003), 43 C.B.R. (4th) 284, 2003 CarswellOnt 2786 (Ont. S.C.J. [Commercial List]) — considered

Statutes considered:

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

Pt. IV — referred to

s. 9(1) — considered

s. 18.1 [en. 1997, c. 12, s. 125] — considered

s. 21 — considered

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s. 44 — referred to

s. 45(1) "foreign proceeding" — considered

s. 45(2) — considered

s. 47 — considered

s. 47(1) — considered

s. 47(2) — considered

s. 49(1) — considered

s. 50 — considered

Insolvency Act, 1986, c. 45
Generally — referred to

***Newbould J.*:**

1 This application was made on November 11, 2009 under s. 47(1) [1] of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA") for an order recognizing the administration proceedings (the "foreign proceedings") commenced in respect of each of Aero Inventory (UK) Limited and Aero Inventory plc (the "foreign debtors") in the High Court of Justice of England and Wales as a "foreign main proceeding" for the purposes of section 47 of the CCAA, and for other consequential relief. At the conclusion of the hearing I made the order sought for reasons to follow. These are my reasons.

Factual background

2 On November 11, 2009, the applicants were appointed by the High Court of Justice of England and Wales (Chancery Division, Companies Court) as administrators (the "Administrators") over Aero Inventory (UK) Limited ("Aero Inventory (UK)") and Aero Inventory plc ("Aero plc").

3 Aero Inventory (UK) provides procurement and inventory management services in the aerospace industry. These services are provided with regard to consumable and expendable parts required for aerospace maintenance and related activities, such as nuts, bolts and gaskets. Aero plc is the corporate parent of Aero Inventory (UK) and has been listed on the Alternative Investment Market (AIM) of the London Stock Exchange since 2000.

4 The foreign debtors are both located in New Barnet, Hertfordshire, United Kingdom. Their business operations are managed and administered in the United Kingdom. Aero Inventory (UK) has customers and/or supplies products from the following countries and regions: England, The Republic of Ireland, Australia, Bahrain, El Salvador, Canada, China, Hong Kong, Indonesia, Japan, Switzerland and the United States.

5 Aero Inventory (UK) has conducted business in Canada since 2007. It provides inventory and procurement services to two Canadian customers, Air Canada and Aveos Fleet Performance Inc. ("Aveos").

6 While it has a registered address in Quebec, Aero Inventory (UK) has no physical presence in Canada. The property at this address is in fact leased by the foreign debtors' Canadian affiliate, Aero Inventory (Canada) Inc. ("Aero (Canada)"). The foreign debtors have no premises and no employees in Canada. The inventory of Aero Inventory (UK) is physically located at the premises of its customer.

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7 Aero (Canada) provides services in Canada to the foreign debtors pursuant to a management arrangement. Aero (Canada) has employees but no customers or inventory and no source of revenues other than through its management arrangement.

8 In November 2007, Aero Inventory (UK) signed a 10-year sole supplier agreement for consumable aircraft parts with ACTS Technical Support & Services Inc., which was later renamed Aveos. This agreement covers the procurement and management of all parts required by Aveos for its operations in Canada and, through its subsidiary Aeroman, in El Salvador.

9 The entire inventory owned by the foreign debtors in Canada, whether bound for Air Canada or for Aveos, is located at various warehouses across Canada operated by Aveos These warehouses are located in Ontario, Quebec, Manitoba and British Columbia. This inventory is not physically segregated from inventory owned by Aveos and is not within the foreign debtors' control. Further, inventory bound for Air Canada is not segregated from inventory bound for Aveos.

10 According to the Aveos accounting systems, approximately Cdn. $130 million in inventory owned by the foreign debtors is currently held at Aveos sites across Canada. This represents a supply of over nine months worth of inventory based upon traditional turnover rates.

11 As stated, on November 11, 2009, James Robert Tucker, Richard Heis and Allan Watson Graham of KPMG LLP were appointed Administrators of the foreign debtors by orders of the High Court of England and Wales. These orders were made pursuant to the *Insolvency Act 1986*. Pursuant to these orders, the Administrators are responsible for managing the affairs, business and property of the foreign debtors. They are required to perform their functions with the objective of: (a) rescuing the foreign debtors as a going concern or in the alternative, winding up or realizing upon the property of the foreign debtors in order to make a distribution to one or more secured or preferential creditors.

Recognition of the UK Proceeding

(a) Jurisdiction

12 Pursuant to section 9(1) of the CCAA, where a company does not have a place of business in Canada it may file an application in any province in which it has assets. Neither of the foreign debtors appears to have a place of business in Canada. Given that the foreign debtors have assets located within Ontario, this Court has jurisdiction to deal with this application.

(b) Recognition

13 Under s. 47 of the CCAA, a court shall make an order recognizing a foreign proceeding if it is satisfied that the application for such recognition "relates to a foreign proceeding and that the applicant is a foreign representative in respect of that foreign proceeding." Section 47(1) states:

> If the court is satisfied that the application for the recognition of a foreign proceeding relates to a foreign proceeding and that the applicant is a foreign representative in respect of that foreign proceeding, the court shall make an order recognizing the foreign proceeding. (Underlining added)

14 Section 45(1) of the CCAA defines "foreign proceeding" as:

> a judicial or an administrative proceeding, including an interim proceeding, in a jurisdiction outside Canada dealing with creditors' collective interests generally under any law relating to bankruptcy or insolvency in which a debtor company's business and financial affairs are subject to control or supervision by a foreign court for the purpose of reorganization.

15 As the Administrators were appointed by the English High Court pursuant to the *Insolvency Act 1986*, there can be no doubt that the foreign proceeding is a "foreign proceeding" within the meaning of s. 45(1) of the CCAA.

16 It is to be noted that under s. 47(1), the order sought is mandatory if the conditions in that section are met. This is in keeping with the purpose of the new cross-border provisions of the CCAA as set out in s. 44 to promote cooperation with foreign

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jurisdictions in cases of cross-border insolvencies. This statutory recognition of comity follows the principles of international comity in insolvency situations recognized in such cases as *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 20 C.B.R. (3d) 165 (Ont. Gen. Div.), *United Air Lines Inc., Re* (2003), 43 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) and *Lear Canada, Re* (2009), 55 C.B.R. (5th) 57 (Ont. S.C.J. [Commercial List]).

17 In this case as the conditions of s. 47(1) have been met, an order recognizing the foreign proceedings shall go. It is to be noted that Lloyds TSB Commercial Finance Limited, which holds a debenture and is owed approximately $500 million, supports the appointment of the Administrators and this application in Canada. The only other party with a registered security interest in Canada is Air Canada, but nothing is owed by the foreign debtors to it. Rather, there is a receivable of approximately $9.6 million owed by Air Canada to Aero Inventory UK.

18 Under s. 47(2) of the CCAA, a court making an order recognizing a foreign proceeding must specify whether such proceeding is the "foreign main proceeding" or the "foreign non-main proceeding". Under s. 45(1), a "foreign main proceeding" is a "foreign proceeding in a jurisdiction where the debtor company has the centre of its main interests." Section 45(2) provides that in the absence of proof to the contrary, a debtor company's registered office is deemed to be the centre of its main interests.

19 Aero Inventory UK has a registered office in Quebec. Thus by virtue of section 45(2), in the absence of proof to the contrary, Quebec is deemed to be the centre of its main interest. However, the foreign debtors have business interests globally and their head office is in the United Kingdom from where they are managed and administered. Aero plc is publicly listed on the AIM of the London Stock Exchange. I am satisfied that this evidence is sufficient to conclude that the main interests of the foreign debtors are centred in the United Kingdom and thus the foreign proceeding should be specified as the "foreign main proceeding".

Other relief sought

(a) Appointment of an Information Officer

20 The applicants have requested an order appointing KPMG Inc. as an information officer in respect of these proceedings. While the CCAA does not expressly provide for the appointment of an information officer, such an officer is sometimes appointed under the Court's general powers to make appropriate orders in the circumstances. In the case of an application such as this in connection with a cross-border insolvency, the Court is expressly given the power to make such order as it considers appropriate in section 49(1), so long as the order is consistent with any other order that may be made under the Act, and in section 50 which provides:

> 50. An order under this Part may be made on any terms and conditions that the court considers appropriate in the circumstances.

21 The order sought would authorize, but not require, the information officer to provide such assistance to the Foreign Representative as might be required, and authorize the information officer to respond to reasonable requests for information from stakeholders. The information officer would be required to report to the Court at least once every three months regarding the proceedings and other information the information officer believes material.

22 In the circumstances of this case, in which the foreign debtors have no place of business or employees in Canada, it is particularly appropriate to have an information officer appointed who can deal with matters as they arise in Canada and who can also provide information and advice to the Foreign Representative as needed. The order sought shall go.

(b) Stay of Set-Off Rights

23 In this case, because of the fact that the foreign debtors do not have physical control of their inventory in Canada as the inventory is in warehouses operated by Aveos, a concern has been raised that set-off could adversely impact the foreign proceeding and impact the recoveries available to creditors. Although Aveos is a purchaser from Aero Inventory (UK), it apparently is owed approximately $1 million and its contract with Aero Inventory (UK) contains a liquidated damage clause.

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24 As stated, a court on an application under the CCAA in cross-border insolvencies has the power under sections 49(1) and 50 to make an order considered appropriate in the circumstances.

25 The provisions regarding set-off in section 21 must, however, be considered in the request for relief regarding a stay of set-off. Section 21 provides:

> 21. The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

26 The applicants submit that while the provisions of section 21 of the CCAA may prevent a court from permanently barring all claims of set-off, it does not prevent a court from making an order in appropriate circumstances temporarily staying the determination and enforcement of a person's rights of set-off pending leave of the court. They rely on *Air Canada, Re* (2003), 45 C.B.R. (4th) 13 (Ont. S.C.J. [Commercial List]). In that case, Farley J. reviewed in some detail the law of set-off and struck from the Initial Order a provision that no person could set off any obligations of Air Canada to such person which arose prior to the Initial Order. Farley J. held that while the Initial Order should recognize the rights of set-off permitted under section 18.1 of the CCAA (now section 21), such rights could be temporarily stayed pending further order of the Court. In that case there was no opposition to such a temporal stay. He stated:

> With respect to the question of what I have described as a temporal stay, there does not appear to be any opposition by the Moving Creditors to the proposition that whatever their rights of set-off in substance are determined to be, that such determination and enforcement of such determined rights should await until a convenient time when AC has stabilized (or I suppose, alternatively cratered). It would seem to me that the likely time for this would be in conjunction with the formation of a reorganization plan of arrangement and compromise. However I leave that question open pending future submissions and further order of the court emanating as a result thereof.

27 I accept that a court may temporarily stay the right of set-off protected in section 21 of the CCAA. How temporary that stay should be will obviously depend on the circumstances existing at the relevant time.

28 In his witness statement provided to the High Court in England, Mr. Trupp, a director of the foreign debtors, discussed concerns relating to the fact that the inventory is out of their control. He stated:

> 19. The Companies are, in their current financial position, extremely distressed with the threat of creditor enforcement action in key countries. and
>
> 29. This matter is now urgent and there are a number of reasons for this urgency, including:
>
> (a) the supply of airline, parts is time critical and must continue uninterrupted;
>
> (c) there is a risk that if the stock is not secured quickly it will disappear or become very difficult to access, particularly as it is not in the physical control of the Companies. There is therefore a risk of significant loss to the secured creditors and creditors generally if there is any delay in getting the administration orders made. Customers have direct control of the stock and could seize it if concerned about the solvency of the Companies;

29 The applicants submit that no party is unreasonably prejudiced by the proposed set-off relief which is intended to operate only to prevent fresh inventory of the foreign debtors from being appropriated by third parties without an ensuing payment. The proposed relief does not affect the position of the parties on the date of the recognition order but ensures that no further prejudice is caused to the foreign debtors' estate. If the foreign debtors' inventory were in their possession rather than in the possession of third parties, they could control and minimize such potential prejudice by obtaining assurances of payment ahead of providing new supplies.

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30 The applicants are concerned that as Aveos has physical control of the foreign debtors' inventory, any refusal to supply their inventory without assurances of payment might lead to the grounding of several airplanes, thereby causing prejudice to the foreign debtors' customers. They submit that in the circumstances, the better option to ensure continued supply to customers and payment for fresh inventory is by the granting of a temporal stay of any right of set-off

31 It seems to me that at this stage the relief sought should be granted. The amount of inventory in Canada, $130 million, is substantial. The consolidated interim financial statements of the foreign debtors as at December 30, 2008 indicate that there are total inventories of U.S. $751 million, although Mr. Trupp believes these are inaccurate and may be overstated. It is apparent that the Canadian inventory comprises a substantial portion of the total inventory. That inventory should be properly protected to enable the foreign debtors to attempt to continue as a going concern.

32 Taking into account the purposes of part IV if the CCAA relating to cross-border insolvencies, as set out in section 44, including co-operation between the courts of the jurisdictions involved and the maximization of the value of the debtor company's property, it is appropriate in this circumstances of this case to stay set-off rights pending further order of this Court. How long that stay should be is a matter of conjecture at this stage. The proceedings have just commenced and what the outcome will be is not possible to know. Thus the length of any stay of set-of rights is an unknown.

33 The order contains a 4 days notice come-back clause and any person concerned with the order thus has the ability to make application to vary or rescind the order. .

34 The application is granted in accordance with these reasons.

Footnotes

1 This section and the other sections dealing with cross-border insolvencies in part IV of the CCAA came into effect on September 18, 2009

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TAB 2

1921 CarswellOnt 33
Ontario Supreme Court, In Bankruptcy

Canadian Cereal & Flour Mills Co., Re

1921 CarswellOnt 33, 2 C.B.R. 158, 51 O.L.R. 316, 67 D.L.R. 234

In re Canadian Cereal and Flour Mills Company Limited

Orde, J.

Judgment: December 13, 1921

Counsel: *H. J. Stuart*, for the trustee.
R. H. Parmenter, for the Montreal Trust Company.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Bankruptcy --- Assignments in bankruptcy — Types of assignors — Corporations — General

Bankruptcy --- Proposal — General

Corporations --- Winding-up — Under Dominion Act — Scope and application of Act — General

Effect on Corporate Powers apart from Control of Assets.

Except in those cases in which an order is made by the bankruptcy court that proceedings taken under *The Bankruptcy Act*, 1919, Can., shall be continued under *The Winding-up Act*, R.S.C., 1906, ch. 144, a trading corporation which has made an assignment for creditors under *The Bankruptcy Act* still has power thereafter to hold directors' meetings and shareholders' meetings and to pass resolutions expressing its corporate decisions.

[*The Bankruptcy Act*, 1919, sec. 66, 1 C.B.R. 74, Bankruptcy Rule 13, 1 C.B.R. 181, and *The Winding-up Act*, R.S.C., 1906, ch. 144, secs. 20 and 31, considered].

Registration in Company's Share Register.

Notwithstanding the making of an authorized assignment by a corporation under *The Bankruptcy Act* it may still make registration of transfers of its paid-up shares and issue share certificates in substitution for certificates surrendered by transferors of such shares. The new certificates are to be signed by the usual officers as before the assignment or by such officers as the directors may appoint under the by-laws; and the bankruptcy trustee should permit the use of the corporate seal and the corporation's share register for this purpose. But in the case of shares not fully paid up, the question of contribution by the transferring shareholder must first be disposed of before the company can accept or register any share transfer.

How to Be Made.

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A proposal of a composition, extension or scheme of arrangement under sec. 13 of *The Bankruptcy Act* may be made by an insolvent company after the making of an authorized assignment. The procedure to be followed for the expression of the company's decision to make the proposal will be such as the company's by-laws or its charter or articles of association provide.

Proof of Claim for Tax which Insolvent Company had Agreed to Pay.

On the re-organization of a company by the transfer of its business to a new company in consideration of securities and shares of the new company delivered to trust company for distribution to the parties entitled, the fact that the new company had covenanted to pay the share transfer tax but had become bankrupt before the distribution of the new shares was completed, will not justify its bankruptcy trustee in paying the share transfer tax out of the bankruptcy estate. If in order to complete the transfer the trust company or the transferees have to pay the tax, their remedy is to file proofs of claim as creditors for the amount disbursed.

Bankruptcy Trustee not Bound to Make Annual Returns under Companies Act.

The bankruptcy trustee of a company organized under *The Ontario Companies Act* is under no obligation to see to the making of the annual returns required by sec. 135 of that Act in order to preserve the life of the company. The responsibility in that regard devolves upon the directors and shareholders of the company.

Motion by the bankruptcy trustee for directions heard before Orde, J. in Chambers at Toronto, December 5, 1921.

Orde, J. **:**

1 The authorized trustee applies to the Court under sec. 18(*d*) of *The Bankruptcy Act* as amended by the Act of 1921 [1 C.B.R. 567] for directions in relation to certain mat ters affecting the administration of the estate. The Montreal Trust Company, which holds certain shares of the insolvent company under certain trusts, was notified and was represented on the application.

2 The insolvent company had been incorporated and organized to take over the business of an earlier company, and, as the result of certain agreements, bonds and shares of the new company were delivered and issued to the Montreal Trust Company, whose duty it was to distribute them among the holders of the bonds of the old company upon the surrender of such bonds. Before this distribution was completed the new company made an authorized assignment under *The Bankruptcy Act* .

3 The questions which are now submitted to the Court involve in a broad sense the question, whether and to what extent the assignment affects the status and corporate powers of the insolvent company and particularly the powers of the directors and shareholders to meet and to decide by resolution upon certain courses of action on behalf of the company.

4 *The Bankruptcy Act* contains no provisions corresponding to those in the Dominion *Winding-up Act* which in effect deprive the shareholders and directors of all further power in the administration of the company's affairs. Under a winding-up order, the affairs of the company are being wound up so that, unless some action of the Court revives the company, it necessarily ceases to exist upon the termination of the winding-up proceedings. See secs. 20 and 31, *inter alia* , of *The Winding-up Act* , R.S.C., 1906, ch. 144.

5 But under *The Bankruptcy Act* , except in those cases in which the proceedings are continued under *The Winding-up Act* by virtue of Bankruptcy Rule 13 (which Rule is given its effectiveness by subsec. 2 of sec. 66 of the Act), a company which makes an authorized assignment is to all intents and purposes in no different position from a natural person. It has parted with all its assets to the trustee, including by virtue of sec. 36 the right to collect from contributory shareholders. But there is nothing in the Act which destroys its corporate entity or interferes with its power to "function" as a corporation. It is always possible that a corporation may pay its creditors in full, and it is said that that will probably be the result in this case under careful

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management. It would doubtless be entitled to a discharge in a proper case, though it is obvious that in the great majority of cases the discharge of a company would be a mere formality.

6 Apart from these grounds for believing that an assignment cannot affect the company's status or the powers of the directors and shareholders, there is the fact that under sec. 13 of the Act the insolvent, whether under an assignment or under a receiving order, may always submit to the creditors, through the trustee, a proposal for a composition, or for an extension, or for a scheme of arrangement. And this right is as clearly open to a corporation as to an individual. If so, how can the company authoritatively decide upon or present such a proposal unless its directors and shareholders can meet for the purpose of deliberation? Limited though the scope of the company's activity must necessarily be because of its inability to carry on its business, yet, within the circumscribed ambit of its curtailed powers, it has clearly in my judgment still power to continue its corporate existence, and this, not as in a merely dormant or moribund state, but so as to express its corporate decisions for all such purposes as may be expedient or necessary.

7 With this broad expression of my views as to the effect of the assignment, upon the company, I proceed to deal with the questions submitted to me.

8 1. The company can register and give effect to the transfer of 2,600 shares to the estate of the late Hon. Sidney A. Fisher. There is nothing in this *Bankruptcy Act* to prevent this.

9 2. (a) The form of stock certificate to be issued upon the registration of the transfer ought not to vary from the form heretofore adopted by the company. The certificate should be signed by the usual officers in that behalf or such officers as the directors may appoint under the by-laws of the company, and if desired the corporate seal should be attached. If the seal and the books of the company are in the possession of the trustee he should permit their use for the registration of the transfer and the issue of the certificate.

10 (b) The payment of the Dominion and Ontario taxes upon the transfer is a matter with which the company itself would not ordinarily be concerned. I understand that for the purpose of completing the reorganization and the exchange of bonds and shares the company covenanted to pay the transfer taxes. That, however, would not justify the trustee's paying the taxes as an item of expense in the bankruptcy. If in order to complete the transfer the Montreal Trust Company or the transferees of the shares are called upon to pay the taxes, then they may be able to prove as creditors in the bankruptcy under the company's covenant.

11 3. The company may deal with all transfers of stock in the way already indicated, if the stock is fully paid up, or, if not paid up, the question of contribution by the transferring shareholder ought to be dealt with before the company accepts and registers any such transfer.

12 4. The calling and holding of meetings of directors and shareholders and the passage of resolutions and by-laws thereat will still be regulated by the charter and by-laws of the company. As to the application of sec. 85 of *The Bankruptcy Act*, while I think it is primarily intended to apply to corporations having dealings with the company and the trustee, I see no reason why it should not also apply to the insolvent company itself.

13 5. If the shareholders desire to propose a composition, extension, or scheme of arrangement under sec. 13, which, as I have already held, they have power to do, the method of conveying that proposal to the trustee must be such as the charter and by-laws, or the shareholders themselves acting within the powers imposed by the charter and by-laws, may provide. *The Bankruptcy Act* presents no difficulties in this regard.

14 6. The trustee must be governed by the advice of the inspectors and by ordinary business judgment in delaying the acceptance of any tender for the purchase of the company's assets. The Court has no power to prevent a tenderer from withdrawing his tender, if by the conditions under which he tendered he has the right to do so.

15 7. If creditors have been inadvertently omitted from the list of creditors to whom notices were sent under sec. 11 (4) of the Act, I think the trustee should notify them to file their proofs, and if convenient notify them of what has already taken place. I do not think he is required to call a new meeting of creditors merely because of the omission.

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16 8. The making of the annual returns to the provincial secretary under sec. 135 of *The Ontario Companies Act* , R.S.O., 1914, ch. 178, is something with which the trustee is not concerned. If my view as to the continuance of the company's corporate status and powers is correct, then the directors by failing to make returns might subject themselves to the penalties imposed by *The Ontario Companies Act* . If the directors and shareholders desire to keep the company alive, then it would seem to be incumbent upon them to comply with sec. 135 and to pay the fees incidental thereto.

17 The costs of both parties to this application should be paid out of the estate.

Directions accordingly.

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TAB 3

1962 CarswellBC 15
British Columbia Supreme Court, In Bankruptcy

Fintry Estates Ltd., Re

1962 CarswellBC 15, 35 D.L.R. (2d) 584, 39 W.W.R. 690, 4 C.B.R. (N.S.) 128

Re Fintry

Aikins J.

Judgment: July 11, 1962

Counsel: *Mrs. C. R. Parkin*, for the appellants.
R. Saunders, for the petitioning creditor.
A. J. Carmichael, for the trustee.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Bankruptcy --- Meeting of creditors — Voting — Who may vote

Meeting of creditors — Voting on appointment of trustee or inspectors — The Bankruptcy Act, s. 79(3)(b) — Only officers and directors of bankrupt corporation at time of vote disqualified.

A receiving order was made against the bankrupt corporation on 22nd March 1961. At the time the receiving order was made, M. and B. were officers and directors of the bankrupt. Both M. and B. by reason of written resignations ceased to be officers and directors before the first meeting of creditors was held on 17th July 1961. At all material times M. and B. were creditors of the bankrupt corporation. At the first meeting of creditors, M. and B. claimed the right to vote on the appointment of inspectors but the chairman of the meeting applying s. 79(3)(*b*) of the Bankruptcy Act ruled that they were not eligible to vote and an appeal was brought from that ruling.

Held, the appeal should be allowed and M. and B. were eligible to vote. Section 79(3)(*b*) disqualifies from voting on the appointment of a trustee and inspectors only those persons who are officers, directors or employees of a bankrupt corporation at the time of voting.

Annotation

This decision is contrary to the practice which has existed in connection with s. 79(3)(*b*). The reasons for not interpreting the section in the manner in which the learned judge has interpreted it, are fully set forth in the judgment and need not be repeated. In reaching the conclusion which was arrived at, the Court ignored the words in s. 79(3)(*b*) "when the bankrupt is a corporation". By s. 2(*c*) "bankrupt" is defined as meaning "a person who has made an assignment or against whom a receiving order has been made". This, it is submitted, establishes the relevant time for the section and the word "thereof" at the end of the section must relate the words "officer, director or employee" to that point of time.

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This section was added to the Bankruptcy Act in 1932 by 22-23 Geo. V c. 39, s. 33. This appears to be the first time that the section has been judicially interpreted. If the interpretation in the present case is correct, it would open the way to grave abuses.

Aikins J.:

1 This is an appeal under s. 71(1) of the Bankruptcy Act, R.S.C., 1952, c. 14, from a decision of the nominee of the Official Receiver as chairman at the first meeting of creditors of the bankrupt company Fintry Estates Ltd. The first meeting of creditors was held at Vancouver on 17th July 1961.

2 Mr. Ian Bell, the nominee of the Official Receiver and chairman of the first creditors' meeting, decided that two creditors, Mr. Sydney A. McDonald and Mr. Arthur Bailey, were ineligible to vote on the election of the inspectors. The decision of the chairman was made under the provisions of s. 79(3)(*b*) of the Act and on the basis that McDonald and Bailey were disqualified from voting as they were directors and officers of the bankrupt company.

3 Section 79(3) of the Bankruptcy Act is as follows:

79. (3) The following persons are not entitled to vote on the appointment of a trustee or inspectors, namely:

(*a*)the father, mother, son, daughter, sister, brother, uncle or aunt by blood or marriage, wife or husband of the bankrupt;

(*b*) where the bankrupt is a corporation, any officer, director or employee thereof;

(*c*) where the bankrupt is a corporation any wholly owned subsidiary corporation or any officer, director or employee thereof.

4 A receiving order was made against Fintry Estates Ltd. on 22nd March 1961. On the hearing before me, counsel agreed on the facts necessary to the determination of this appeal, *viz.*: (1) That both McDonald and Bailey were officers and directors of the bankrupt company at the time the receiving order was made; (2) That both McDonald and Bailey, by reason of written resignations, ceased to be directors and officers of the bankrupt company before the first creditors' meeting was held on 17th July 1961; (3) That both McDonald and Bailey were at all material times creditors of the bankrupt company Fintry Estates Ltd.

5 At the first creditors' meeting, both McDonald and Bailey claimed the right to vote on the appointment of inspectors. The chairman, applying s. 79(3)(*b*), held that they were ineligible to vote. It is clear, as agreed by counsel, that neither McDonald nor Bailey were directors or officers of the bankrupt company at the time that they claimed the right to vote at the first creditors' meeting, and the point which is to be decided in this appeal is whether s. 79(3)(*b*) disqualifies only a person who is a director or officer at the time of voting or whether the words used in sub-para. (*b*), "any officer, director or employee thereof" should be construed to include any person who, while not being a director or officer at the time of voting at the first creditors' meeting, has at any time prior to that meeting been a director or officer.

6 While it was discussed in argument, it was not seriously suggested by counsel for the respondents that the section should be construed so as to include and thereby disqualify any person who had at any time been a director or officer of the bankrupt company. Essentially, the argument for the respondents was that the section should be construed so as to include and disqualify persons who are directors or officers at the time of the first meeting of creditors and persons who were directors and officers at the time of the commencement of the bankruptcy, notwithstanding that such persons have ceased to be directors or officers between the time of the commencement of the bankruptcy and the time of the voting at the first creditors' meeting, and accordingly are neither directors nor officers at the time of the first creditors' meeting.

7 In summary form, the arguments advanced by counsel for both respondents were these:

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8 (1) Section 79(3)(*b*) was enacted to further one object of the Act, namely, the investigation of the affairs of the bankrupt, by depriving officers, directors and employees in the charge of the management of the bankrupt at the time of bankruptcy of any power to control the election of inspectors and the trustee whose duty it is to investigate the affairs of the bankrupt. As authority for the proposition that one of the objects of the Act is to allow investigation, I was referred to Houlden and Morawetz, Bankruptcy Law of Canada, p. 2, para. 6.

9 The sections of the Act dealing with the examination of bankrupts (ss. 120 to 125) and the sections dealing with the discharge of bankrupts (ss. 127 to 139) in general provide for the investigation of the affairs of the bankrupt and establish, I think, that one of the purposes of the Act is to permit investigation of the affairs of a bankrupt.

10 (2) That it might well wholly thwart the investigative purposes of the Act if directors, officers and employees of the bankrupt at the time of bankruptcy were permitted to vote on the election of the trustee and inspectors.

11 (3) That the section should be liberally construed to give the effect to, rather than frustrate, the investigative intention of the Act and to this end two principles should be applied: firstly, the Bankruptcy Act is a commercial statute and as such should be given a broad rather than a technical interpretation, so as to give effect to the legislative intention; and secondly, the section should be interpreted fairly, largely and liberally so as to ensure the fulfilment of the object of the Act in accordance with the requirements of s. 15 of the Interpretation Act, R.S.C. 1952, c. 158.

12 (4) That the "relation back" section of the Bankruptcy Act, s. 41(4), which is as follows:

13 "41. (4) The bankruptcy shall be deemed to have relation back to and to commence at the time of the filing of the petition on which a receiving order is made or of the filing of an assignment with the official receiver", applies to s. 79(3) and that s. 79(3) must therefore be treated as speaking not only as at the time of the creditors' meeting but also as at the time of the commencement of the bankruptcy.

14 Counsel for the appellants argued that the words of the statute which I have quoted bear a perfectly plain meaning free of ambiguity and that I should give effect to that plain meaning. The proper approach to this problem, in my view, is to first examine the words of the section of the statute in question to see whether, taking such words as having their ordinary meanings (none of the words have any special technical significance) and applying the rules of grammar to their arrangement, the section has a clear meaning free of any ambiguity, patent or latent.

15 I find no difficulty in applying this approach. The plain meaning of s. 79(3) of the Act, in so far as a corporation is concerned, is that a person who is an officer, director or employee of a bankrupt corporation, is not entitled to vote on the election of the trustee or inspectors. In my view, the section where it refers to officer, director or employee, is speaking of a person who is an officer, director or employee at the time of voting and not at any other time.

16 The second step, once a clear meaning free of ambiguity is found, is to inquire whether application of the law, as clearly stated, would yield a result which could not have been intended by the legislative body responsible for the enactment. The conditions under which a meaning other than the plain meaning of legislation may be sought are stringent and are, I think, correctly set out in Maxwell on the Interpretation of Statutes, 11th ed., at p. 221:

> Where the language of a statute, in its ordinary meaning and grammatical construction, leads to a manifest contradiction of the apparent purpose of the enactment, or to some inconvenience or absurdity, hardship or injustice, presumably not intended, a construction may be put upon it which modifies the meaning of the words, and even the structure of the sentence. This may be done by departing from the rules of grammar, by giving an unusual meaning to particular words, by altering their collocation, or by rejecting them altogether, under the influence, no doubt, of an irresistible conviction that the Legislature could not possibly have intended what its words signify, and that the modifications thus made are mere corrections of careless language and really give the true meaning. Where the main object and intention of a statute are clear, it must not be reduced to a nullity by the draftsman's unskilfulness or ignorance of the law, except in a case of

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> necessity, or the absolute intractability of the language used. Nevertheless, the courts are very reluctant to substitute words in a statute, or to add words to it, and it has been said that they will only do so where there is a repugnancy to good sense.

17 The position, therefore, is that before I should attack the section in question with the object of wresting from it some meaning other than its plain meaning, I must be satisfied that the Legislature could not have intended the plain meaning because the plain meaning leads to some "manifest contradiction of the apparent purpose of the enactment, or to some inconvenience or absurdity, hardship or injustice." I am unable to find that the plain meaning of s. 79(3)(*b*), when applied, would lead to any manifest contradiction or to any perverse result which would justify the search for a meaning which would give a satisfactory result in application.

18 A company which has become bankrupt, notwithstanding the bankruptcy, continues to exist as a body corporate, and may hold meetings, remove directors and officers, accept resignations and elect or appoint other directors and officers: *In re Can. Cereal & Flour Mills Co.* (1921), 51 O.L.R. 316, 21 O.W.N. 212, 2 C.B.R. 158, 67 D.L.R. 234, 3 Can. Abr. 299. The directors at the commencement of a bankruptcy will not of necessity be the directors at the time of the first creditors' meeting. Parliament must be deemed to have been aware of this. Parliament was obviously alert to the conflict of interest that a director or officer or employee of a bankrupt company might well have when voting for a trustee or inspectors. Parliament should, I think, be presumed to be aware that persons who were directors, officers or employees at the commencement of the bankruptcy might have special reasons for desiring a particular trustee or inspectors who would not strenuously pursue any investigation of the management of the company during the period leading up to bankruptcy. It was open to Parliament in enacting s. 79(3)(*b*) to have provided by suitable words that any person who had been a director, officer or employee at the time of the commencement of bankruptcy would not be entitled to vote. Parliament did not make any such provision.

19 Under s. 79(3)(*b*), an officer, director or employee of a bankrupt corporation is ineligible to vote. An officer, director or employee of a corporation owes a duty to the corporation, and the observance of that existing duty might conflict with the best interests of the creditors as to the person to be elected trustee or as to the persons to be elected as inspectors. In my view, the purpose of s. 79(3)(*b*) is to protect the creditors against the election of a trustee or inspectors who might be partial to the bankrupt rather than wholly devoted to the welfare of the creditors. On its plain meaning the section goes no further in effecting this purpose than taking the vote from persons who are officers, directors or employees of the company at the time of voting. Parliament has not seen fit to take the vote away from persons who are creditors and who also as directors, officers or employees of a company at the time of bankruptcy, may have been concerned with, or instrumental in, the company becoming bankrupt. It may be, as was argued, that the investigative purpose of the Act would be better served if Parliament had deprived such persons of the right to vote but the fact is that Parliament did not do so.

20 As I have found that the section in question has a plain meaning and that the law as plainly stated by that section not only does not give rise to any manifest contradiction or to any perverse result but serves a reasonable and useful purpose, there is no reason for me to seek any meaning other than the plain meaning stated by the section.

21 In effect, counsel for the respondents have pointed out to me a gap in the legislation and have asked me to fill that gap by construing s. 79(3)(*b*) contrary to its plain meaning by adding thereto, as being necessary by implication to carry out one of the broad purposes of the Act, certain words which do not appear in the section, when it is quite unnecessary for the purposes of the meaning of the section to make any addition.

22 In respect of interpretation of legislation by ascertaining the intent and seeking to carry it out, and in respect of courts filling in gaps in legislation, the words used by Lord Simonds in *Magor and St. Mellons Rural Dist. Council v. Newport Corpn.*, [1952] A.C. 189, [1951] 2 All E.R. 839, are apposite. Lord Simonds says at pp. 190-191:

> But it is on the approach of the Lord Justice to what is a question of construction and nothing else that I think it desirable to make some comment; for at a time when so large a proportion of the cases that are brought before the courts depend on the construction of modern statutes it would not be right for this House to pass unnoticed the propositions which the learned Lord Justice lays down for the guidance of himself and, presumably, of others.

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> 'We sit here,' he says, 'to find out the intention of Parliament and of Ministers and carry it out, and we do this better by filling in the gaps and making sense of the enactment than by opening it up to destructive analysis.' The first part of this passage appears to be an echo of what was said in *Heydon's Case* (1584), 3 Co. Rep. 7a, 76 E.R. 637, 300 years ago, and, so regarded, is not objectionable. But the way in which the learned Lord Justice summarizes the broad rules laid down by Sir Edward Coke in that case may well induce grave misconception of the function of the court. The part which is played in the judicial interpretation of a statute by reference to the circumstances of its passing is too well known to need restatement; it is sufficient to say that the general proposition that it is the duty of the court to find out the intention of Parliament — and not only of Parliament but of Ministers also — cannot by any means be supported. The duty of the court is to interpret the words that the legislature has used; those words may be ambiguous, but, even if they are, the power and duty of the court to travel outside them on a voyage of discovery are strictly limited: see, for instance, *Assam Railways & Trading Co. v. Inland Revenue Commrs.*, [1935] A.C. 445, and particularly the observations of Lord Wright. (p. 458).
>
> The second part of the passage that I have cited from the judgment of the learned Lord Justice is no doubt the logical sequel of the first. The court, having discovered the intention of Parliament and of Ministers too, must proceed to fill in the gaps. What the legislature has not written, the court must write. This proposition, which restates in a new form the view expressed by the Lord Justice in the earlier case of *Seaford Court Estates Ltd. v. Asher*, [1949] 2 K.B. 481, at 498-9, (to which the Lord Justice himself refers), cannot be supported. It appears to me to be a naked usurpation of the legislative function under the thin disguise of interpretation. And it is the less justifiable when it is guesswork with what material the legislature would, if it had discovered the gap, have filled it in. If a gap is disclosed, the remedy lies in an amending Act.

23 Finally, I must consider the argument that the "relation back" section, that is, s. 41(4), must be applied to s. 79(3)(*b*), and that s. 79(3)(*b*) therefore relates not only to the time of the meeting of the creditors to elect a trustee and inspectors but to the time of the commencement of the bankruptcy. Section 41(4) is primarily designed to deal with property transactions taking place after the filing of the petition or the filing of the assignment with the Official Receiver. I cannot see how it applies to s. 79(3)(*b*) without importing into that section words which are not there, such as adding after the words "officer, director or employee thereof" further suitable words to make it clear that the section is referring to the persons being officers, directors or employees at the time of the bankruptcy.

24 In my conclusion, s. 79(3)(*b*) speaks as at the time of the meeting of the creditors to elect a trustee and inspectors. To make it speak as at the time of the commencement of the bankruptcy would require finding that further words which are not in fact there be read into the section by implication. To do so, it would be necessary to fill a supposed gap in the legislation and if there is a gap in this legislation, it is one which should, I think, be filled by Parliament and not by the courts.

25 The appeal is allowed and the decision of the chairman at the first meeting of the creditors ruling that McDonald and Bailey were not entitled to vote is set aside.

26 The chairman held a "hypothetical vote" allowing McDonald and Bailey to vote thereon in case he was wrong in his conclusion that they were disqualified. Counsel were, I think, in substantial agreement that a further vote should be taken and that the "hypothetical vote" should not be treated as valid. Under the provisions of ss. 80 and 82(12) of the Act, the inspectors elected under the vote now found to be invalid will be adequately protected.

27 Costs were not spoken to by counsel. The subject matter of this appeal was of some novelty and importance, and subject to what counsel may say if they wish to speak to me concerning the matter, I direct that costs be paid out of the estate. However, as the matter of costs was not discussed before me, counsel will have leave to speak to me if they wish to do so before entry of the order.

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TAB 4

1993 CarswellOnt 183
Ontario Court of Justice (General Division — Commercial List)

Lehndorff General Partner Ltd., Re

1993 CarswellOnt 183, [1993] O.J. No. 14, 17 C.B.R. (3d) 24, 37 A.C.W.S. (3d) 847, 9 B.L.R. (2d) 275

Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36; Re Courts of Justice Act, R.S.O. 1990, c. C-43; Re plan of compromise in respect of LEHNDORFF GENERAL PARTNER LTD. (in its own capacity and in its capacity as general partner of LEHNDORFF UNITED PROPERTIES (CANADA), LEHNDORFF PROPERTIES (CANADA) and LEHNDORFF PROPERTIES (CANADA) II) and in respect of certain of their nominees LEHNDORFF UNITED PROPERTIES (CANADA) LTD., LEHNDORFF CANADIAN HOLDINGS LTD., LEHNDORFF CANADIAN HOLDINGS II LTD., BAYTEMP PROPERTIES LIMITED and 102 BLOOR STREET WEST LIMITED and in respect of THG LEHNDORFF VERMÖGENSVERWALTUNG GmbH (in its capacity as limited partner of LEHNDORFF UNITED PROPERTIES (CANADA))

Farley J.

Heard: December 24, 1992
Judgment: January 6, 1993
Docket: Doc. B366/92

Counsel: *Alfred Apps, Robert Harrison* and *Melissa J. Kennedy* , for applicants.
L. Crozier , for Royal Bank of Canada.
R.C. Heintzman , for Bank of Montreal.
J. Hodgson, Susan Lundy and *James Hilton* , for Canada Trustco Mortgage Corporation.
Jay Schwartz , for Citibank Canada.
Stephen Golick , for Peat Marwick Thorne* Inc., proposed monitor.
John Teolis , for Fuji Bank Canada.
Robert Thorton , for certain of the advisory boards.

Subject: Corporate and Commercial; Insolvency

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Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) — *referred to*

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Canada Systems Group (EST) v. Allen-Dale Mutual Insurance Co. (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) [affirmed (1983), 41 O.R. (2d) 135, 33 C.P.C. 210, 145 D.L.R. (3d) 266 (C.A.)] — *referred to*

Empire-Universal Films Ltd. v. Rank, [1947] O.R. 775 [H.C.] — *referred to*

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Fine's Flowers Ltd. v. Fine's Flowers (Creditors of) (1992), 10 C.B.R. (3d) 87, 4 B.L.R. (2d) 293, 87 D.L.R. (4th) 391, 7 O.R. (3d) 193 (Gen. Div.) — *referred to*

Gaz Métropolitain v. Wynden Canada Inc. (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) [affirmed (1982), 45 C.B.R. (N.S.) 11 (Que. C.A.)] — *referred to*

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.) — *referred to*

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Reference re Companies' Creditors Arrangement Act (Canada), [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75 — *referred to*

Seven Mile Dam Contractors v. R. (1979), 13 B.C.L.R. 137, 104 D.L.R. (3d) 274 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) — *referred to*

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) — *referred to*

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Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) — *referred to*

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Statutes considered:

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s. 85

s. 142

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

s. 2

s. 3

s. 4

s. 5

s. 6

s. 7

s. 8

s. 11

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

Judicature Act, The, R.S.O. 1937, c. 100.

Limited Partnerships Act, R.S.O. 1990, c. L.16 —

s. 2(2)

s. 3(1)

s. 8

s. 9

s. 11

s. 12(1)

s. 13

s. 15(2)

s. 24

Partnership Act, R.S.A. 1980, c.P-2 — Pt. 2

s. 75

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Rules considered:

Ontario, Rules of Civil Procedure —

r. 8.01

r. 8.02

Application under Companies' Creditors Arrangement Act to file consolidated plan of compromise and for stay of proceedings.

***Farley J.*:**

1 These are my written reasons relating to the relief granted the applicants on December 24, 1992 pursuant to their application under the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36 ("CCAA") and the *Courts of Justice Act* , R.S.O. 1990, c. C.43 ("CJA"). The relief sought was as follows:

(a) short service of the notice of application;

(b) a declaration that the applicants were companies to which the CCAA applies;

(c) authorization for the applicants to file a consolidated plan of compromise;

(d) authorization for the applicants to call meetings of their secured and unsecured creditors to approve the consolidated plan of compromise;

(e) a stay of all proceedings taken or that might be taken either in respect of the applicants in their own capacity or on account of their interest in Lehndorff United Properties (Canada) ("LUPC"), Lehndorff Properties (Canada) ("LPC") and Lehndorff Properties (Canada) II ("LPC II") and collectively (the "Limited Partnerships") whether as limited partner, as general partner or as registered titleholder to certain of their assets as bare trustee and nominee; and

(f) certain other ancillary relief.

2 The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issues under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermögensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the *Limited Partnership Act* , R.S.O. 1990, c. L.16 ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the *Partnership Act* , R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had

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outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of intercorporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

3 This process has now evolved to a point where management has developed a consolidated restructuring plan which plan addresses the following issues:

(a) The compromise of existing conventional, term and operating indebtedness, both secured and unsecured.

(b) The restructuring of existing project financing commitments.

(c) New financing, by way of equity or subordinated debt.

(d) Elimination or reduction of certain overhead.

(e) Viability of existing businesses of entities in the Lehndorff Group.

(f) Restructuring of income flows from the limited partnerships.

(g) Disposition of further real property assets aside from those disposed of earlier in the process.

(h) Consolidation of entities in the Group; and

(i) Rationalization of the existing debt and security structure in the continuing entities in the Group.

Formal meetings of the beneficial limited partners of the Limited Partnerships are scheduled for January 20 and 21, 1993 in Germany and an information circular has been prepared and at the time of hearing was being translated into German. This application was brought on for hearing at this time for two general reasons: (a) it had now ripened to the stage of proceeding with what had been distilled out of the strategic and consultative meetings; and (b) there were creditors other than senior secured lenders who were in a position to enforce their rights against assets of some of the applicants (and Limited Partnerships) which if such enforcement did take place would result in an undermining of the overall plan. Notice of this hearing was given to various creditors: Barclays Bank of Canada, Barclays Bank PLC, Bank of Montreal, Citibank Canada, Canada Trustco Mortgage Corporation, Royal Trust Corporation of Canada, Royal Bank of Canada, the Bank of Tokyo Canada, Funtauna Investments Limited, Canadian Imperial Bank of Commerce, Fuji Bank Canada and First City Trust Company. In this respect the applicants have recognized that although the initial application under the CCAA may be made on an ex parte basis (s. 11 of the CCAA; *Re Langley's Ltd.*, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) ; *Re Keppoch Development Ltd.* (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) . The court will be concerned when major creditors have not been alerted even in the most minimal fashion (*Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) at p. 310). The application was either supported or not opposed.

4 "Instant" debentures are now well recognized and respected by the courts: see *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44 (N.B. Q.B.) , at pp. 55-56, varied on reconsideration (1988), 68 C.B.R. (N.S.) 170 (N.B. Q.B.) , reversed on different grounds (1988), 69 C.B.R. (N.S.) 161 (N.B. C.A.) , at pp. 165-166; *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) at pp. 250-251; *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan*

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Corp. v. Comiskey) (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (sub nom. *Ultracare Management Inc. v. Gammon*) (1990), 1 O.R. (3d) 321 (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

5 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659 at p. 661, 16 C.B.R. 1, [1934] 4 D.L.R. 75 ; *Meridian Developments Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215 (Alta. Q.B.) at pp. 219-220; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361 (Q.B.) , at pp. 12-13 (C.B.R.); *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.) , at pp. 310-311, affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.) .; *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra, at p. 307 (O.R.); *Fine's Flowers v. Fine's Flowers (Creditors of)* (1992), 7 O.R. (3d) 193 (Gen. Div.) , at p. 199 and "Reorganizations Under The Companies' Creditors Arrangement Act", Stanley E. Edwards (1947) 25 Can. Bar Rev. 587 at p. 592.

6 The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. see *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra at pp. 297 and 316; *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252 and *Ultracare Management Inc. v. Zevenberger (Trustee of)* , supra, at p. 328 and p. 330. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed: see *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at p. 220 (W.W.R.). The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 108-110; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (C.A.) , at pp. 315-318 (C.B.R.) and *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252.

7 One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the *Bankruptcy Act* , R.S.C. 1985, c. B-3, before the amendments effective November 30, 1992 to transform it into the *Bankruptcy and Insolvency Act* ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an

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application under the BIA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 318 and *Re Associated Investors of Canada Ltd.* (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) at pp. 245, reversed on other grounds at (1988), 71 C.B.R. (N.S.) 71 (Alta. C.A.) . It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See *Re Associated Investors of Canada Ltd.* , supra, at p. 318; *Re Amirault Fish Co.*, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) at pp. 187-188 (C.B.R.).

8 It strikes me that each of the applicants in this case has a realistic possibility of being able to continue operating, although each is currently unable to meet all of its expenses albeit on a reduced scale. This is precisely the sort of circumstance in which all of the creditors are likely to benefit from the application of the CCAA and in which it is appropriate to grant an order staying proceedings so as to allow the applicant to finalize preparation of and file a plan of compromise and arrangement.

9 Let me now review the aspect of the stay of proceedings. Section 11 of the CCAA provides as follows:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act* , whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

10 The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affected the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* , supra, at pp. 12-17 (C.B.R.) and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 296-298 (B.C. S.C.) and pp. 312-314 (B.C. C.A.) and *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at pp. 219 ff. Further the court has the power to order a stay that is effective in respect of the rights arising in favour of secured creditors under all forms of commercial security: see *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 320 where Gibbs J.A. for the court stated:

> The trend which emerges from this sampling will be given effect here by holding that where the word "security" occurs in the C.C.A.A., it includes s. 178 security and, where the word creditor occurs, it includes a bank holding s. 178 security. To the extent that there may be conflict between the two statutes, therefore, the broad scope of the C.C.A.A. prevails.

11 The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see *Gaz Métropolitain v. Wynden Canada Inc.* (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) at pp. 290-291 and *Quintette Coal Ltd. v.*

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Nippon Steel Corp. , supra, at pp. 311-312 (B.C. C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (C.A. Que.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

> 8. This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

The power to grant a stay may also extend to prevent persons from exercising any right of set off in respect of the amounts owed by such a person to the debtor company, irrespective of whether the debtor company has commenced any action in respect of which the defense of set off might be formally asserted: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 312-314 (B.C.C.A.).

12 It was submitted by the applicants that the power to grant a stay of proceedings may also extend to a stay of proceedings against non-applicants who are not companies and accordingly do not come within the express provisions of the CCAA. In support thereof they cited a CCAA order which was granted staying proceedings against individuals who guaranteed the obligations of a debtor-applicant which was a qualifying company under the terms of the CCAA: see *Re Slavik* , unreported, [1992] B.C.J. No. 341 [now reported at 12 C.B.R. (3d) 157 (B.C. S.C.)]. However in the *Slavik* situation the individual guarantors were officers and shareholders of two companies which had sought and obtained CCAA protection. Vickers J. in that case indicated that the facts of that case included the following unexplained and unamplified fact [at p. 159]:

> 5. The order provided further that all creditors of Norvik Timber Inc. be enjoined from making demand for payment upon that firm or upon any guarantor of an obligation of the firm until further order of the court.

The CCAA reorganization plan involved an assignment of the claims of the creditors to "Newco" in exchange for cash and shares. However the basis of the stay order originally granted was not set forth in this decision.

13 It appears to me that Dickson J. in *International Donut Corp. v. 050863 N.D. Ltd.* , unreported, [1992] N.B.J. No. 339 (N.B. Q.B.) [now reported at 127 N.B.R. (2d) 290, 319 A.P.R. 290] was focusing only on the stay arrangements of the CCAA when concerning a limited partnership situation he indicated [at p. 295 N.B.R.]:

> In August 1991 the limited partnership, through its general partner the plaintiff, applied to the Court under the *Companies' Creditors Arrangement Act* , R.S.C., c. C-36 for an order delaying the assertion of claims by creditors until an opportunity could be gained to work out with the numerous and sizable creditors a compromise of their claims. An order was obtained but it in due course expired without success having been achieved in arranging with creditors a compromise. *That effort may have been wasted, because it seems questionable that the federal Act could have any application to a limited partnership in circumstances such as these* . (Emphasis added.)

14 I am not persuaded that the words of s. 11 which are quite specific as relating as to a *company* can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in *Campeau v. Olympia & York Developments Ltd.* unreported, [1992] O.J. No. 1946 [now reported at 14 C.B.R. (3d) 303 (Ont.

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Gen. Div.)] at pp. 4-7 [at pp. 308-310 C.B.R.].

The Power to Stay

The court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co.* (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) , and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act* , R.S.O. 1990, c. C.43, which provides as follows:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

Recently, Mr. Justice O'Connell has observed that this discre tionary power is "highly dependent on the facts of each particular case": *Arab Monetary Fund v. Hashim* (unreported) [(June 25, 1992), Doc. 24127/88 (Ont. Gen. Div.)], [1992] O.J. No. 1330.

Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the court is specifically granted the power to stay in a particular context, by virtue of statute or under the *Rules of Civil Procedure* . The authority to prevent multiplicity of proceedings in the same court, under r. 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the C.C.A.A., is an example of the former. Section 11 of the C.C.A.A. provides as follows.

The Power to Stay in the Context of C.C.A.A. Proceedings

By its formal title the C.C.A.A. is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.

In this respect it has been observed that the C.C.A.A. is "to be used as a practical and effective way of restructuring corporate indebtedness.": see the case comment following the report of *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) , and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A.) at p. 113 [B.C.L.R.].

Gibbs J.A. continued with this comment:

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is *a discretionary power to restrain judicial or extra-judicial conduct* against the debtor company *the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period* .

(emphasis added)

I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of negotiating the compromise or arrangement. [In this respect, see also *Sairex GmbH v. Prudential Steel Ltd.* (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.) at p. 77.]

I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra (a "Mississauga Derailment"

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> case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

It is quite clear from *Empire-Universal Films Limited v. Rank*, [1947] O.R. 775 (H.C.) that McRuer C.J.H.C. considered that *The Judicature Act* [R.S.O. 1937, c. 100] then [and now the CJA] merely confirmed a statutory right that previously had been considered inherent in the jurisdiction of the court with respect to its authority to grant a stay of proceedings. See also *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 (H.C.) and *Canada Systems Group (EST) Ltd. v. Allen-Dale Mutual Insurance Co.* (1982), 29 C.P.C. 60 (H.C.) at pp. 65-66.

15 Montgomery J. in *Canada Systems* , supra, at pp. 65-66 indicated:

> Goodman J. (as he then was) in *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in *Edmeades v. Thames Board Mills Ltd.*, [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in *Edmeades* was approved by Lord Justice Davies in *Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis)*, [1972] 1 All E.R. 430, (sub nom. *Lane v. Willis; Lane v. Beach)* [1972] 1 W.L.R. 326 (C.A.) .
>
> . . . . .
>
> In *Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 , appeal allowed by consent without costs (sub nom. *Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.)* 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.) , Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:
>
> > The principles which must govern in these matters are clearly stated in the case of *Empire Universal Films Ltd. et al. v. Rank et al.*, [1947] O.R. 775 at p. 779, as follows [quoting *St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al.*, [1936] 1 K.B. 382 at p. 398]:
> >
> > > (1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.

16 Thus it appears to me that the inherent power of this court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Is it appropriate to do so in the circumstances? Clearly there is jurisdiction under s. 11 of the CCAA to grant a stay in respect of any of the applicants which are all companies which fit the criteria of the CCAA. However the stay requested also involved the limited partnerships to some degree either (i) with respect to the applicants acting on behalf of the Limited Partnerships or (ii) the stays being effective vis-à-vis any proceedings taken by any party against the property assets and undertaking of the Limited Partnerships in respect of which they hold a direct interest (collectively the "Property") as set out in the terms of the stay provisions of the order paragraphs 4 through 18 inclusive attached as an appendix to these reasons. [Appendix omitted.] I believe that an analysis of the operations of a limited partnership in this context would be beneficial to an understanding of how there is a close inter-relationship to the applicants involved in this CCAA proceedings and how the Limited Partnerships and their Property are an integral part of the operations previously conducted and the

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proposed restructuring.

17 A limited partnership is a creation of statute, consisting of one or more general partners and one or more limited partners. The limited partnership is an investment vehicle for passive investment by limited partners. It in essence combines the flow through concept of tax depreciation or credits available to "ordinary" partners under general partnership law with limited liability available to shareholders under corporate law. See Ontario LPA sections 2(2) and 3(1) and Lyle R. Hepburn, *Limited Partnerships* , (Toronto: De Boo, 1991), at p. 1-2 and p. 1-12. I would note here that the limited partnership provisions of the Alberta PA are roughly equivalent to those found in the Ontario LPA with the interesting side aspect that the Alberta legislation in s. 75 does allow for judgment against a limited partner to be charged against the limited partner's interest in the limited partnership. A general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership. In particular a general partner is fully liable to each creditor of the business of the limited partnership. The general partner has sole control over the property and business of the limited partnership: see Ontario LPA ss. 8 and 13. Limited partners have no liability to the creditors of the limited partnership's business; the limited partners' financial exposure is limited to their contribution. The limited partners do not have any "independent" ownership rights in the property of the limited partnership. The entitlement of the limited partners is limited to their contribution plus any profits thereon, after satisfaction of claims of the creditors. See Ontario LPA sections 9, 11, 12(1), 13, 15(2) and 24. The process of debtor and creditor relationships associated with the limited partnership's business are between the general partner and the creditors of the business. In the event of the creditors collecting on debt and enforcing security, the creditors can only look to the assets of the limited partnership together with the assets of the general partner including the general partner's interest in the limited partnership. This relationship is recognized under the *Bankruptcy Act* (now the BIA) sections 85 and 142.

18 A general partner is responsible to defend proceedings against the limited partnership in the firm name, so in procedural law and in practical effect, a proceeding against a limited partnership is a proceeding against the general partner. See Ontario *Rules of Civil Procedure* , O. Reg. 560/84, Rules 8.01 and 8.02.

19 It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See *Lindley on Partnership* , 15th ed. (London: Sweet & Maxwell, 1984), at pp. 33-35; *Seven Mile Dam Contractors v. R.* (1979), 13 B.C.L.R. 137 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad A. Milne, (1985) 23 Alta. L. Rev. 345, at pp. 350-351. Milne in that article made the following observations:

> The preponderance of case law therefore supports the contention that a limited partnership is not a separate legal entity. It appears, nevertheless, that the distinction made in *Re Thorne* between partnerships and trade unions could not be applied to limited partnerships which, like trade unions, must rely on statute for their validity. The mere fact that limited partnerships owe their existence to the statutory provision is probably not sufficient to endow the limited partnership with the attribute of legal personality as suggested in *Ruzicks* unless it appeared that the Legislature clearly intended that the limited partnership should have a separate legal existence. A review of the various provincial statutes does not reveal any procedural advantages, rights or powers that are fundamentally different from those advantages enjoyed by ordinary partnerships. The legislation does not contain any provision resembling section 15 of the *Canada Business Corporation Act* [S.C. 1974-75, c. 33, as am.] which expressly states that a corporation has the capacity, both in and outside of Canada, of a natural person. It is therefore difficult to imagine that the Legislature intended to create a new category of legal entity.

20 It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, "The Control Test of Investor Liability in Limited Partnerships" (1983) 21 Alta. L. Rev. 303; E. Apps, "Limited Partnerships and the

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'Control' Prohibition: Assessing the Liability of Limited Partners" (1991) 70 Can. Bar Rev. 611; R. Flannigan, "Limited Partner Liability: A Response" (1992) 71 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner — the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: *Control Test*, (1992), supra, at pp. 524-525. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-à-vis any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

21 It seems to me that using the inherent jurisdiction of this court to supplement the statutory stay provisions of s. 11 of the CCAA would be appropriate in the circumstances; it would be just and reasonable to do so. The business operations of the applicants are so intertwined with the limited partnerships that it would be impossible for relief as to a stay to be granted to the applicants which would affect their business without at the same time extending that stay to the undivided interests of the limited partners in such. It also appears that the applicants are well on their way to presenting a reorganization plan for consideration and a vote; this is scheduled to happen within the month so there would not appear to be any significant time inconvenience to any person interested in pursuing proceedings. While it is true that the provisions of the CCAA allow for a cramdown of a creditor's claim (as well as an interest of any other person), those who wish to be able to initiate or continue proceedings against the applicants may utilize the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain that particular stay. It seems to me that in such a comeback motion the onus would be upon the applicants to show that in the circumstances it was appropriate to continue the stay.

22 The order is therefore granted as to the relief requested including the proposed stay provisions.

Application allowed.

Footnotes

* As amended by the court.

End of Document

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TAB 5

2005 CarswellOnt 1188
Ontario Court of Appeal

Stelco Inc., Re

2005 CarswellOnt 1188, [2005] O.J. No. 1171, 138 A.C.W.S. (3d) 222, 196 O.A.C. 142, 253 D.L.R. (4th) 109, 2 B.L.R. (4th) 238, 75 O.R. (3d) 5, 9 C.B.R. (5th) 135

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

And In the Matter of a proposed plan of compromise or arrangement with respect to Stelco Inc. and the other Applicants listed in Schedule "A"

Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

Goudge, Feldman, Blair JJ.A.

Heard: March 18, 2005
Judgment: March 31, 2005
Docket: CA M32289

Proceedings: reversed *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 742, [2005] O.J. No. 729, 7 C.B.R. (5th) 307 ((Ont. S.C.J. [Commercial List])); reversed *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 743, [2005] O.J. No. 730, 7 C.B.R. (5th) 310 ((Ont. S.C.J. [Commercial List])); additional reasons to *Stelco Inc., Re* ((2005)), 2005 CarswellOnt 742, [2005] O.J. No. 729, 7 C.B.R. (5th) 307 ((Ont. S.C.J. [Commercial List]))

Counsel: Jeffrey S. Leon, Richard B. Swan for Appellants, Michael Woollcombe, Roland Keiper
Kenneth T. Rosenberg, Robert A. Centa for Respondent, United Steelworkers of America
Murray Gold, Andrew J. Hatnay for Respondent, Retired Salaried Beneficiaries of Stelco Inc., CHT Steel Company Inc., Stelpipe Ltd., Stelwire Ltd., Welland Pipe Ltd.
Michael C.P. McCreary, Carrie L. Clynick for USWA Locals 5328, 8782
John R. Varley for Active Salaried Employee Representative
Michael Barrack for Stelco Inc.
Peter Griffin for Board of Directors of Stelco Inc.
K. Mahar for Monitor
David R. Byers (Agent) for CIT Business Credit, DIP Lender

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

Headnote

Business associations --- Specific corporate organization matters — Directors and officers — Appointment — General principles

Corporation entered protection under Companies' Creditors Arrangement Act — K and W were involved with companies who made capital proposal regarding corporation — Companies held approximately 20 per cent of corporation's shares — K and W, allegedly with support of over 30 per cent of shareholders, requested to fill two vacant directors' positions of corporation, and be appointed to review committee — K and W claimed that their interest as shareholders would not be represented in proceedings — K and W appointed directors by board, and made members of review committee — Employees' motion for removal of K and W as directors was granted and appointments were voided — Trial judge found possibility existed that K and W would not have best interests of corporation at heart, and might favour certain shareholders

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— Trial judge found interference with business judgment of board was appropriate, as issue touched on constitution of corporation — Trial judge found reasonable apprehension of bias existed, although no evidence of actual bias had been shown — K and W appealed — Appeal allowed — K and W reinstated to board — Court's discretion under s. 11 of Act does not give authority to remove directors, which is not part of restructuring process — Trial judge erred in not deferring to corporation's business judgment — Trial judge erred in adopting principle of reasonable apprehension of bias.

Bankruptcy and insolvency — Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Corporation entered protection under Companies' Creditors Arrangement Act — K and W were involved with companies who made capital proposal regarding corporation — Companies held approximately 20 per cent of corporation's shares — K and W, allegedly with support of over 30 per cent of shareholders, requested to fill two vacant directors' positions of corporation and be appointed to review committee — K and W claimed that their interest as shareholders would not be represented in proceedings — K and W appointed directors by board, and made members of review committee — Employees' motion for removal of K and W as directors was granted and appointments were voided — Trial judge found possibility existed that K and W would not have best interests of corporation at heart, and might favour certain shareholders — Trial judge found interference with business judgment of board was appropriate, as issue touched on constitution of corporation — Trial judge found reasonable apprehension of bias existed, although no evidence of actual bias had been shown — K and W appealed — Appeal allowed — K and W reinstated to board — Court's discretion under s. 11 of Act does not give authority to remove directors, which is not part of restructuring process — Trial judge erred in not deferring to corporation's business judgment — Trial judge erred in adopting principle of reasonable apprehension of bias.

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s. 122(1)(a) — referred to

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Generally — referred to

s. 11 — considered

s. 11(1) — considered

s. 11(3) — considered

s. 11(4) — considered

s. 11(6) — considered

s. 20 — considered

APPEAL by potential board members from judgments reported at *Stelco Inc., Re* (2005), 2005 CarswellOnt 742, 7 C.B.R. (5th) 307 (Ont. S.C.J. [Commercial List]) and at *Stelco Inc., Re* (2005), 2005 CarswellOnt 743, 7 C.B.R. (5th) 310 (Ont. S.C.J. [Commercial List]), granting motion by employees for removal of certain directors from board of corporation under protection of *Companies Creditors' Arrangement Act*.

***Blair J.A.*:**

Part I — Introduction

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1 Stelco Inc. and four of its wholly owned subsidiaries obtained protection from their creditors under the *Companies' Creditors Arrangement Act* [1] on January 29, 2004. Since that time, the Stelco Group has been engaged in a high profile, and sometimes controversial, process of economic restructuring. Since October 2004, the restructuring has revolved around a court-approved capital raising process which, by February 2005, had generated a number of competitive bids for the Stelco Group.

2 Farley J., an experienced judge of the Superior Court Commercial List in Toronto, has been supervising the CCAA process from the outset.

3 The appellants, Michael Woollcombe and Roland Keiper, are associated with two companies — Clearwater Capital Management Inc., and Equilibrium Capital Management Inc. — which, respectively, hold approximately 20% of the outstanding publicly traded common shares of Stelco. Most of these shares have been acquired while the CCAA process has been ongoing, and Messrs. Woollcombe and Keiper have made it clear publicly that they believe there is good shareholder value in Stelco in spite of the restructuring. The reason they are able to take this position is that there has been a solid turn around in worldwide steel markets, as a result of which Stelco, although remaining in insolvency protection, is earning annual operating profits.

4 The Stelco board of directors ("the Board") has been depleted as a result of resignations, and in January of this year Messrs. Woollcombe and Keiper expressed an interest in being appointed to the Board. They were supported in this request by other shareholders who, together with Clearwater and Equilibrium, represent about 40% of the Stelco common shareholders. On February 18, 2005, the Board appointed the appellants directors. In announcing the appointments publicly, Stelco said in a press release:

> After careful consideration, and given potential recoveries at the end of the company's restructuring process, the Board responded favourably to the requests by making the appointments announced today.
>
> Richard Drouin, Chairman of Stelco's Board of Directors, said: "I'm pleased to welcome Roland Keiper and Michael Woollcombe to the Board. Their experience and their perspective will assist the Board as it strives to serve the best interests of all our stakeholders. We look forward to their positive contribution."

5 On the same day, the Board began its consideration of the various competing bids that had been received through the capital raising process.

6 The appointments of the appellants to the Board incensed the employee stakeholders of Stelco ("the Employees"), represented by the respondent Retired Salaried Beneficiaries of Stelco and the respondent United Steelworkers of America ("USWA"). Outstanding pension liabilities to current and retired employees are said to be Stelco's largest long-term liability — exceeding several billion dollars. The Employees perceive they do not have the same, or very much, economic leverage in what has sometimes been referred to as 'the bare knuckled arena' of the restructuring process. At the same time, they are amongst the most financially vulnerable stakeholders in the piece. They see the appointments of Messrs. Woollcombe and Keiper to the Board as a threat to their well being in the restructuring process, because the appointments provide the appellants, and the shareholders they represent, with direct access to sensitive information relating to the competing bids to which other stakeholders (including themselves) are not privy.

7 The Employees fear that the participation of the two major shareholder representatives will tilt the bid process in favour of maximizing shareholder value at the expense of bids that might be more favourable to the interests of the Employees. They sought and obtained an order from Farley J. removing Messrs. Woollcombe and Keiper from their short-lived position of directors, essentially on the basis of that apprehension.

8 The Employees argue that there is a reasonable apprehension the appellants would not be able to act in the best interests of the corporation — as opposed to their own best interests as shareholders — in considering the bids. They say this is so because of prior public statements by the appellants about enhancing shareholder value in Stelco, because of the appellants' linkage to such a large shareholder group, because of their earlier failed bid in the restructuring, and because of their opposition to a capital proposal made in the proceeding by Deutsche Bank (known as "the Stalking Horse Bid"). They submit further that

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the appointments have poisoned the atmosphere of the restructuring process, and that the Board made the appointments under threat of facing a potential shareholders' meeting where the members of the Board would be replaced en masse.

9 On the other hand, Messrs. Woollcombe and Keiper seek to set aside the order of Farley J. on the grounds that (a) he did not have the jurisdiction to make the order under the provisions of the CCAA, (b) even if he did have jurisdiction, the reasonable apprehension of bias test applied by the motion judge has no application to the removal of directors, (c) the motion judge erred in interfering with the exercise by the Board of its business judgment in filling the vacancies on the Board, and (d) the facts do not meet any test that would justify the removal of directors by a court in any event.

10 For the reasons that follow, I would grant leave to appeal, allow the appeal, and order the reinstatement of the applicants to the Board.

Part II — Additional Facts

11 Before the initial CCAA order on January 29, 2004, the shareholders of Stelco had last met at their annual general meeting on April 29, 2003. At that meeting they elected eleven directors to the Board. By the date of the initial order, three of those directors had resigned, and on November 30, 2004, a fourth did as well, leaving the company with only seven directors.

12 Stelco's articles provide for the Board to be made up of a minimum of ten and a maximum of twenty directors. Consequently, after the last resignation, the company's corporate governance committee began to take steps to search for new directors. They had not succeeded in finding any prior to the approach by the appellants in January 2005.

13 Messrs. Woollcombe and Keiper had been accumulating shares in Stelco and had been participating in the CCAA proceedings for some time before their request to be appointed to the Board, through their companies, Clearwater and Equilibrium. Clearwater and Equilibrium are privately held, Ontario-based, investment management firms. Mr. Keiper is the president of Equilibrium and associated with Clearwater. Mr. Woollcombe is a consultant to Clearwater. The motion judge found that they "come as a package".

14 In October 2004, Stelco sought court approval of its proposed method of raising capital. On October 19, 2004, Farley J. issued what has been referred to as the Initial Capital Process Order. This order set out a process by which Stelco, under the direction of the Board, would solicit bids, discuss the bids with stakeholders, evaluate the bids, and report on the bids to the court.

15 On November 9, 2004, Clearwater and Equilibrium announced they had formed an investor group and had made a capital proposal to Stelco. The proposal involved the raising of $125 million through a rights offering. Mr. Keiper stated at the time that he believed "the value of Stelco's equity would have the opportunity to increase substantially if Stelco emerged from CCAA while minimizing dilution of its shareholders." The Clearwater proposal was not accepted.

16 A few days later, on November 14, 2004, Stelco approved the Stalking Horse Bid. Clearwater and Equilibrium opposed the Deutsche Bank proposal. Mr. Keiper criticized it for not providing sufficient value to existing shareholders. However, on November 29, 2004, Farley J. approved the Stalking Horse Bid and amended the Initial Capital Process Order accordingly. The order set out the various channels of communication between Stelco, the monitor, potential bidders and the stakeholders. It provided that members of the Board were to see the details of the different bids before the Board selected one or more of the offers.

17 Subsequently, over a period of two and a half months, the shareholding position of Clearwater and Equilibrium increased from approximately 5% as at November 19, to 14.9% as at January 25, 2005, and finally to approximately 20% on a fully diluted basis as at January 31, 2005. On January 25, Clearwater and Equilibrium announced that they had reached an understanding jointly to pursue efforts to maximize shareholder value at Stelco. A press release stated:

> Such efforts will include seeking to ensure that the interests of Stelco's equity holders are appropriately protected by its board of directors and, ultimately, that Stelco's equity holders have an appropriate say, by vote or otherwise, in determining the future course of Stelco.

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18 On February 1, 2005, Messrs. Keiper and Woollcombe and others representatives of Clearwater and Equilibrium, met with Mr. Drouin and other Board members to discuss their views of Stelco and a fair outcome for all stakeholders in the proceedings. Mr. Keiper made a detailed presentation, as Mr. Drouin testified, "encouraging the Board to examine how Stelco might improve its value through enhanced disclosure and other steps". Mr. Keiper expressed confidence that "there was value to the equity of Stelco", and added that he had backed this view up by investing millions of dollars of his own money in Stelco shares. At that meeting, Clearwater and Equilibrium requested that Messrs. Woollcombe and Keiper be added to the Board and to Stelco's restructuring committee. In this respect, they were supported by other shareholders holding about another 20% of the company's common shares.

19 At paragraphs 17 and 18 of his affidavit, Mr. Drouin, summarized his appraisal of the situation:

> 17. It was my assessment that each of Mr. Keiper and Mr. Woollcombe had personal qualities which would allow them to make a significant contribution to the Board in terms of their backgrounds and their knowledge of the steel industry generally and Stelco in particular. In addition I was aware that their appointment to the Board was supported by approximately 40% of the shareholders. In the event that these shareholders successfully requisitioned a shareholders meeting they were in a position to determine the composition of the entire Board.
>
> 18. I considered it essential that there be continuity of the Board through the CCAA process. I formed the view that the combination of existing Board members and these additional members would provide Stelco with the most appropriate board composition in the circumstances. The other members of the Board also shared my views.

20 In order to ensure that the appellants understood their duties as potential Board members and, particularly that "they would no longer be able to consider only the interests of shareholders alone but would have fiduciary responsibilities as a Board member to the corporation as a whole", Mr. Drouin and others held several further meetings with Mr. Woollcombe and Mr. Keiper. These discussions "included areas of independence, standards, fiduciary duties, the role of the Board Restructuring Committee and confidentiality matters". Mr. Woollcombe and Mr. Keiper gave their assurances that they fully understood the nature and extent of their prospective duties, and would abide by them. In addition, they agreed and confirmed that:

> a) Mr. Woollcombe would no longer be an advisor to Clearwater and Equilibrium with respect to Stelco;
>
> b) Clearwater and Equilibrium would no longer be represented by counsel in the CCAA proceedings; and
>
> c) Clearwater and Equilibrium then had no involvement in, and would have no future involvement, in any bid for Stelco.

21 On the basis of the foregoing — and satisfied "that Messrs. Keiper and Woollcombe would make a positive contribution to the various issues before the Board both in [the] restructuring and the ongoing operation of the business" — the Board made the appointments on February 18, 2005.

22 Seven days later, the motion judge found it "appropriate, just, necessary and reasonable to declare" those appointments "to be of no force and effect" and to remove Messrs. Woollcombe and Keiper from the Board. He did so not on the basis of any actual conduct on the part of the appellants as directors of Stelco but because there was some risk of anticipated conduct in the future. The gist of the motion judge's rationale is found in the following passage from his reasons (at para. 23):

> In these particular circumstances and aside from the Board feeling coerced into the appointments for the sake of continuing stability, I am not of the view that it would be appropriate to wait and see if there was any explicit action on behalf of K and W while conducting themselves as Board members which would demonstrate that they had not lived up to their obligations to be "neutral". They may well conduct themselves beyond reproach. But if they did not, the fallout would be very detrimental to Stelco and its ability to successfully emerge. What would happen to the bids in such a dogfight? I fear that it would be trying to put Humpty Dumpty back together again. The same situation would prevail even if K and W conducted themselves beyond reproach but with the Board continuing to be concerned that they not do anything

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seemingly offensive to the bloc. The risk to the process and to Stelco in its emergence is simply too great to risk the wait and see approach.

Part III — Leave to Appeal

23 Because of the "real time" dynamic of this restructuring project, Laskin J.A. granted an order on March 4, 2005, expediting the appellants' motion for leave to appeal, directing that it be heard orally and, if leave be granted, directing that the appeal be heard at the same time. The leave motion and the appeal were argued together, by order of the panel, on March 18, 2005.

24 This court has said that it will only sparingly grant leave to appeal in the context of a CCAA proceeding and will only do so where there are "serious and arguable grounds that are of real and significant interest to the parties": *Country Style Food Services Inc., Re* (2002), 158 O.A.C. 30, [2002] O.J. No. 1377 (Ont. C.A. [In Chambers]), at para. 15. This criterion is determined in accordance with a four-pronged test, namely,

a) whether the point on appeal is of significance to the practice;

b) whether the point is of significance to the action;

c) whether the appeal is *prima facie* meritorious or frivolous;

d) whether the appeal will unduly hinder the progress of the action.

25 Counsel agree that (d) above is not relevant to this proceeding, given the expedited nature of the hearing. In my view, the tests set out in (a) - (c) are met in the circumstances, and as such, leave should be granted. The issue of the court's jurisdiction to intervene in corporate governance issues during a CCAA restructuring, and the scope of its discretion in doing so, are questions of considerable importance to the practice and on which there is little appellate jurisprudence. While Messrs. Woollcombe and Keiper are pursuing their remedies in their own right, and the company and its directors did not take an active role in the proceedings in this court, the Board and the company did stand by their decision to appoint the new directors at the hearing before the motion judge and in this court, and the question of who is to be involved in the Board's decision making process continues to be of importance to the CCAA proceedings. From the reasons that follow it will be evident that in my view the appeal has merit.

26 Leave to appeal is therefore granted.

Part IV — The Appeal

The Positions of the Parties

27 The appellants submit that,

a) in exercising its discretion under the CCAA, the court is not exercising its "inherent jurisdiction" as a superior court;

b) there is no jurisdiction under the CCAA to remove duly elected or appointed directors, notwithstanding the broad discretion provided by s. 11 of that Act; and that,

c) even if there is jurisdiction, the motion judge erred:

(i) by relying upon the administrative law test for reasonable apprehension of bias in determining that the directors should be removed;

(ii) by rejecting the application of the "business judgment" rule to the unanimous decision of the Board to appoint two new directors; and,

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(iii) by concluding that Clearwater and Equilibrium, the shareholders with whom the appellants are associated, were focussed solely on a short-term investment horizon, without any evidence to that effect, and therefore concluding that there was a tangible risk that the appellants would not be neutral and act in the best interests of Stelco and all stakeholders in carrying out their duties as directors.

28 The respondents' arguments are rooted in fairness and process. They say, first, that the appointment of the appellants as directors has poisoned the atmosphere of the CCAA proceedings and, secondly, that it threatens to undermine the even-handedness and integrity of the capital raising process, thus jeopardizing the ability of the court at the end of the day to approve any compromise or arrangement emerging from that process. The respondents contend that Farley J. had jurisdiction to ensure the integrity of the CCAA process, including the capital raising process Stelco had asked him to approve, and that this court should not interfere with his decision that it was necessary to remove Messrs. Woollcombe and Keiper from the Board in order to ensure the integrity of that process. A judge exercising a supervisory function during a CCAA proceeding is owed considerable deference: *Algoma Steel Inc., Re* (2001), 25 C.B.R. (4th) 194 (Ont. C.A.), at para. 8.

29 The crux of the respondents' concern is well-articulated in the following excerpt from paragraph 72 of the factum of the Retired Salaried Beneficiaries:

> The appointments of Keiper and Woollcombe violated every tenet of fairness in the restructuring process that is supposed to lead to a plan of arrangement. One stakeholder group — particular investment funds that have acquired Stelco shares during the CCAA itself — have been provided with privileged access to the capital raising process, and voting seats on the Corporation's Board of Directors and Restructuring Committee. No other stakeholder has been treated in remotely the same way. To the contrary, the salaried retirees have been completely excluded from the capital raising process and have no say whatsoever in the Corporation's decision-making process.

30 The respondents submit that fairness, and the perception of fairness, underpin the CCAA process, and depend upon effective judicial supervision: see *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.); *Ivaco Inc., Re* (2004), 3 C.B.R. (5th) 33 (Ont. S.C.J. [Commercial List]), at para.15-16. The motion judge reasonably decided to remove the appellants as directors in the circumstances, they say, and this court should not interfere.

Jurisdiction

31 The motion judge concluded that he had the power to rescind the appointments of the two directors on the basis of his "inherent jurisdiction" and "the discretion given to the court pursuant to the *CCAA*". He was not asked to, nor did he attempt to rest his jurisdiction on other statutory powers imported into the CCAA.

32 The CCAA is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: *Babcock & Wilcox Canada Ltd., Re*, [2000] O.J. No. 786 (Ont. S.C.J. [Commercial List]), at para. 11. See also, *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.), at p. 320; *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the CCAA, as the source of judicial power in a CCAA proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]), *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]); and *Westar Mining Ltd., Re* (1992), 70 B.C.L.R. (2d) 6 (B.C. S.C.).

33 It is not necessary, for purposes of this appeal, to determine whether inherent jurisdiction is excluded for all supervisory purposes under the CCAA, by reason of the existence of the statutory discretionary regime provided in that Act. In my opinion, however, the better view is that in carrying out his or her supervisory functions under the legislation, the judge is not exercising inherent jurisdiction but rather the statutory discretion provided by s. 11 of the CCAA and supplemented by other statutory powers that may be imported into the exercise of the s. 11 discretion from other statutes through s. 20 of the CCAA.

Inherent Jurisdiction

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34 Inherent jurisdiction is a power derived "from the very nature of the court as a superior court of law", permitting the court "to maintain its authority and to prevent its process being obstructed and abused". It embodies the authority of the judiciary to control its own process and the lawyers and other officials connected with the court and its process, in order "to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner". See I.H. Jacob, "The Inherent Jurisdiction of the Court" (1970) 23 Current Legal Problems 27-28. In Halsbury's Laws of England, 4th ed. (London: Lexis-Nexis UK, 1973 -) vol. 37, at para. 14, the concept is described as follows:

> In sum, it may be said that the inherent jurisdiction of the court is a virile and viable doctrine, and has been defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, in particularly to ensure the observation of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them.

35 In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the Legislature has acted. As Farley J. noted in *Royal Oak Mines Inc.*, *supra*, inherent jurisdiction is "not limitless; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play" (para. 4). See also, *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.* (1975), [1976] 2 S.C.R. 475 (S.C.C.) at 480; *Richtree Inc., Re*, [2005] O.J. No. 251 (Ont. S.C.J. [Commercial List]).

36 In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In that regard, I agree with the comment of Newbury J.A. in *Skeena Cellulose Inc., Re*, [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (B.C. C.A.) at para. 46, that:

> . . . the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the CCAA. . . . This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above,[2] rather than the integrity of their own process.

37 As Jacob observes, in his article "The Inherent Jurisdiction of the Court", *supra*, at p. 25:

> The inherent jurisdiction of the court is a concept which must be distinguished from the exercise of judicial discretion. These two concepts resemble each other, particularly in their operation, and they often appear to overlap, and are therefore sometimes confused the one with the other. There is nevertheless a vital juridical distinction between jurisdiction and discretion, which must always be observed.

38 I do not mean to suggest that inherent jurisdiction can never apply in a CCAA context. The court retains the ability to control its own process, should the need arise. There is a distinction, however — difficult as it may be to draw — between the *court's* process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the *company's* process, on the other hand. The court simply supervises the latter process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose".[3] Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a CCAA proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process.

The Section 11 Discretion

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39 This appeal involves the scope of a supervisory judge's discretion under s. 11 of the CCAA, in the context of corporate governance decisions made during the course of the plan negotiating and approval process and, in particular, whether that discretion extends to the removal of directors in that environment. In my view, the s. 11 discretion — in spite of its considerable breadth and flexibility — does not permit the exercise of such a power in and of itself. There may be situations where a judge in a CCAA proceeding would be justified in ordering the removal of directors pursuant to the oppression remedy provisions found in s. 241 of the CBCA, and imported into the exercise of the s. 11 discretion through s. 20 of the CCAA. However, this was not argued in the present case, and the facts before the court would not justify the removal of Messrs. Woollcombe and Keiper on oppression remedy grounds.

40 The pertinent portions of s. 11 of the CCAA provide as follows:

Powers of court

11. (1) Notwithstanding anything in the *Bankruptcy* and Insolvency Act or the Winding-up Act, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

Initial application court orders

(3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days.

> (a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
>
> (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 or proceeding with any other action, suit or proceeding against the company.

Other than initial application court orders

(4) A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose.

> (a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
>
> (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 or proceeding with any other action, suit or proceeding against the company.

Burden of proof on application

(6) The court shall not make an order under subsection (3) or (4) unless

> (a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
>
> (b) in the case of an order under subsection (4), the applicant also satisfied the court that the applicant has acted, and is acting, in good faith and with due diligence.

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41 The rule of statutory interpretation that has now been accepted by the Supreme Court of Canada, in such cases as *R. v. Sharpe*, [2001] 1 S.C.R. 45 (S.C.C.), at para. 33, and *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at para. 21 is articulated in E.A. Driedger, *The Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) as follows:

> Today, there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See also Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002) at page 262.

42 The interpretation of s. 11 advanced above is true to these principles. It is consistent with the purpose and scheme of the CCAA, as articulated in para. 38 above, and with the fact that corporate governance matters are dealt with in other statutes. In addition, it honours the historical reluctance of courts to intervene in such matters, or to second-guess the business decisions made by directors and officers in the course of managing the business and affairs of the corporation.

43 Mr. Leon and Mr. Swan argue that matters relating to the removal of directors do not fall within the court's discretion under s. 11 because they fall outside of the parameters of the court's role in the restructuring process, in contrast to the company's role in the restructuring process. The court's role is defined by the "on such terms as may be imposed" jurisdiction under subparagraphs 11(3)(a)-(c) and 11(4)(a)-(c) of the CCAA to stay, or restrain, or prohibit proceedings against the company during the "breathing space" period for negotiations and a plan. I agree.

44 What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in *Lehndorff General Partner Ltd., supra*, at para 5, "to make order[s] so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors". But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance *the company's* restructuring efforts.

45 With these principles in mind, I turn to an analysis of the various factors underlying the interpretation of the s. 11 discretion.

46 I start with the proposition that at common law directors could not be removed from office during the term for which they were elected or appointed: *London Finance Corp. v. Banking Service Corp.* (1922), 23 O.W.N. 138 (Ont. H.C.); *Stephenson v. Vokes* (1896), 27 O.R. 691 (Ont. H.C.). The authority to remove must therefore be found in statute law.

47 In Canada, the CBCA and its provincial equivalents govern the election, appointment and removal of directors, as well as providing for their duties and responsibilities. Shareholders elect directors, but the directors may fill vacancies that occur on the board of directors pending a further shareholders meeting: CBCA, ss. 106(3) and 111.[4] The specific power *to remove* directors is vested in the shareholders by s. 109(1) of the CBCA. However, s. 241 empowers the court — where it finds that oppression as therein defined exists — to "make any interim or final order it thinks fit", including (s. 241(3)(e)) "an order appointing directors in place of or in addition to all or any of the directors then in office". This power has been utilized to remove directors, but in very rare cases, and only in circumstances where there has been actual conduct rising to the level of misconduct required to trigger oppression remedy relief: see, for example, *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2004] O.J. No. 4722 (Ont. S.C.J.).

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48 There is therefore a statutory scheme under the CBCA (and similar provincial corporate legislation) providing for the election, appointment, *and removal* of directors. Where another applicable statute confers jurisdiction with respect to a matter, a broad and undefined discretion provided in one statute cannot be used to supplant or override the other applicable statute. There is no legislative "gap" to fill. See *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, *supra*, at p. 480; *Royal Oak Mines Inc. (Re)*, *supra*; and *Richtree Inc. (Re)*, *supra*.

49 At paragraph 7 of his reasons, the motion judge said:

> The board is charged with the standard duty of "manage[ing], [*sic*] or supervising the management, of the business and affairs of the corporation": s. 102(1) CBCA. *Ordinarily the Court will not interfere with the composition of the board of directors. However, if there is good and sufficient valid reason to do so, then the Court must not hesitate to do so to correct a problem.* The directors should not be required to constantly look over their shoulders for this would be the sure recipe for board paralysis which would be so detrimental to a restructuring process; thus interested parties should only initiate a motion where it is reasonably obvious that there is a problem, actual or poised to become actual.
>
> [emphasis added]

50 Respectfully, I see no authority in s. 11 of the CCAA for the court to interfere with the composition of a board of directors on such a basis.

51 Court removal of directors is an exceptional remedy, and one that is rarely exercised in corporate law. This reluctance is rooted in the historical unwillingness of courts to interfere with the internal management of corporate affairs and in the court's well-established deference to decisions made by directors and officers in the exercise of their business judgment when managing the business and affairs of the corporation. These factors also bolster the view that where the CCAA is silent on the issue, the court should not read into the s. 11 discretion an extraordinary power — which the courts are disinclined to exercise in any event — except to the extent that that power may be introduced through the application of other legislation, and on the same principles that apply to the application of the provisions of the other legislation.

The Oppression Remedy Gateway

52 The fact that s. 11 does not itself provide the authority for a CCAA judge to order the removal of directors does not mean that the supervising judge is powerless to make such an order, however. Section 20 of the CCAA offers a gateway to the oppression remedy and other provisions of the CBCA and similar provincial statutes. Section 20 states:

> The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

53 The CBCA is legislation that "makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them". Accordingly, the powers of a judge under s. 11 of the CCAA may be applied together with the provisions of the CBCA, including the oppression remedy provisions of that statute. I do not read s. 20 as limiting the application of outside legislation to the provisions of such legislation dealing specifically with the sanctioning of compromises and arrangements between the company and its shareholders. The grammatical structure of s. 20 mandates a broader interpretation and the oppression remedy is, therefore, available to a supervising judge in appropriate circumstances.

54 I do not accept the respondents' argument that the motion judge had the authority to order the removal of the appellants by virtue of the power contained in s. 145(2)(b) of the CBCA to make an order "declaring the result of the disputed election or appointment" of directors. In my view, s. 145 relates to the procedures underlying disputed elections or appointments, and not to disputes over the composition of the board of directors itself. Here, it is conceded that the appointment of Messrs. Woollcombe and Keiper as directors complied with all relevant statutory requirements. Farley J. quite properly did not seek to base his jurisdiction on any such authority.

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The Level of Conduct Required

55 Colin Campbell J. recently invoked the oppression remedy to remove directors, without appointing anyone in their place, in *Catalyst Fund General Partner I Inc. v. Hollinger Inc., supra* The bar is high. In reviewing the applicable law, C. Campbell J. said (para. 68):

> Director removal is *an extraordinary remedy* and certainly should be *imposed most sparingly*. As a starting point, I accept the basic proposition set out in Peterson, "Shareholder Remedies in Canada" [5]:
>
> > SS. 18.172 *Removing and appointing directors to the board is an extreme form of judicial intervention.* The board of directors is elected by the shareholders, vested with the power to manage the corporation, and appoints the officers of the company who undertake to conduct the day-to-day affairs of the corporation. [Footnote omitted.] It is clear that the board of directors has control over policymaking and management of the corporation. *By tampering with a board, a court directly affects the management of the corporation.* If a reasonable balance between protection of corporate stakeholders and the freedom of management to conduct the affairs of the business in an efficient manner is desired, altering the board of directors should be *a measure of last resort.* The order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or directors would remedy the oppressive conduct without a receiver or receiver-manager.
>
> [emphasis added]

56 C. Campbell J. found that the continued involvement of the Ravelston directors in the *Hollinger* situation would "significantly impede" the interests of the public shareholders and that those directors were "motivated by putting their interests first, not those of the company" (paras. 82-83). The evidence in this case is far from reaching any such benchmark, however, and the record would not support a finding of oppression, even if one had been sought.

57 Everyone accepts that there is no evidence the appellants have conducted themselves, as directors — in which capacity they participated over two days in the bid consideration exercise — in anything but a neutral fashion, having regard to the best interests of Stelco and all of the stakeholders. The motion judge acknowledged that the appellants "may well conduct themselves beyond reproach". However, he simply decided there was a risk — a reasonable apprehension — that Messrs. Woollcombe and Keiper would not live up to their obligations to be neutral in the future.

58 The risk or apprehension appears to have been founded essentially on three things: (1) the earlier public statements made by Mr. Keiper about "maximizing shareholder value"; (2) the conduct of Clearwater and Equilibrium in criticizing and opposing the Stalking Horse Bid; and (3) the motion judge's opinion that Clearwater and Equilibrium — the shareholders represented by the appellants on the Board — had a "vision" that "usually does not encompass any significant concern for the long-term competitiveness and viability of an emerging corporation", as a result of which the appellants would approach their directors' duties looking to liquidate their shares on the basis of a "short-term hold" rather than with the best interests of Stelco in mind. The motion judge transposed these concerns into anticipated predisposed conduct on the part of the appellants as directors, despite their apparent understanding of their duties as directors and their assurances that they would act in the best interests of Stelco. He therefore concluded that "the risk to the process and to Stelco in its emergence [was] simply too great to risk the wait and see approach".

59 Directors have obligations under s. 122(1) of the CBCA (a) to act honestly and in good faith with a view to the best interest of the corporation (the "statutory fiduciary duty" obligation), and (b) to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (the "duty of care" obligation). They are also subject to control under the oppression remedy provisions of s. 241. The general nature of these duties does not change when the company approaches, or finds itself in, insolvency: *People's Department Stores Ltd. (1992) Inc., Re*, [2004] S.C.J. No. 64 (S.C.C.) at paras. 42-49.

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60 In *Peoples* the Supreme Court noted that "the interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders" (para. 43), but also accepted "as an accurate statement of the law that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment" (para. 42). Importantly as well — in the context of "the shifting interest and incentives of shareholders and creditors" — the court stated (para. 47):

> In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders.

61 In determining whether directors have fallen foul of those obligations, however, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office. Although the motion judge concluded that there was a risk of harm to the Stelco process if Messrs Woollcombe and Keiper remained as directors, he did not assess the level of that risk. The record does not support a finding that there was a sufficient risk of sufficient misconduct to warrant a conclusion of oppression. The motion judge was not asked to make such a finding, and he did not do so.

62 The respondents argue that this court should not interfere with the decision of the motion judge on grounds of deference. They point out that the motion judge has been case-managing the restructuring of Stelco under the CCAA for over fourteen months and is intimately familiar with the circumstances of Stelco as it seeks to restructure itself and emerge from court protection.

63 There is no question that the decisions of judges acting in a supervisory role under the CCAA, and particularly those of experienced commercial list judges, are entitled to great deference: see *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78 (Ont. C.A.) at para. 16. The discretion must be exercised judicially and in accordance with the principles governing its operation. Here, respectfully, the motion judge misconstrued his authority, and made an order that he was not empowered to make in the circumstances.

64 The appellants argued that the motion judge made a number of findings without any evidence to support them. Given my decision with respect to jurisdiction, it is not necessary for me to address that issue.

The Business Judgment Rule

65 The appellants argue as well that the motion judge erred in failing to defer to the unanimous decision of the Stelco directors in deciding to appoint them to the Stelco Board. It is well-established that judges supervising restructuring proceedings — and courts in general — will be very hesitant to second-guess the business decisions of directors and management. As the Supreme Court of Canada said in *Peoples, supra*, at para. 67:

> Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making . . .

66 In *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289 (Ont. C.A.) at 320, this court adopted the following statement by the trial judge, Anderson J.:

> Business decisions, honestly made, should not be subjected to microscopic examination. There should be no interference simply because a decision is unpopular with the minority. [6]

67 McKinlay J.A then went on to say:

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> There can be no doubt that on an application under s. 234[7] the trial judge is required to consider the nature of the impugned acts and the method in which they were carried out. That does not meant that the trial judge should substitute his own business judgment for that of managers, directors, or a committee such as the one involved in assessing this transaction. Indeed, it would generally be impossible for him to do so, regardless of the amount of evidence before him. He is dealing with the matter at a different time and place; it is unlikely that he will have the background knowledge and expertise of the individuals involved; he could have little or no knowledge of the background and skills of the persons who would be carrying out any proposed plan; and it is unlikely that he would have any knowledge of the specialized market in which the corporation operated. In short, he does not know enough to make the business decision required.

68 Although a judge supervising a CCAA proceeding develops a certain "feel" for the corporate dynamics and a certain sense of direction for the restructuring, this caution is worth keeping in mind. See also *Skeena Cellulose Inc., Re, supra*, *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]); *Olympia & York Developments Ltd. (Re), supra*; *Alberta-Pacific Terminals Ltd., Re* (1991), 8 C.B.R. (3d) 99 (B.C. S.C.). The court is not catapulted into the shoes of the board of directors, or into the seat of the chair of the board, when acting in its supervisory role in the restructuring.

69 Here, the motion judge was alive to the "business judgment" dimension in the situation he faced. He distinguished the application of the rule from the circumstances, however, stating at para. 18 of his reasons:

> With respect I do not see the present situation as involving the "management of the business and affairs of the corporation", but rather as a quasi-constitutional aspect of the corporation entrusted albeit to the Board pursuant to s. 111(1) of the CBCA. I agree that where a board is actually engaged in the business of a judgment situation, the board should be given appropriate deference. However, to the contrary in this situation, I do not see it as a situation calling for (as asserted) more deference, but rather considerably less than that. With regard to this decision of the Board having impact upon the capital raising process, as I conclude it would, then similarly deference ought not to be given.

70 I do not see the distinction between the directors' role in "the management of the business and affairs of the corporation" (CBCA, s. 102) — which describes the directors' overall responsibilities — and their role with respect to a "quasi-constitutional aspect of the corporation" (i.e. in filling out the composition of the board of directors in the event of a vacancy). The "affairs" of the corporation are defined in s. 1 of the CBCA as meaning "the relationships among a corporation, it affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate". Corporate governance decisions relate directly to such relationships and are at the heart of the Board's business decision-making role regarding the corporation's business *and* affairs. The dynamics of such decisions, and the intricate balancing of competing interests and other corporate-related factors that goes into making them, are no more within the purview of the court's knowledge and expertise than other business decisions, and they deserve the same deferential approach. Respectfully, the motion judge erred in declining to give effect to the business judgment rule in the circumstances of this case.

71 This is not to say that the conduct of the Board in appointing the appellants as directors may never come under review by the supervising judge. The court must ultimately approve and sanction the plan of compromise or arrangement as finally negotiated and accepted by the company and its creditors and stakeholders. The plan must be found to be fair and reasonable before it can be sanctioned. If the Board's decision to appoint the appellants has somehow so tainted the capital raising process that those criteria are not met, any eventual plan that is put forward will fail.

72 The respondents submit that it makes no sense for the court to have jurisdiction to declare the process flawed only after the process has run its course. Such an approach to the restructuring process would be inefficient and a waste of resources. While there is some merit in this argument, the court cannot grant itself jurisdiction where it does not exist. Moreover, there are a plethora of checks and balances in the negotiating process itself that moderate the risk of the process becoming irretrievably tainted in this fashion — not the least of which is the restraining effect of the prospect of such a consequence. I do not think that this argument can prevail. In addition, the court at all times retains its broad and flexible supervisory jurisdiction — a jurisdiction which feeds the creativity that makes the CCAA work so well — in order to address fairness and process concerns along the way. This case relates only to the court's exceptional power to order the removal of directors.

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The Reasonable Apprehension of Bias Analogy

73 In exercising what he saw as his discretion to remove the appellants as directors, the motion judge thought it would be useful to "borrow the concept of reasonable apprehension of bias . . .with suitable adjustments for the nature of the decision making involved" (para. 8). He stressed that "there was absolutely no allegation against [Mr. Woollcombe and Mr. Keiper] of any actual 'bias' or its equivalent" (para. 8). He acknowledged that neither was alleged to have done anything wrong since their appointments as directors, and that at the time of their appointments the appellants had confirmed to the Board that they understood and would abide by their duties and responsibilities as directors, including the responsibility to act in the best interests of the corporation and not in their own interests as shareholders. In the end, however, he concluded that because of their prior public statements that they intended to "pursue efforts to maximize shareholder value at Stelco", and because of the nature of their business and the way in which they had been accumulating their shareholding position during the restructuring, and because of their linkage to 40% of the common shareholders, there was a risk that the appellants would not conduct themselves in a neutral fashion in the best interests of the corporation as directors.

74 In my view, the administrative law notion of apprehension of bias is foreign to the principles that govern the election, appointment and removal of directors, and to corporate governance considerations in general. Apprehension of bias is a concept that ordinarily applies to those who preside over judicial or quasi-judicial decision-making bodies, such as courts, administrative tribunals or arbitration boards. Its application is inapposite in the business decision-making context of corporate law. There is nothing in the CBCA or other corporate legislation that envisages the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment.

75 Instead, the conduct of directors is governed by their common law and statutory obligations to act honestly and in good faith with a view to the best interests of the corporation, and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (CBCA, s. 122(1)(a) and (b)). The directors also have fiduciary obligations to the corporation, and they are liable to oppression remedy proceedings in appropriate circumstances. These remedies are available to aggrieved complainants — including the respondents in this case — but they depend for their applicability on the director having engaged in conduct justifying the imposition of a remedy.

76 If the respondents are correct, and reasonable apprehension that directors may not act neutrally because they are aligned with a particular group of shareholders or stakeholders is sufficient for removal, all nominee directors in Canadian corporations, and all management directors, would automatically be disqualified from serving. No one suggests this should be the case. Moreover, as Iacobucci J. noted in *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5 (S.C.C.) at para. 35, "persons are assumed to act in good faith unless proven otherwise". With respect, the motion judge approached the circumstances before him from exactly the opposite direction. It is commonplace in corporate/commercial affairs that there are connections between directors and various stakeholders and that conflicts will exist from time to time. Even where there are conflicts of interest, however, directors are not removed from the board of directors; they are simply obliged to disclose the conflict and, in appropriate cases, to abstain from voting. The issue to be determined is not whether there is a connection between a director and other shareholders or stakeholders, but rather whether there has been some conduct on the part of the director that will justify the imposition of a corrective sanction. An apprehension of bias approach does not fit this sort of analysis.

Part V — Disposition

77 For the foregoing reasons, then, I am satisfied that the motion judge erred in declaring the appointment of Messrs. Woollcombe and Keiper as directors of Stelco of no force and effect.

78 I would grant leave to appeal, allow the appeal and set aside the order of Farley J. dated February 25, 2005.

79 Counsel have agreed that there shall be no costs of the appeal.

Goudge J.A.:

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I agree.

Feldman J.A.:

I agree.

Appeal allowed.

Footnotes

1 R.S.C. 1985, c. C-36, as amended.

2 The reference is to the decisions in *Dyle, Royal Oak Mines, and Westar*, cited above.

3 See paragraph 43, *infra*, where I elaborate on this distinction.

4 It is the latter authority that the directors of Stelco exercised when appointing the appellants to the Stelco Board.

5 Dennis H. Peterson, Shareholder Remedies in Canada (Markham: LexisNexis — Butterworths — Looseleaf Service, 1989) at 18-47.

6 Or, I would add, unpopular with other stakeholders.

7 Now s. 241.

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TAB 6

2000 CarswellAlta 622
Alberta Court of Queen's Bench

Canadian Airlines Corp., Re

2000 CarswellAlta 622, [2000] A.W.L.D. 666, [2000] A.J. No. 1692, 19 C.B.R. (4th) 1

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

The Bank of Nova Scotia Trust Company of New York, As Trustee for the Holders of Senior Secured Notes and Montreal Trust Company of Canada, As Collateral Agent for the Holders of Senior Secured Notes, Plaintiffs and Canadian Airlines Corporation, Canadian Airlines International Ltd., Canadian Regional Airlines Ltd., Canadian Regional Airlines (1998) Ltd. and Canadian Airlines Fuel Corporation Inc., Defendants

Paperny J.

Judgment: May 4, 2000
Docket: Calgary 0001-05071, 0001-05044

Counsel: *G. Moraweiz, A.J. McConnell* and *R.N. Billington*, for Bank of Nova Scotia Trust Co. of New York and Montreal Trust Co. of Canada.
A.L. Friend, Q.C., and *H.M. Kay, Q.C.*, for Canadian Airlines.
S. Dunphy, for Air Canada and 853350 Alberta Ltd.
R. Anderson, Q.C., for Loyalty Group.
H. Gorman, for ABN AMRO Bank N.V.
P. McCarthy, for Monitor - Price Waterhouse Cooper.
D. Haigh, Q.C., and *D. Nishimura*, for Unsecured noteholders - Resurgence Asset Management.
C.J. Shaw, for Airline Pilots Association International.
G. Wells, for NavCanada.
D. Hardy, for Royal Bank of Canada.

Subject: Corporate and Commercial; Insolvency

Headnote

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

Senior secured noteholders brought application for appointment of receiver over collateral on same day that airline was granted CCAA protection — Noteholders constituted separate class that intended to vote against plan and had voted to realize on security — Noteholders brought application for order lifting stay of proceedings against them to allow for appointment of receiver and manager over assets and property charged in their favour, and for order appointing court officer with exclusive right to negotiate sale of assets or shares of airline's subsidiary — Application dismissed — In determining whether stay should be lifted, court had to balance interests of all parties who stood to be affected — This would include general public, which would be affected by collapse of airline — Evidence indicated that liquidation would be inevitable were noteholders to realize on collateral — Objective of stay was not to maintain literal status quo but to maintain situation that was not prejudicial to creditors while allowing airline "breathing room" — It was premature to conclude that plan would be rejected or that proposal acceptable to noteholders could not be reached — Evidence indicated that airline was moving to effect compromises swiftly and in good faith — Appointment of receiver to manage collateral would negate effect of stay and thwart purposes of Act — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

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

Senior secured noteholders brought application for appointment of receiver over collateral on same day that airline was granted CCAA protection — Noteholders constituted separate class that intended to vote against plan and voted to realize on security — Noteholders brought application for order lifting stay of proceedings against them to allow for appointment of receiver and manager over assets and property charged in their favour, and for order appointing court officer with exclusive right to negotiate sale of assets or shares of airline's subsidiary — Application dismissed — Proposal that airline make interim payments for use of security was not viable — Suggestion that other airline financially supporting plan should pay out airline's debts to noteholders was without legal foundation — Existence of solvent entity financially supporting plan with view to obtaining economic benefit for itself did not create obligation on that entity to pay airline's creditors — Noteholders could not require sale of assets or shares of airline's subsidiary — Subsidiary was not debtor company but was itself property of airline — Marketing of subsidiary's assets would constitute "proceeding in respect of petitioners' property" within meaning of s. 11 of Act — Even if marketing of subsidiary's assets did not so qualify, court has inherent jurisdiction to grant stays in relation to proceedings against third parties where exercise of jurisdiction is important to reorganization process — In deciding whether to exercise inherent jurisdiction, court weighs interests of insolvent corporation against interests of parties who would be affected by stay — Threshold of prejudice required to persuade court not to exercise inherent jurisdiction to grant stay is lower than threshold required to persuade court not to exercise discretion under s. 11 of Act — Noteholders failed to meet either threshold — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

Table of Authorities

Cases considered by *Paperny J.*:

Alberta-Pacific Terminals Ltd., Re (1991), 8 C.B.R. (3d) 99 (B.C. S.C.) — considered

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

Citibank Canada v. Chase Manhattan Bank of Canada (1991), 5 C.B.R. (3d) 165, 2 P.P.S.A.C. (2d) 21, 4 B.L.R. (2d) 147 (Ont. Gen. Div.) — referred to

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 4 C.B.R. (3d) 311, (sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136 (B.C. C.A.) — referred to

Meridian Development Inc. v. Toronto Dominion Bank, [1984] 5 W.W.R. 215, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Alta. Q.B.) — referred to

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

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

Pacific National Lease Holding Corp., Re (1992), 72 B.C.L.R. (2d) 368, 19 B.C.A.C. 134, 34 W.A.C. 134, 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]) — considered

Philip's Manufacturing Ltd., Re (1992), 9 C.B.R. (3d) 25, 67 B.C.L.R. (2d) 84, 4 B.L.R. (2d) 142 (B.C. C.A.) — considered

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Philip's Manufacturing Ltd., Re (1992), 15 C.B.R. (3d) 57 (note), 143 N.R. 286 (note), 70 B.C.L.R. (2d) xxxiii (note), 15 B.C.A.C. 240 (note), 27 W.A.C. 240 (note), 6 B.L.R. (2d) 149 (note) (S.C.C.) — referred to

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 80 C.B.R. (N.S.) 98 (B.C. S.C.) — considered

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236, 79 B.C.L.R. (2d) 257 (B.C. S.C.) — considered

Statutes considered:

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

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

s. 11 — considered

s. 11(4) — considered

APPLICATION by holders of senior secured notes in corporation for order lifting stay of proceedings against them in *Companies' Creditors Arrangement Act* proceeding to allow for appointment of receiver and manager over assets and property charged in their favour and for order appointing court officer with exclusive right to negotiate sale of assets or shares of corporation's subsidiary.

***Paperny J.* (orally):**

1 Montreal Trust Company of Canada, Collateral Agent for the holders of the Senior Secured Notes, and the Bank of Nova Scotia Trust Company of New York, Trustee for the holders of the Senior Secured Notes, apply for the following relief:

1. In the CCAA proceeding (Action No. 0001-05071) an order lifting the stay of proceedings against them contained in the orders of this court dated March 24, 2000 and April 19, 2000 to allow for the court-ordered appointment of Ernst & Young Inc. as receiver and manager over the assets and property charged in favour of the Senior Secured Noteholders; and

2. In Action No. 0001-05044, an order appointing Ernst & Young Inc. as a court officer with the exclusive right to negotiate the sale of the assets or shares of Canadian Regional Airlines (1998) Ltd.

2 Canadian Airlines Corporation ("CAC") is a Canadian based holding company which, through its majority owned subsidiary Canadian Airlines International Ltd. ("CAIL") provides domestic, U.S.-Canada transborder and international jet air transportation services. CAC also provides regional transportation through its subsidiary Canadian Regional Airlines (1998) Ltd. ("Canadian Regional"). Canadian Regional is not an applicant under the CCAA proceedings.

3 The Senior Secured Notes were issued under an Indenture dated April 24, 1998 between CAC and the Trustee. The principal face amount is $175 million U.S. As well, there is interest outstanding. The Senior Secured Notes are directly and indirectly secured by a diverse package of assets and property of the CCAA applicants, including spare engines, rotables, repairables, hangar leases and ground equipment. The security comprises the key operational assets of CAC and CAIL. The security also includes the outstanding shares of Canadian Regional and the $56 million intercompany indebtedness owed by Canadian Regional to CAIL.

4 Under the terms of the Indenture, CAC is required to make an offer to purchase the Senior Secured Notes where there is a "change of control" of CAC. It is submitted by the Senior Secured Noteholders that Air Canada indirectly acquired control of

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CAC on January 4, 2000 resulting in a change of control. Under the Indenture, CAC is then required to purchase the notes at 101 percent of the outstanding principal, interest and costs. CAC did not do so. According to the Trustee, an Event of Default occurred, and on March 6, 2000 the Trustee delivered Notices of Intention to Enforce Security under the Bankruptcy and Insolvency Act.

5 On March 24, 2000, the Senior Secured Noteholders commenced Action No. 0001-05044 and brought an application for the appointment of a receiver over their collateral. On the same day, CAC and CAIL were granted CCAA protection and the Senior Secured Noteholders adjourned their application for a receiver. However, the Senior Secured Noteholders made further application that day for orders that Ernst & Young be appointed monitor over their security and for weekly payments from CAC and CAIL of $500,000 U.S. These applications were dismissed.

6 The CCAA Plan filed on April 25, 2000, proposes that the Senior Secured Noteholders constitute a separate class and offers them two alternatives:

1. To accept repayment of less than the outstanding amount; or

2. To be unaffected by the CCAA Plan and realize on their security.

7 On April 26th, 2000, the Senior Secured Noteholders met and unanimously rejected the first option. They passed a resolution to take steps to realize on the security.

8 The Senior Secured Noteholders argue that the time has come to permit them to realize on their security. They have already rejected the Plan and see no utility in waiting to vote in this regard on May 26th, 2000, the date set by this court.

9 The Senior Secured Noteholders submit that since the CCAA proceedings began five weeks ago, the following has occurred:

-interest has continued to accrue at approximately $2 million U.S. per month;

-the security has decreased in value by approximately $6 million Canadian;

-the Collateral Agent and the Trustee have incurred substantial costs;

-no amounts have been paid for the continued use of the collateral, which is key to the operations of CAIL;

-no outstanding accrued interest has been paid; and- they are the only secured creditor not getting paid.

10 The Senior Secured Noteholders emphasize that one of the end results of the Plan is a transfer of CAIL's assets to Air Canada. The Senior Secured Noteholders assert that the Plan is sponsored by this very solvent proponent, who is in a position to pay them in full. They are argue that Air Canada has made an economic decision not to do so and instead is using the CCAA to achieve its own objectives at their expense, an inappropriate use of the Act.

11 The Senior Secured Noteholders suggest that the Plan will not be impacted if they are permitted to realize on their security now instead of after a formal rejection of the Plan at the court-scheduled vote on May 26, 2000. The Senior Secured Noteholders argue that for all of the preceding reasons lifting the stay would be in accordance with the spirit and intent of the CCAA.

12 The CCAA is remedial legislation which should be given a large and liberal interpretation: See, for example, *Citibank Canada v. Chase Manhattan Bank of Canada* (1991), 5 C.B.R. (3d) 165 (Ont. Gen. Div.). It is intended to permit the court to make orders which will effectively maintain the status quo for a period while the struggling company attempts to develop a plan to compromise its debts and ultimately continue operations for the benefit of both the company and its creditors: See for example, *Meridian Development Inc. v. Toronto Dominion Bank* (1984), 52 C.B.R. (N.S.) 109 (Alta. Q.B.), and *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.).

13 This aim is facilitated by the power to stay proceedings provided by Section 11 of the Act. The stay power is the key element of the CCAA process.

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14 The granting of a stay under Section 11 is discretionary. On the debtor's initial application, the court may order a stay at its discretion for a period not to exceed 30 days. The burden of proof to obtain a stay extension under Section 11(4) is on the debtor. The debtor must satisfy the court that circumstances exist that make the request for a stay extension appropriate and that the debtor has acted, and is acting, in good faith and with due diligence. CAC and CAIL discharged this burden on April 19, 2000. However, unlike under the Bankruptcy and Insolvency Act, there is no statutory test under the CCAA to guide the court in lifting a stay against a certain creditor.

15 In determining whether a stay should be lifted, the court must always have regard to the particular facts. However, in every order in a CCAA proceeding the court is required to balance a number of interests. McFarlane J.A. states in his closing remarks of his reasons in *Re Pacific National Lease Holding Corp.* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]):

> In supervising a proceeding under the C.C.A.A. orders are made, and orders are varied as changing circumstances require. Orders depend upon a careful and delicate balancing of a variety of interests and problems.

16 Also see Blair J.'s decision in *Campeau v. Olympia & York Developments Ltd.* (1992), 14 C.P.C. (3d) 339 (Ont. Gen. Div.), for another example of the balancing approach.

17 As noted above, the stay power is to be used to preserve the status quo among the creditors of the insolvent company. Huddart J., as she then was, commented on the status quo in *Re Alberta-Pacific Terminals Ltd.* (1991), 8 C.B.R. (3d) 99 (B.C. S.C.). She stated:

> The status quo is not always easy to find... Nor is it always easy to define. The preservation of the status quo cannot mean merely the preservation of the relative pre-stay debt status of each creditor. Other interests are served by the CCAA. Those of investors, employees, and landlords among them, and in the case of the Fraser Surrey terminal, the public too, not only of British Columbia, but also of the prairie provinces. The status quo is to be preserved in the sense that manoeuvres by creditors that would impair the financial position of the company while it attempts to reorganize are to be prevented, not in the sense that all creditors are to be treated equally or to be maintained at the same relative level. It is the company and all the interests its demise would affect that must be considered.

18 Further commentary on the status quo is contained in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 80 C.B.R. (N.S.) 98 (B.C. S.C.). Thackray J. comments that the maintenance of the status quo does not mean that every detail of the status quo must survive. Rather, it means that the debtor will be able to stay in business and will have breathing space to develop a proposal to remain viable.

19 Finally, in making orders under the CCAA, the court must never lose sight of the objectives of the legislation. These were concisely summarized by the chambers judge and adopted by the British Columbia Court of Appeal in *Re Pacific National Lease Holding Corp.* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]):

> (1) The purpose of the CCAA is to allow an insolvent company a reasonable period of time to reorganize its affairs and prepare and file a plan for its continued operation subject to the requisite approval of the creditors and court.
>
> (2) The CCAA is intended to serve not only the company's creditors but also a broad constituency which includes the shareholders and employees.
>
> (3) During the stay period, the Act is intended to prevent manoeuvres for positioning amongst the creditors of the company.
>
> (4) The function of the court during the stay period is to play a supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure.

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(5) The status quo does not mean preservation of the relative pre-stay debt status of each creditor. Since the companies under CCAA orders continue to operate and having regard to the broad constituency of interests the Act is intended to serve, the preservation of the status quo is not intended to create a rigid freeze of relative pre-stay positions.

(6) The court has a broad discretion to apply these principles to the facts of th particular case.

20 At pages 342 and 343 of this text, Canadian Commercial Reorganization: Preventing Bankruptcy (Aurora: Canada Law Book, looseleaf), R.H. McLaren describes situations in which the court will lift a stay:

1. When the plan is likely to fail;

2. The applicant shows hardship (the hardship must be caused by the stay itself and be independent of any pre-existing condition of the applicant creditor);

3. The applicant shows necessity for payment (where the creditors' financial problems are created by the order or where the failure to pay the creditor would cause it to close and thus jeopardize the debtor's company's existence);

4. The applicant would be severely prejudiced by refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors;

5. It is necessary to permit the applicant to take steps to protect a right which could be lost by the passage of time;

6. After the lapse of a significant time period, the insolvent is no closer to a proposal than at the commencement of the stay period.

21 I now turn to the particular circumstances of the applications before me.

22 I would firstly address the matter of the Senior Secured Noteholders' current rejection of the compromise put forward under the Plan. Although they are in a separate class under CAC's Plan and can control the vote as it affects their interest, they are not in a position to vote down the Plan in its entirety. However, the Senior Secured Noteholders submit that where a plan offers two options to a class of creditors and the class has selected which option it wants, there is no purpose to be served in delaying that class from proceeding with its chosen course of action. They rely on the *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101 (Ont. C.A.) at 115, as just one of several cases supporting this proposition. *Re Philip's Manufacturing Ltd.* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.) at pp. 27-28, leave to appeal to S.C.C. refused (1992), 15 C.B.R. (3d) 57 (note) (S.C.C.), would suggest that the burden is on the Senior Secured Noteholders to establish that the Plan is "doomed to fail". To the extent that Nova Metal and Philip's Manufacturing articulate different tests to meet in this context, the application of either would not favour the Senior Secured Noteholders.

23 The evidence before me suggests that progress may still be made in the negotiations with the representatives of the Senior Secured Noteholders and that it would be premature to conclude that any further discussions would be unsuccessful. The parties are continuing to explore revisions and alternative proposals which would satisfy the Senior Secured Noteholders.

24 Mr. Carty's affidavit sworn May 1, 2000, in response to these applications states his belief that these efforts are being made in good faith and that, if allowed to continue, there is a real prospect for an acceptable proposal to be made at or before the creditors' meeting on May 26, 2000. Ms. Allen's affidavit does not contain any assertion that negotiations will cease. Despite the emphatic suggestion of the Senior Secured Noteholders' counsel that negotiations would be "one way", realistically I do not believe that there is no hope of the Senior Secured Noteholders coming to an acceptable compromise.

25 Further, there is no evidence before me that would indicate the Plan is "doomed to fail". The evidence does disclose that CAC and CAIL have already achieved significant compromises with creditors and continue to work swiftly and diligently to achieve further progress in this regard. This is reflected in the affidavits of Mr. Carty and the reports from the Monitor.

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26 In any case, there is a fundamental problem in the application of the Senior Secured Noteholders to have a receiver appointed in respect of their security which the certainty of a "no" vote at this time does not vitiate: It disregards the interests of the other stakeholders involved in the process. These include other secured creditors, unsecured creditors, employees, shareholders and the flying public. It is not insignificant that the debtor companies serve an important national need in the operation of a national and international airline which employs tens of thousands of employees. As previously noted, these are all constituents the court must consider in making orders under the CCAA proceeding.

27 Paragraph 11 of Mr. Carty's May 1, 2000 affidavit states as follows:

> In my opinion, the continuation of the stay of proceedings to allow the restructuring process to continue will be of benefit to all stakeholders including the holders of the Senior Secured Notes. A termination of the stay proceedings as regards the security of the holders of the Senior Secured Notes would immediately deprive CAIL of assets which are critical to its operational integrity and would result in grave disruption of CAIL's operations and could lead to the cessation of operations. This would result in the destruction of value for all stakeholders, including the holders of the Senior Secured Notes. Furthermore, if CAIL ceased to operate, it is doubtful that Canadian Regional Airlines (1998) Ltd. ("CRAL98"), whose shares form a significant part of the security package of the holders of the Senior Secured Notes, would be in a position to continue operating and there would be a very real possibility that the equity of CAIL and CRAL, valued at approximately $115 million for the purposes of the issuance of the Senior Secured Notes in 1998, would be largely lost. Further, if such seizure caused CAIL to cease operations, the market for the assets and equipment which are subject to the security of the holders of the Senior Secured Notes could well be adversely affected, in that it could either lengthen the time necessary to realize on these assets or reduce realization values.

28 The alternative to this Plan proceeding is addressed in the Monitor's reports to the court. For example, in Paragraph 8 of the Monitor's third report to the court states:

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

29 This evidence is uncontradicted and flies in the face of the Senior Secured Noteholders' assertion that realizing on their collateral at this point in time will not affect the Plan. Although, as the Senior Secured Noteholders heavily emphasized the Plan does contemplate a "no" vote by the Senior Secured Noteholders, the removal of their security will follow that vote. 9.8(c) of the Plan states that:

> If the Required Majority of Affected Secured Noteholders fails to approve the Plan, arrangements in form and substance satisfactory to the Applicants will have been made with the Affected Secured Noteholders or with a receiver appointed over the assets comprising the Senior Notes Security, which arrangements provide for the transitional use by [CAIL], and subsequent sale, of the assets comprising the Senior Notes Security.

30 On the other side of the scale, the evidence of the Senior Secured Noteholders is that the value of their security is well in excess of what they are owed. Paragraph 15(a) of the Monitor's third report to the court values the collateral at $445 million. The evidence suggests that they are not the only secured creditor going unpaid. CAIL is asking that they be permitted to continue the restructuring process and their good faith efforts to attempt to reach an acceptable proposal with the Senior Secured Noteholders until the date of the creditors meeting, which is in three weeks. The Senior Secured Noteholders have not established that they will suffer any material prejudice in the intervening period.

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31 The appointment of a receiver at this time would negate the effect of the order staying proceedings and thwart the purposes of the CCAA.

32 Accordingly, I am dismissing the application, with leave to reapply in the event that the Senior Secured Noteholders vote to reject the Plan on May 26, 2000.

33 An alternative to receivership raised by the Senior Secured Noteholders was interim payment for use of the security. The Monitor's third report makes it clear that the debtor's cash flow forecasts would not permit such payments.

34 The Senior Secured Noteholders suggested Air Canada could make the payments and, indeed, that Air Canada should pay out the debt owed to them by CAC. It is my view that, in the absence of abuse of the CCAA process, simply having a solvent entity financially supporting a plan with a view to ultimately obtaining an economic benefit for itself does not dictate that that entity should be required to pay creditors in full as requested. In my view, the evidence before me at this time does not suggest that the CCAA process is being improperly used. Rather, the evidence demonstrates these proceedings to be in furtherance of the objectives of the CCAA.

35 With respect to the application to sell shares or assets of Canadian Regional, this application raises a distinct issue in that Canadian Regional is not one of the debtor companies. In my view, Paragraph 5(a) of Chief Justice Moore's March 24, 2000 order encompasses marketing the shares or assets of Canadian Regional. That paragraph stays, inter alia:

> ...any and all proceedings ... against or in respect of ... any of the Petitioners' property ... whether held by the Petitioners directly or indirectly, as principal or nominee, beneficially or otherwise...

36 As noted above, Canadian Regional is CAC's subsidiary, and its shares and assets are the "property" of CAC and marketing of these would constitute a "proceeding ... in respect of ... the Petitioners' property" within the meaning of Paragraph 5(a) and Section 11 of the CCAA.

37 If I am incorrect in my interpretation of Paragraph 5(a), I rely on the inherent jurisdiction of the court in these proceedings.

38 As noted above, the CCAA is to be afforded a large and liberal interpretation. Two of the landmark decisions in this regard hail from Alberta: *Meridian Development Inc. v. Toronto Dominion Bank*, supra, and *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.). At least one court has also recognized an inherent jurisdiction in relation to the CCAA in order to grant stays in relation to proceedings against third parties: *Re Woodward's Ltd.* (1993), 17 C.B.R. (3d) 236 (B.C. S.C.). Tysoe J. urged that although this power should be used cautiously, a prerequisite to its use should not be an inability to otherwise complete the reorganization. Rather, what must be shown is that the exercise of the inherent jurisdiction is important to the reorganization process. The test described by Tysoe J. is consistent with the critical balancing that must occur in CCAA proceedings. He states:

> In deciding whether to exercise its inherent jurisdiction, the court should weigh the interests of the insolvent company against the interests of parties who will be affected by the exercise of the inherent jurisdiction. If, in relative terms, the prejudice to the affected party is greater than the benefit that will be achieved by the insolvent company, the court should decline to its inherent jurisdiction. The threshold of prejudice will be much lower than the threshold required to persuade the court that it should not exercise its discretion under Section 11 of the CCAA to grant or continue a stay that is prejudicial to a creditor of the insolvent company (or other party affected by the stay).

39 The balancing that I have described above in the context of the receivership application equally applies to this application. While the threshold of prejudice is lower, the Senior Secured Noteholders still fail to meet it. I cannot see that it is important to the CCAA proceedings that the Senior Secured Noteholders get started on marketing Canadian Regional. Instead, it would be disruptive and endanger the CCAA proceedings which, on the evidence before me, have progressed swiftly and in good faith.

40 The application in Action No. 0001-05044 is dismissed, also with leave to reapply after the vote on May 26, 2000.

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41 I appreciate that the Senior Secured Noteholders will be disappointed and likely frustrated with the outcome of these applications. I would emphasize that on the evidence before me their rights are being postponed and not eradicated. Any hardship they experience at this time must yield to the greater hardship that the debtor companies and the other constituents would suffer were the stay to be lifted at this time.

Application dismissed.

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TAB 7

CITATION: Unique Broadband Systems (Re), 2011 ONSC 224
COURT FILE NO.: CV-11-9283-00CL
DATE: 2012-01-25

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED and IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF UNIQUE BROADBAND SYSTEMS, INC.

BEFORE: Wilton-Siegel J.

COUNSEL: *Peter Roy* and *Sean Grayson*, for the Applicant, 2064818 Ontario Inc.

E. Patrick Shea, for the Applicant, Unique Broadband Systems, Inc.

Peter C. Wardle, for the UBS Directors, Grant McCutcheon, Henry Eaton and Robert Ulicki

Matthew P. Gottlieb, for the Monitor, Duff & Phelps Canada Restructuring Inc.

Raj Sahni, for Jolian Investments Inc., in its capacity as a creditor

HEARD: December 20, 2011

ENDORSEMENT

[1] 2064818 Ontario Inc. ("206") seeks an order pursuant to ss. 11.5(1) and (2) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") removing Grant McCutcheon ("McCutcheon") and Henry Eaton ("Eaton") as directors of Unique Broadband Systems, Inc. ("UBS"). UBS seeks an amendment to the initial order under the CCAA dated July 5, 2011 (the "Initial Order") granting protection to UBS that would extend the stay thereunder to include a stay of an oppression action against the UBS directors commenced by 206 on December 22, 2010 (the "Oppression Action"). I will deal with each matter in turn after briefly setting out the background.

Background

The Parties

[2] UBS is a public corporation incorporated in Ontario under the *Business Corporations Act*, R.S.O. 1990, c. B16 (the "OBCA").

[3] LOOK Communications Inc. ("Look") is a public corporation incorporated under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "CBCA").

[4] UBS owns shares in Look carrying 39.2% of the equity and 37.6% of the votes. UBS also provides management services to Look pursuant to a management services agreement described below.

[5] 206 is a corporation controlled by Alex Dolgonos ("Dolgonos"). 206 is a substantial shareholder of UBS holding slightly less than 20% of the outstanding shares of UBS. Dolgonos also owns all of the outstanding shares of DOL Technologies Inc. ("DOL"), a private corporation incorporated under the OBCA.

The Election of the UBS Directors

[6] Each of the current UBS directors, being McCutcheon, Eaton and Robert Ulicki ("Ulicki") (collectively, the "UBS Directors"), was elected to the UBS board of directors at a special meeting of the shareholders held on July 5, 2010 to replace the former directors, being McGocy, Douglas Reesan and Louis Mitrovich, pursuant to s. 122 of the OBCA. The election of these directors was the subject of a proxy contest between the existing management and the shareholders who supported the UBS Directors.

[7] On July 6, 2010, UBS advised Look that it had the support of shareholders of Look possessing sufficient votes to effect a change of control of the board of directors of Look. UBS requested that the then-current board of Look resign and appoint a replacement slate of directors proposed by UBS, which included the UBS Directors, Laurence Silber ("Silber") and David Rattee ("Rattee"), without calling a special meeting of shareholders.

[8] On July 20, 2010, all five Look directors resigned and McCutcheon, Eaton and Ulicki were appointed directors of Look. On July 21, 2010, McCutcheon was also appointed the chief executive officer of Look, replacing McGocy who had previously served in that position pursuant to the provisions of a management services agreement between UBS and Look, described below. Silber and Rattee were subsequently elected directors of Look on July 27, 2010. Ulicki resigned from the board of directors of Look on October 29, 2010, with the result that there are currently four directors of Look.

[9] The UBS Directors were re-elected at the annual general meeting of UBS shareholders on February 25, 2011. 206 opposed the current slate of directors and proposed its own slate, which included the two directors it seeks on this motion to have installed as directors in place of McCutcheon and Eaton.

The Current Litigation

[10] UBS had previously retained DOL pursuant to an agreement dated July 12, 2008 (the "DOL Technology Agreement") to provide the services of Dolgonos as a "chief technology officer" to UBS. The DOL Technology Agreement was terminated by DOL after the election of the UBS Directors based on "change of control" provisions in the Agreement. DOL then commenced an action against UBS claiming amounts totalling approximately $8.6 million. This action is being defended by UBS, which asserts that the largest component of the DOL claim is

not payable pursuant to the terms of the DOL Technology Agreement. UBS has also counterclaimed to set aside the DOL Technology Agreement.

[11] UBS had also previously retained Jolian Investments Inc., a corporation controlled by Gerald McGoey ("McGoey"), to provide his services as chief executive officer of UBS pursuant to an agreement dated January 1, 2006 (the "Jolian Agreement"). The Jolian Agreement was also terminated by Jolian after the election of the UBS Directors based both on the failure to elect McGoey to the UBS board and on "change of control" provisions in the Agreement. Jolian then commenced an action against UBS claiming amounts totalling approximately $7.5 million. This action is also being defended by UBS, which asserts that the largest component of the Jolian claim is also not payable pursuant to the terms of the Jolian Agreement. UBS has also counterclaimed to set aside the Jolian Agreement. On July 5, 2010, McCutcheon was appointed the chief executive officer of Look to replace McGoey.

[12] In the DOL action and the Jolian action, DOL, Dolgonos, Jolian and McGoey brought motions seeking confirmation of their right to an advancement of funds in respect of the legal costs of pursuing their respective claims and defending the UBS counterclaims against them. UBS resisted such relief and sought an order requiring the parties to return certain retainers previously advanced by UBS to counsel for such parties. By order dated April 11, 2011, Marrocco J. held that these parties were entitled to an advancement of funds as more particularly specified therein. UBS has appealed this order to the Court of Appeal and, pending the hearing of such appeal, has refused to advance or pay any of the amounts addressed in the order of Marrocco J.

[13] In addition, on July 6, 2010, Look also commenced an action against Dolgonos, DOL, McGoey and Jolian, among others, seeking damages based on allegations of breach of fiduciary duty and negligence. The action relates to certain restructuring awards paid by Look in 2009, for which Look seeks recovery.

The Oppression Action

[14] On December 22, 2010, DOL commenced the Oppression Action against both UBS and the UBS Directors. At the hearing of this motion, 206 advised that it is not pursuing the claims against UBS. The statement of claim in the Oppression Action seeks nine separate heads of relief against the UBS Directors in addition to interest and costs.

[15] The Oppression Action centres on two principal allegations. First, it is alleged the UBS Directors acted oppressively in approving a settlement between UBS and Look that was made pursuant to an agreement dated December 3, 2010 (the "Amending Agreement"), that amended a management services agreement dated May 19, 2004 between UBS and Look (collectively, with the Amending Agreement, the "Look MSA"). Second, it is alleged that, by failing to re-elect McGoey to the UBS board of directors on July 5, 2011, the UBS Directors intentionally triggered certain provisions of the Jolian Agreement, giving rise to a right in favour of Jolian to terminate the Agreement. It is alleged that these actions of the UBS Directors exposed UBS to the consequences of the default. 206 also alleges that the UBS Directors acted improperly in

defending the DOL claim described above. More generally, 206 alleges that the UBS Directors have depleted the funds of UBS by these actions contrary to their announced intention at the time of the proxy fight in July 2010 to minimize UBS' expenses and conserve its funds.

[16] 206 seeks damages for oppressive behavior against the UBS Directors in the amount of any loss suffered as a result of execution of the Amending Agreement and in the amount of any payment required to be made to Jolian under the Jolian Agreement. It also seeks declarations that the UBS Directors had a conflict of interest in respect of the execution of the Amending Agreement and have preferred the Look shareholders over the UBS shareholders. On these grounds, 206 further seeks an order removing the UBS Directors from the UBS board.

The CCAA Proceedings

[17] UBS is insolvent. It obtained protection under the CCAA pursuant to the Initial Order. Duff & Phelps Canada Restructuring Inc. (the "Monitor") has been appointed the monitor in the CCAA proceedings. Under the Initial Order, the Oppression Claim is currently stayed against UBS but not against the UBS Directors.

[18] Pursuant to an order dated August 4, 2011, the court approved a claims process in respect of claims against UBS. In accordance with this order, 206 filed a proof of claim in an amount "to be determined" that specifically referred to, and attached, the statement of claim in the Oppression Action.

[19] The largest claims filed in the claims process are: the DOL and Jolian claims described above; a contingent claim by Look for the remainder of the monies due to it under the Amending Agreement, which will expire in June 2012 provided UBS continues to provide services to Look in accordance with the terms of the Look MSA; and the 206 claim in respect of the Oppression Action. Each of the UBS Directors also filed contingent claims respecting indemnification of legal fees that may be incurred in defending the Oppression Action, based on indemnities dated July 5, 2010 granted to them by UBS.

[20] 206 took the position that McCutcheon and Eaton should not review any of the claims filed against UBS in the claims process by virtue of the alleged conflict of interest addressed below. While UBS disputes the existence of such a conflict of interest, these directors did not participate in the UBS review of the claims filed with it, which were therefore reviewed by Ulicki alone together with legal counsel. The UBS position regarding each of these claims was provided to the Monitor by letter dated December 9, 2011.

The Oppression Claim

[21] UBS seeks to have the court exercise its authority under s. 11.03(1) of the CCAA to extend the stay of proceedings in the Initial Order to include the Oppression Action in respect of the UBS Directors. It seeks to have the Oppression Action determined in its entirety in the CCAA proceedings.

[22] UBS makes several arguments in support of this relief. Among others, it submits that the requested relief will further the purposes of the CCAA by allowing the directors to focus on the restructuring rather than diverting their time and effort to other litigation. 206 says that this argument is of no force if the court finds that McCutcheon and Eaton are conflicted and grants its motion to replace them. Given the determination below on 206's motion, I accept this argument of UBS.

[23] In addition to the forgoing reason for extending the stay, there are three other considerations that also support such an order.

[24] First, unless and until a court determines that the UBS Directors are not entitled to indemnification by UBS in respect of the claims made against them in the Oppression Action, the UBS Directors have claims against UBS in the CCAA proceedings arising out of the Oppression Action that must be addressed in the restructuring. As a result, the restructuring cannot proceed until the Oppression Action and related indemnification claims are determined.

[25] Second, the Jolian claim against UBS is already proceeding in the CCAA proceedings. Given the similarity in the factual matrix between the claims in the Jolian action and the Oppression Action, any determination in the Jolian action will also likely apply to the claims and defences in the Oppression Action. Accordingly, the Oppression Action must proceed within the CCAA proceedings to avoid the possibility of both a multiplicity of actions and potentially conflicting decisions.

[26] Lastly, I note that there is no suggestion of any material prejudice to 206 if the determination of the Oppression Action also proceeds within the CCAA proceedings.

[27] Based on the foregoing considerations, the UBS motion to extend the stay in the Initial Order is granted.

Removal Motion

[28] I propose to first address the applicable law in respect of this motion before considering the specific issue in this proceeding.

Applicable Law

[29] Section 11.5 of the CCAA provides as follows:

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

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

[30] Accordingly, to succeed on this motion, 206 must demonstrate that the actions of McCutcheon and Eaton, or their positions as directors of both UBS and Look, are such that either (1) they are unreasonably impairing or are likely to impair the possibility of a viable restructuring; or (2) they are acting or are likely to act improperly as directors. Further, it should be noted that any such order, while it requires such a finding, remains subject to the discretion of the court.

[31] 206 does not propose a particular standard applicable to a determination under s. 11.5, apart from stating that the CCAA is remedial legislation and should therefore be construed liberally in accordance with the modern purposive approach to statutory interpretation. I understand this to mean that 206 would interpret s. 11.5(1) to establish a low threshold for entitlement to relief thereunder. UBS submits that there must be a "clear demonstration" of facts supporting a determination under s. 11.5, which appears directed more toward the standard of proof required than the nature of the threshold established under s. 11.5(1).

[32] There is nothing in the wording of s. 11.5 that displaces the ordinary standard of proof on a balance of probabilities. However, the language of s. 11.5(1) does establish a significant threshold for the entitlement to relief thereunder.

[33] A determination as to whether conduct is impairing, or is likely to impair, a restructuring requires a careful examination of the actions of the directors in the context of the particular restructuring proceedings, the interests of the stakeholders and the feasible options available to the debtor. A similar examination of the actions of the directors is required for a determination that a director has acted inappropriately in the circumstances of a particular restructuring. I note, in particular, that given this language, the fact that a shareholder or creditor may not agree with a decision of a director is far from being a sufficient ground for the director's removal. As a related matter, there is nothing in s. 11.5 that evidences an intention to displace the "business judgment rule".

[34] Further, the language of s. 11.5 expressly requires that the actions of a director "unreasonably" impair, or are likely to "unreasonably" impair, a viable restructuring or are "inappropriate", or are likely to be "inappropriate", in the circumstances.

[35] In addition, two other considerations also argue in favour of a significant threshold, although they may also be relevant to a determination regarding the exercise of judicial discretion where the necessary factual determinations have been made.

[36] First, removing and replacing directors of a corporation, even a debtor corporation subject to the CCAA, is an extreme form of judicial intervention in the business and affairs of the corporation. The shareholders have elected the directors and remain entitled to bring their own action to remove or replace directors under the applicable corporate legislation. At a minimum, in determining whether it should exercise its discretion, the court can take into consideration the absence of any such action by the other shareholders.

[37] Similarly, in a CCAA restructuring, the Monitor performs a supervisory function that provides a form of protection to the corporation's stakeholders. In determining whether to exercise its discretion in s. 11.5(1), a court would ordinarily take into consideration the presence or absence of any recommendation from the Monitor.

Analysis and Conclusions

Positions of the Parties

[38] 206 asserts that McCutcheon and Eaton have a conflict of interest as directors of both UBS and Look which prevents them from fulfilling their responsibilities as directors in the restructuring and justifies an order under s. 11.5 of the CCAA.

[39] 206 has advised the court that it does not allege a monetary conflict based on a larger personal economic interest in Look than in UBS. Instead, 206 alleges that McCutcheon and Eaton are conflicted by virtue of their concurrent positions as directors of both UBS and Look. 206 says that, as a result, these directors can have no role in the UBS CCAA proceedings and should be removed.

[40] UBS takes the position that these directors are not conflicted and are not prevented from participating in any aspect of the CCAA proceedings except for (1) the determination of the Look contingent claim; and (2) the determination of their individual contingent claims for indemnification. It says that, as a result of the position taken by 206 regarding the review of the claims filed under the CCAA proceedings, McCutcheon and Eaton voluntarily did not participate in the UBS review of these claims. However, they intend to be involved on a going-forward basis after determination of this motion, subject to the exceptions described above.

Analysis and Conclusions

[41] For the purposes of this motion, I accept the premise of 206's argument — that the presence of a conflict of interest may prevent directors from fulfilling their responsibilities in a CCAA proceeding to the extent that their continued involvement unreasonably impairs, or is likely to unreasonably impair, the possibility of a viable compromise or arrangement being made in respect of the insolvent company. I also accept that McCutcheon and Eaton have a conflict of interest as directors of both Look and UBS that prevents them from acting in respect of any matter within the CCAA proceedings that pertains to the relationship between the two corporations.

[42] However, such a conflict of interest is not, by itself, sufficient to satisfy the requirements of s. 11.5. Courts have long recognized that interlocking directorships are acceptable, often inevitable or necessary, in the corporate context. Further, the Court of Appeal expressly recognized that "a reasonable apprehension that directors may not act neutrally because they are aligned with a particular group of shareholders or stakeholders" is insufficient for removal of directors: see *Stelco Inc. (Re)*, [2005] O.J. No. 1171 (C.A.), at para. 76. Instead, courts recognize that conflicts of interest may exist that are to be dealt with in accordance with applicable fiduciary law principles. There is nothing in s. 11.5 that evidences an intention to alter the

general rule, stated by Blair J.A. in *Stelco*, at paras. 74-76, that apprehension of bias is insufficient, on its own, to remove a director.

[43] More generally, as Blair J.A. made clear in *Stelco*, at paras. 74-76, directors will only be removed if their conduct, rather than the mere existence of a conflict of interest, justifies such a sanction:

> In my view, the administrative law notion of apprehension of bias is foreign to the principles that govern the election, appointment and removal of directors, and to corporate governance considerations in general. Apprehension of bias is a concept that ordinarily applies to those who preside over judicial or quasi-judicial decision-making bodies, such as courts, administrative tribunals or arbitration boards. Its application is inapposite in the business decision-making context of corporate law. There is nothing in the CBCA or other corporate legislation that envisages the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment.
>
> Instead, the conduct of directors is governed by their common law and statutory obligations to act honestly and in good faith with a view to the best interests of the corporation, and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (CBCA, s. 122(1)(a) and (b)). The directors also have fiduciary obligations to the corporation, and they are liable to oppression remedy proceedings in appropriate circumstances. These remedies are available to aggrieved complainants -- including the respondents in this case -- but they depend for their applicability on the director having engaged in conduct justifying the imposition of a remedy.
>
> If the respondents are correct, and reasonable apprehension that directors may not act neutrally because they are aligned with a particular group of shareholders or stakeholders is sufficient for removal, all nominee directors in Canadian corporations, and all management directors, would automatically be disqualified from serving. No one suggests this should be the case. Moreover, as Iacobucci J. noted in *Blair* v. *Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, (S.C.C.) at para. 35, "persons are assumed to act in good faith unless proven otherwise". With respect, the motion judge approached the circumstances before him from exactly the opposite direction. It is commonplace in corporate/commercial affairs that there are connections between directors and various stakeholders and that conflicts will exist from time to time. Even where there are conflicts of interest, however, directors are not removed from the board of directors; they are simply obliged to disclose the conflict and, in appropriate cases, to abstain from voting. The issue to be determined is not whether there is a connection between a director and other shareholders or stakeholders, but rather whether there has been some conduct on the part of the director that will justify the imposition of a corrective sanction. An apprehension of bias approach does not fit this sort of analysis.

[44] Accordingly, on this motion, 206 must demonstrate either (1) that McCutcheon and Eaton have breached their duties as directors in respect of the conflict that exists in a manner that constitutes acting inappropriately in the circumstances; or (2) that the existence of such conflict of interest prevents them from acting as directors of UBS in a meaningful manner in the restructuring such that they are unreasonably impairing the possibility of a viable restructuring.

[45] I am not persuaded that the fact that McCutcheon and Eaton are directors of both UBS and Look justifies an order replacing them as directors of UBS under s. 11.5 of the CCAA on either ground. I reach this conclusion for the following reasons.

[46] First, the evidence does not disclose that this conflict of interest has prevented the USB board from functioning. Prior to the CCAA proceeding, the Amending Agreement was negotiated between Rattee, on behalf of Look, and Ulicki on behalf of UBS with the benefit of legal counsel. 206 may object to the result on the basis that the agreement was not in the best interests of UBS. However, that is a matter to be addressed in the Oppression Action. It cannot be said that the fact that the other two directors were unable to participate in the decision prevented the negotiations between UBS and Look from proceeding to a conclusion or would have resulted in a different agreement.

[47] Moreover, it should be noted that the Amending Agreement was negotiated and signed before the CCAA proceedings began. In the current proceeding, the only issue that is relevant to the progress of a restructuring of UBS in which the two directors have a conflict of interest is the Look contingent claim. Apart from their individual indemnification claims, there is nothing that prevents these directors from acting in respect of all other aspects of the CCAA proceedings. The fact that they have not done so to date is attributable not to any legal impediment but to the position taken by 206, which cannot survive the order giving effect to these Reasons.

[48] Second, I am not persuaded that the record demonstrates a preference by these directors for the shareholders of Look over the shareholders of UBS. I will first address three specific matters raised by 206 as evidence of this alleged preferment. I will then address the issue more generally.

[49] The first allegation pertains to the terms of the Amending Agreement, which involved a release of a payment obligation of Look to UBS of $900,000. This has been addressed above — the determination of this allegation is a matter for the Oppression Action. The court cannot reach any conclusion on this issue at this time based on the record before the court.

[50] The second allegation is that the UBS Directors are spending the remaining cash of UBS rather than causing Look to pay a dividend to the Look shareholders, including UBS. This allegation is part of a larger allegation that the UBS Directors are taking an inordinate amount of time to deal with the claims filed in the CCAA proceeding and refuse to consider financing alternatives, with the result, if not the intention, that the Look shares owned by UBS will be ultimately sold at a discount to Look or its other principal shareholder, a brother of Silber.

[51] The evidence does not support this allegation for a number of reasons. Whether or not McCutcheon and Eaton are on the Look board, the non-UBS directors of Look will determine

whether to pay a dividend based on their view of the best interests of Look. UBS cannot cause such a dividend to be paid. On this basis, I do not see how the failure of the Look board to consider such a dividend is a relevant consideration. Further, for the moment at least, the evidence does not support 206's position that there is an imminent likelihood that UBS will run out of cash to fund its operations. Moreover, there can be no restructuring plan until the principal claims in the claims process are resolved. While the time spent responding to the claims filed may have been longer than desirable, the evidence does not, at the present time, support the conclusion that the three-month period was inordinate and without reasonable explanation. Lastly, and in any event, 206 has failed to put a specific, alternative funding proposal to the directors for their consideration.

[52] The third allegation is that the Look shareholders have benefitted from the UBS proxy fight by which the UBS Directors were nominated. UBS bore the $600,000 cost of the proxy fight. Referring to a letter of Ulicki to Rattee and Silber dated November 17, 2010, 206 says that, absent the UBS proxy fight, UBS would have controlled Look and the cost of any Look action against Dolgonos, DOL, McGoey and Jolian would have been borne by individual 206 shareholders.

[53] While this may be factually correct, there is no evidence before the court that would justify a conclusion that, in taking such action, the UBS Directors preferred the Look shareholders to the UBS shareholders. Their position is that there is a common interest in initiating claims against the defendants in the Look action. On the current evidence, this position is at least as probable as 206's position. The court cannot determine this issue on this motion.

[54] More generally, the fact that UBS and Look have adopted a common position in regard to Dolgonos and McGoey, and their respective companies, since the election of the UBS Directors is not, *per se*, evidence that McCutcheon and Eaton are preferring the interests of the Look shareholders over the interests of the UBS shareholders. The actions that the UBS Directors, including McCutcheon and Eaton, have taken may not be supported by Dolgonos and 206, but that is not evidence of the alleged preferment absent proof as to the absence of any reasonable basis for the actions of the UBS Directors. At this stage in the proceedings, such proof is not before the court.

[55] In reaching the foregoing conclusions, I should add that the court has also had regard to the Monitor's advice that it has not observed any conduct of these directors that will compromise the CCAA proceeding or UBS's attempt to restructure, and that it has also not observed any conduct that the Monitor would consider inappropriate or would cause the Monitor concern that they would act inappropriately in the future. Further, the Monitor has advised that, in its view, there would be no benefit and substantial harm to the CCAA proceedings if these directors were removed from their position. This advice would argue against the exercise of the court's discretion in the present circumstances even if 206 had otherwise established activity on the part of these directors that satisfied the requirements of s. 11.5.

[56] Lastly, the backdrop to this motion is a dispute between two opposing groups of UBS shareholders. A particular objective of 206 is to have a new board of directors review the

decision of the UBS Directors to defend the DOL action brought against UBS. However, s. 11.5 cannot be used to replace a board of directors to the extent that the purpose of such relief is to have a new board of directors revisit decisions taken by the existing board. At this stage, the court cannot decide the merits of the issues of the appropriateness of the past payments to Dolgonos and McGocy, the actions of the UBS Directors in respect of the Amending Agreement, or their competing visions for the future of Look/UBS. These issues involve all three of the UBS Directors. These issues are the subject of the litigation between the parties, including the Oppression Action, to be addressed in the claims process with the CCAA proceedings. Equally important, as mentioned above, the "business judgment rule" continues to govern judicial intervention in the affairs of a debtor corporation under the CCAA. To succeed on this motion, 206 must provide evidence that establishes the elements of the test in section 11.5. It cannot do so on the facts before the court on this motion.

[57] Based on the foregoing, the 206 motion to replace McCutcheon and Eaton as directors of UBS is dismissed.

Costs

[58] The parties will have thirty days from the date of this Endorsement to make written submissions as to costs not to exceed five pages in length.

Wilton-Siegel J.

Date: January 25, 2012

TAB 8

CITATION: Unique Broadband Systems (Re), 2012 ONSC 1459
COURT FILE NO.: CV-11-9283-00CL
DATE: 2012-03-06

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED and IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF UNIQUE BROADBAND SYSTEMS, INC.

BEFORE: Wilton-Siegel J.

COUNSEL: *E. Patrick Shea*, for the Applicant, Unique Broadband Systems, Inc.

Peter Roy and *Sean Grayson*, for the Respondent, 2064818 Ontario Inc.

Matthew P. Gottlieb, for the Monitor, Duff & Phelps Canada Restructuring Inc.

Jennifer Lynch, for the Ontario Securities Commission

HEARD: March 2, 2012

ENDORSEMENT

[1] On this motion Unique Broadband Systems, Inc. ("UBS") seeks a declaration that a partial takeover bid of 2064818 Ontario Inc. ("206") described below is stayed or suspended pending a determination of certain claims in the ongoing restructuring proceedings of UBS under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA").

Background

The Parties

[2] UBS is a public corporation incorporated in Ontario under the *Business Corporations Act*, R.S.O. 1990, c. B.16 (the "OBCA").

[3] LOOK Communications Inc. ("Look") is a public corporation incorporated under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "CBCA").

[4] UBS owns shares in Look carrying 39.2% of the equity and 37.6% of the votes. UBS also provides management services to Look pursuant to a management services agreement described below.

[5] 206 is a corporation controlled by Alex Dolgonos ("Dolgonos"). 206 is a substantial shareholder of UBS holding 22,898,255 UBS shares, representing slightly more than 22% of the outstanding shares of UBS. Between December 23, 2011 and February 1, 2012, 206 acquired

2,493,000 UBS shares in the market. Dolgonos also owns all of the outstanding shares of DOL Technologies Inc. ("DOL"), a private corporation incorporated under the OBCA.

The Election of the UBS Directors

[6] Each of the current UBS directors, being Grant McCutcheon ("McCutcheon"), Henry Eaton ("Eaton") and Robert Ulicki ("Ulicki") (collectively, the "UBS Directors"), was elected to the UBS board of directors at a special meeting of the shareholders held on July 5, 2010 to replace the former directors, being Gerald McGoey ("McGoey"), Douglas Reesan and Louis Mitrovich, pursuant to s. 122 of the OBCA. The election of these directors was the subject of a proxy contest between the existing management and the shareholders who supported the UBS Directors.

[7] On July 6, 2010, UBS advised Look that it had the support of shareholders of Look possessing sufficient votes to effect a change of control of the board of directors of Look. UBS requested that the board of Look resign and appoint a replacement slate of directors proposed by UBS, which included the UBS Directors, Laurence Silber ("Silber") and David Rattee ("Rattee"), without calling a special meeting of shareholders.

[8] On July 20, 2010, all five Look directors resigned and McCutcheon, Eaton and Ulicki were appointed directors of Look. On July 21, 2010, McCutcheon was also appointed the chief executive officer of Look, replacing McGoey who had previously served in that position pursuant to the provisions of a management services agreement between UBS and Look, described below. Silber and Rattee were subsequently elected directors of Look on July 27, 2010. Ulicki resigned from the board of directors of Look on October 29, 2010, with the result that there are currently four directors of Look.

[9] The UBS Directors were re-elected at the annual general meeting of UBS shareholders on February 25, 2011. 206 opposed the current slate of directors and proposed its own slate of directors.

Current Litigation Among the Parties

[10] UBS had previously retained DOL pursuant to an agreement dated July 12, 2008 (the "DOL Technology Agreement") to provide the services of Dolgonos as a "chief technology officer" to UBS. The DOL Technology Agreement was terminated by DOL after the election of the UBS Directors based on "change of control" provisions in the Agreement. DOL then commenced an action against UBS claiming amounts totalling approximately $8.6 million (the "DOL action"). The DOL action is being defended by UBS, which asserts that the largest component of the DOL claim is not payable pursuant to the terms of the DOL Technology Agreement. UBS has also counterclaimed to set aside the DOL Technology Agreement.

[11] UBS had also previously retained Jolian Investments Inc. ("Jolian"), a corporation controlled by McGoey, to provide his services as chief executive officer of UBS pursuant to an agreement dated January 1, 2006 (the "Jolian Agreement"). The Jolian Agreement was also terminated by Jolian after the election of the UBS Directors based both on the failure to elect McGoey to the UBS board and on "change of control" provisions in the Agreement. Jolian then commenced an action against UBS claiming amounts totalling approximately $7.5 million (the

"Jolian action"). The Jolian action is also being defended by UBS, which asserts that the largest component of the Jolian claim is also not payable pursuant to the terms of the Jolian Agreement. UBS has also counterclaimed to set aside the Jolian Agreement. On July 5, 2010, McCutcheon was appointed the chief executive officer of Look to replace McGoey.

[12] In the DOL action and the Jolian action, DOL, Dolgonos, Jolian and McGoey brought motions seeking confirmation of their right to an advance of funds in respect of the legal costs of pursuing their respective claims and defending the UBS counterclaims against them. UBS resisted such relief and sought an order requiring the parties to return certain retainers previously advanced by UBS to counsel for such parties. By order dated April 11, 2011, Marrocco J. held that these parties were entitled to an advance of funds as more particularly specified therein. UBS has appealed this order to the Court of Appeal, and, pending the hearing of such appeal, has refused to advance or pay any of the amounts addressed in the order of Marrocco J.

[13] In addition, on July 6, 2010, Look also commenced an action against Dolgonos, DOL, McGoey and Jolian, among others, seeking damages based on allegations of breach of fiduciary duty and negligence (the "Look action"). The Look action relates to certain restructuring awards paid by Look in 2009, for which Look seeks recovery.

[14] On December 22, 2010, DOL commenced a further action (the "the Oppression Action") against the UBS Directors. The statement of claim in the Oppression Action seeks nine separate heads of relief against the UBS Directors in addition to interest and costs.

[15] The Oppression Action centres on two principal allegations. First, it is alleged the UBS Directors acted oppressively in approving a settlement between UBS and Look that was made pursuant to an agreement dated December 3, 2010 (the "Amending Agreement"), that amended a management services agreement dated May 19, 2004 between UBS and Look (collectively, with the Amending Agreement, the "Look MSA"). Second, it is alleged that, by failing to re-elect McGoey to the UBS board of directors on July 5, 2011, the UBS Directors intentionally triggered certain provisions of the Jolian Agreement, giving rise to a right in favour of Jolian to terminate the Jolian Agreement. It is alleged that these actions of the UBS Directors exposed UBS to the consequences of the default. 206 also alleges that the UBS Directors acted improperly in defending the DOL action. More generally, 206 alleges that the UBS Directors have depleted the funds of UBS by these actions contrary to their announced intention at the time of the proxy fight in July 2010 to minimize UBS' expenses and conserve its funds.

[16] 206 seeks damages for oppressive behaviour against the UBS Directors in the amount of any loss suffered as a result of execution of the Amending Agreement and in the amount of any payment required to be made to Jolian under the Jolian Agreement. It also seeks declarations that the UBS Directors had a conflict of interest in respect of the execution of the Amending Agreement and have preferred the Look shareholders over the UBS shareholders. On these grounds, 206 further seeks an order removing the UBS Directors from the UBS board.

The CCAA Proceedings

[17] UBS is insolvent given the amounts claimed in the DOL action and the Jolian action. UBS obtained protection under the CCAA pursuant to an Initial Order dated July 5, 2011 (the

"Initial Order"). Duff & Phelps Canada Restructuring Inc. (the "Monitor") has been appointed the monitor in the CCAA proceedings.

[18] Pursuant to an order dated August 4, 2011, the court approved a claims process in respect of claims against UBS.

[19] The largest claims filed in the claims process are: the DOL and Jolian claims described above; a contingent claim by Look for the remainder of the monies due to it under the Amending Agreement, which will expire in June 2012 provided UBS continues to provide services to Look in accordance with the terms of the Look MSA; and the 206 claim in an amount "to be determined" in respect of the Oppression Action. Each of the UBS Directors also filed contingent claims respecting indemnification of legal fees that may be incurred in defending the Oppression Action, based on indemnities dated July 5, 2010 granted to them by UBS.

[20] 206 took the position that McCutcheon and Eaton should not review any of the claims filed against UBS in the claims process by virtue of an alleged conflict of interest addressed in the motion of 206 described below. These directors did not participate in the UBS review of the claims filed with it, which were therefore reviewed by Ulicki alone together with legal counsel. The UBS position regarding each of these claims was provided to the Monitor by letter dated December 9, 2011.

The December Motions

[21] In December 2011, both UBS and Dolgonos brought motions seeking relief in this court. The decision of the court was set out in its endorsement dated January 25, 2012 (the "Endorsement").

[22] UBS sought an order under s. 11.03(1) of the CCAA, extending the stay of proceedings in the Initial Order to include the Oppression Action in respect of the UBS Directors. By this means, it sought to have the Oppression Action determined pursuant to the CCAA claims process. This relief was granted by the court.

[23] 2064818 Ontario Inc. ("206") sought an order pursuant to ss. 11.5(1) and (2) of the CCAA removing McCutcheon and Eaton as directors of UBS. This relief was denied for the reasons set out in the Endorsement.

The Takeover Bid

[24] On February 1, 2012, 206 launched a partial takeover bid (the "Partial Bid") seeking to acquire 10 million UBS shares, representing approximately 10% of the UBS voting shares, at a price of $0.08 per share. This price represents a material premium over the current market price of the shares. The Partial Bid expires on March 9, 2011.

[25] In the takeover bid circular that was mailed to all UBS shareholders in connection with the Partial Bid, 206 states an intention, during the course of or following the Partial Bid, to requisition a special meeting of the UBS shareholders to elect a new board of directors. 206 further stated that it is seeking to preserve the remaining value of UBS, including its cash resources and its investment in Look.

[26] The Partial Bid is opposed by the UBS Directors. On February 6, 2011, legal counsel for UBS sent a letter to the Ontario Securities Commission ("OSC") alleging certain breaches by Dolgonos, directly or indirectly through his affiliates including 206, leading up to and in connection with the Partial Bid. In this letter, UBS urged staff of the OSC to investigate this matter, and if appropriate, to seek an order cease trading the Partial Bid. To date, the OSC has taken no steps to cease trade the Partial Bid or to order any other relief in respect of the Partial Bid, other than to extend the date for delivery by UBS of the directors' circular required under the *Securities Act*, R.S.O. 1990, c. S.5.

[27] UBS mailed the directors' circular in respect of the Partial Bid on or about February 27, 2011. Accordingly, UBS has already incurred the costs to it that result from the making of the Partial Bid. The UBS Directors recommended rejection of the Partial Bid and that UBS shareholders not tender their UBS shares.

Additional Circumstances

[28] In order to requisition a meeting of shareholders, 206 must first deposit a requisition under s. 105 of the OBCA. Section 105 imposes a duty on the directors of a corporation to respond to the requisition within 21 days of receipt of the requisition. Neither of these steps have occurred.

[29] In his affidavit in support of the UBS motion, Ulicki states his belief that a fair valuation of the UBS shares in Look, representing the only assets of UBS, would be between $9 million and $14 million, depending upon the outcome of the Look action. There are currently 102,747,854 UBS shares outstanding. The value of the UBS shares therefore essentially depends upon the outcome of the DOL action and the Jolian action. Similarly, the extent to which UBS is, in fact, insolvent depends upon the outcome of these actions. Put another way, it would appear that the value in UBS is the subject of a contest between DOL and Jolian, on the one hand, and the UBS shareholders on the other hand (including 206 to the extent of its interest as a shareholder).

[30] On February 24, 2012, Look declared a dividend in the amount of $0.05 on each of its two classes of shares, payable on or about March 13, 2012. UBS will receive approximately $2,739,000 in respect of this dividend, which will materially improve its current cash position.

The Current Motion

[31] On this motion, UBS seeks a declaration that the Partial Bid is stayed by paragraph 13 of the Initial Order or an order pursuant to s. 11 of the CCAA that the Partial Bid shall be stayed or suspended pending a determination of the DOL action and the Jolian action. I will address each in turn.

Does the Partial Bid Contravene the Stay in the Initial Order?

[32] UBS alleges that the Partial Bid is caught by paragraph 13 of the Initial Order, which reads as follows:

> **THIS COURT ORDERS** that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "**Persons**" and each being a "**Person**") against or in respect of the Applicant or the Monitor, *or affecting the Business or the Property*, are herby stayed and suspended except with the written consent of the Applicant and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower the Applicant to carry on any business which the Applicant is not lawfully entitled to carry on, (ii) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien. [Emphasis added.]

Accordingly, UBS says 206 required the consent of UBS and the Monitor or leave of the court to make the Partial Bid.

[33] UBS argues that its "Business" is the orderly settlement of the outstanding claims against it and a winding up thereafter. While I think that the "Business" of UBS is more properly characterized as that of a holding company, I will accept the UBS description for purposes of this endorsement. UBS says that, given Dolgonos' stated intention to requisition a shareholders meeting to change the board of directors of UBS, the purpose of the Partial Bid is to change the Business of UBS. UBS argues that the stay of proceedings should be interpreted broadly and in accordance with the objective of providing debtors with the best possible chance of affecting a successful restructuring and ensuring that creditors are treated fairly. It relies for this proposition on the statement of Pepall J. in *Re Canwest Global Communications Corp.*, 2010 ONSC 3530, [2010] O.J. No. 3075 (S.C.), at para. 30. It says that the purpose of the stay in the Initial Order is to provide it, as an insolvent company, with breathing room, and, by doing so, to preserve the *status quo* to assist it in its restructuring or arrangement and to prevent any particular stakeholder from obtaining an advantage over other stakeholders during the restructuring process: see *Re Canwest Global Communications Corp.*, [2009] O.J. No. 5379 (S. Ct.) at para. 25.

[34] I am not persuaded that the Partial Bid affects either the Property or the Business of UBS, and, accordingly, I do not consider that the Initial Order extends to the Partial Bid. I reach this conclusion for four reasons.

[35] First, while I agree that the court should interpret the stay in paragraph 13 broadly to accomplish the purpose of the CCAA as described above, it is necessary to start with the concept of rights and remedies which are the subject of paragraph 13 of the Initial Order. I do not think that a takeover bid falls within the concept of a right or remedy as such terms are understood for the purposes of the stay in paragraph 13. It is not meaningful to talk of a right to make a takeover bid in this context. Paragraph 13 is instead directed toward legal rights and remedies of a contractual or statutory nature.

[36] Second, consistent with the foregoing consideration, there is a significant difference between the shares of a public corporation and either its business or its property. Absent special circumstances, an offer for the shares of a company in CCAA proceedings is not an offer "affecting" its property or its business.

[37] Third, the special circumstances alleged in this case – that the Partial Bid will necessarily entail a change in the UBS Business via a change in the directors – has not been established to the requisite standard of a balance of probabilities. The evidence before the court is not sufficient to establish that Dolgonos will be in a position to change the composition of the board of directors even if he is successful in obtaining an additional 10% of the UBS shares under the Partial Bid. Therefore, I cannot conclude, even if I were inclined to do so, that the Partial Bid will affect the Business of UBS.

[38] Fourth, I do not think that the UBS submission is commercially reasonable. The UBS shares have continued to trade freely since the Initial Order as the UBS Directors have maintained their listing on the TSX Venture Exchange. Accordingly, Dolgonos has been able to acquire shares by means of open market purchases, including a "normal course purchase" transaction under applicable securities legislation. UBS wishes the court to draw a distinction in principle for the purposes of this motion between such purchases of shares and the Partial Bid. The basis of that distinction according to UBS is that responding to the Partial Bid requires time and energy on the part of the directors whereas the earlier purchases did not. While this may be a consideration in respect of the exercise of the court's discretion, it is not rationally connected to the UBS argument that the Partial Bid affects its Business as described above.

[39] Accordingly, I find that 206 was not required to seek leave of the court to lift the stay in paragraph 13 of the Initial Order in order to make the Partial Bid.

Exercise of the Court's Discretion

[40] In the alternative, UBS seeks an order of the court pursuant to the exercise of its discretion under s. 11 of the CCAA which reads as follows:

> Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

[41] The parties are agreed that the court has discretion under s. 11 of the CCAA to enjoin the Partial Bid. There are, however, no reported cases in which a court has exercised its discretion to enjoin a takeover bid. The parties disagree on the factors that the court should take into consideration in deciding whether or not to exercise its discretion in such circumstances.

[42] UBS says that the court should have regard exclusively to whether the Partial Bid will adversely affect the purpose of the restructuring. In the present circumstances, UBS argues that a stay furthers this purpose by ensuring that the focus of the attention of UBS and its management will remain on the CCAA reorganization. It says the efforts of management, and the limited financial resources of UBS, ought not to be expended on matters that are not directly related to the determination of the claims and the development of a plan of reorganization, in the absence of clear and compelling circumstances.

[43] UBS argues that it is therefore appropriate to suspend the Partial Bid in order to allow UBS to focus on a determination of the claims in the DOL action and in the Jolian action, after which it says it would be appropriate for the Partial Bid to proceed. It is supported by the Monitor who says that, in its view, it is in the best interests of the restructuring that the UBS Directors be allowed to concentrate on the restructuring rather than having to address further efforts by Dolgonos to change the board of directors.

[44] In exercising this discretion, I agree that the principal consideration must be whether the Partial Bid will adversely affect the restructuring process. On the other hand, the present circumstances are complicated by the need to balance any adverse effect of the Partial Bid against the detriment to the shareholders if they are denied the right to accept the Partial Bid if they so choose. In balancing these considerations, I have taken into account the following factors.

[45] First, I must assume that Dolgonos will requisition a special shareholders meeting with a view to changing the composition of the board of directors. On the other hand, as mentioned, the record does not establish that he would be successful in doing so even if a meeting were called. In other words, even if successful, the Partial Bid will not necessarily result in a change in the *status quo*.

[46] Second, I am also mindful not only of the beneficial effect of the Partial bid – being a price above market for shares that may ultimately have no value if the DOL action and the Jolian action are successful– but also of its potentially abusive nature as a bid for only 10% of the UBS shares, even if the OSC Staff have not taken any action to cease trade the Partial Bid in furtherance of the OSC's public interest mandate. I am also mindful of the fact that, in the circumstances of a CCAA proceeding, the usual defences to a hostile and potentially abusive takeover bid, in particular imposition of a poison pill and identification of a "white knight" – are not practical. The court must therefore have regard to maintenance of an appropriate balance between the bidder and the target corporation and its shareholders.

[47] Third, there is a later opportunity for the court to address the appropriateness of Dolgonos' plan to seek a special meeting of shareholders to change the board in the context of the restructuring. This is the real concern of UBS. As mentioned, section 105 of the OBCA requires the directors of a corporation to respond within 21 days of receipt of a shareholder requisition. If the UBS board of directors declines to order a meeting after any such requisition is delivered, the court will be required to address the merits of such action if Dolgonos wishes to proceed.

[48] Balancing these considerations, I conclude that the court should not exercise its discretion in the present circumstances for the following reasons.

[49] First, based on the evidence before the court, the only adverse consequence of the Partial Bid is the likely, if not probable, need for the UBS Directors to respond to a shareholder requisition, and, quite possibly, to a further court proceeding to compel such a meeting if the directors deny the requisition. While this will undoubtedly require some further diversion of the energies of the UBS Directors and entail some further financial expense, such actions cannot materially adversely affect the UBS reorganization on their own.

[50] Second, I think that a motion addressing the directors' response to a shareholder requisition is a more appropriate proceeding in which to address the impact of a proposed change in the board of directors. At that time, the actual proposal of Dolgonos will be available for consideration, including any features directed toward addressing the legitimate concern of the UBS Directors that his principal objective is to have a new board of directors re-examine the merits of defending the DOL action. In addition, the schedule for determination of the DOL action and the Jolian action, as well as the identities of the proposed directors, will be known. In the absence of such information, I think it is premature for the court to exercise its discretion. With this information, the court can make a more informed, and possibly a more nuanced, determination regarding the merits of any request for a special meeting of shareholders as well as the timing of any such meeting.

[51] Third, those shareholders who wish to sell their shares at a premium to market should be given an opportunity to do so. There is no suggestion that the disclosure in the market regarding the consequences of the Partial Bid on UBS, or the likelihood of pro rationing the shares taken up under the Partial Bid, is in any way inadequate. Nor is the value of the UBS shares affected by the outcome of the Partial Bid alone. It is also relevant that the OSC has not chosen to intervene in respect of the Partial Bid. In general, absent such factors, a court should be reluctant to enjoin a takeover bid, even a partial bid, at a premium to market. I think such an action should be considered only if there is an issue regarding disclosure of the purpose and effect of the bid and no later opportunity to address the principal concern in relation to the takeover bid. In this case, as mentioned above, there is no issue regarding the disclosure and there will be a later opportunity to address the issue of a proposed meeting of UBS shareholders to change the board of directors.

[52] On balance, therefore, I consider that any adverse consequences resulting from the Partial Bid are more than compensated for by the benefit to shareholders of allowing them to consider the bid as well as the protection afforded by the necessity of a subsequent proceeding in which the merits of any proposed action to change the board of directors would be addressed by the court.

[53] Accordingly, the UBS motion is denied.

C. Wilton-Siegel J.

Wilton-Siegel J.

Date: March 6, 2012

TAB 9

2005 CarswellOnt 255
Ontario Superior Court of Justice [Commercial List]

Richtree Inc., Re

2005 CarswellOnt 255, [2005] O.J. No. 251, 10 B.L.R. (4th) 334, 136 A.C.W.S. (3d) 768, 13 C.B.R. (5th) 111, 74 O.R. (3d) 174, 7 C.B.R. (5th) 294

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

In the Matter of a Plan of Compromise or Arrangement of Richtree Inc. and Richtree Markets Inc.

Lax J.

Heard: December 8, 2004
Judgment: January 26, 2005
Docket: 04-CL-5584

Counsel: Edmond F.B. Lamek, for Applicant, Richtree Inc.
Michael Weinczok, for Catalyst Fund General Partner Inc.
Kelley McKinnon, Alexandra S. Clark, J.H. Grout, for Respondent, Ontario Securities Commission

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

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Application of Act

R Ltd. was under protection of Companies' Creditors Arrangement Act ("CCAA") — R Ltd. brought motion for exemption from filing certain financial statements with various securities commissions in Canada — Motion dismissed — CCAA does not give court authority to exempt debtors from filing requirements in s. 80 of Securities Act — Under CCAA, debtor companies are not immunized from complying with regulatory regimes.

Securities and commodities --- Commissions and exchanges — Nature and powers — General

Company was under protection of Companies' Creditors Arrangement Act (CCAA) — Company applied to Mutual Reliance Review System for Exemptive Relief Applications for exemption from various filing requirements with Canadian securities commissions — Company appointed Ontario Securities Commission (OSC) as principal regulator — OSC informed company that it would recommend refusal of request — Company brought motion requesting exemption — Motion dismissed — No CCAA provision addressed or contemplated court applications for exemptions from filing requirements of Securities Act — Court's discretionary power under CCAA could not be used to override provincial statutes — While court sometimes extended deadlines under CCAA proceedings for annual general shareholder meetings, relief of reporting issuer from providing information to public while shares traded would be very different — As Legislature had decided that OSC was proper forum for balancing company and stakeholder interests against public interests, OSC was proper forum for debating filing requirement — Requested order had nothing to do with company's restructuring process but was intended to grant directors personal protection for their reputations — Sole consequence of failure to meet filing requirements would be placement on OSC's default list, which had not been shown to harm companies in past as result — Directors had paramount fiduciary duties requiring them to act honestly and in good faith and should not have let reputation concerns play role — CCAA does not give court authority to exempt debtors from filing requirements in s. 80 of Securities Act — Under CCAA, debtor companies are not immunized from complying with regulatory regimes.

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Securities and commodities --- Trading in securities — Prospectus — Exemptions from filing requirements — General

Company was under protection of Companies' Creditors Arrangement Act (CCAA) — Company applied to Mutual Reliance Review System for Exemptive Relief Applications for exemption from various filing requirements with Canadian securities commissions — Company appointed Ontario Securities Commission (OSC) as principal regulator — OSC informed company that it would recommend refusal of request — Company brought motion requesting exemption — Motion dismissed — No CCAA provision addressed or contemplated court applications for exemptions from filing requirements of Securities Act — Court's discretionary power under CCAA could not be used to override provincial statutes — While court sometimes extended deadlines under CCAA proceedings for annual general shareholder meetings, relief of reporting issuer from providing information to public while shares traded would be very different — As Legislature had decided that OSC was proper forum for balancing company and stakeholder interests against public interests, OSC was proper forum for debating filing requirement — Requested order had nothing to do with company's restructuring process but was intended to grant directors personal protection for their reputations — Sole consequence of failure to meet filing requirements would be placement on OSC's default list, which had not been shown to harm companies in past as result — Directors had paramount fiduciary duties requiring them to act honestly and in good faith and should not have let reputation concerns play role.

Table of Authorities

Cases considered by *Lax J.*:

Baxter Student Housing Ltd. v. College Housing Co-operative Ltd. (1975), [1976] 2 S.C.R. 475, [1976] 1 W.W.R. 1, 20 C.B.R. (N.S.) 240, 57 D.L.R. (3d) 1, 5 N.R. 515, 1975 CarswellMan 3, 1975 CarswellMan 85 (S.C.C.) — considered

GMAC Commercial Credit Corp.-Canada v. TCT Logistics Inc. (2004), 71 O.R. (3d) 54, 2004 C.L.L.C. 220-029, 185 O.A.C. 138, 48 C.B.R. (4th) 256, 40 C.C.P.B. 45, 238 D.L.R. (4th) 677, 2004 CarswellOnt 1284 (Ont. C.A.) — referred to

Loewen Group Inc., Re (2001), 2001 CarswellOnt 4910, 32 C.B.R. (4th) 54, 22 B.L.R. (3d) 134 (Ont. S.C.J. [Commercial List]) — considered

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 51 B.C.L.R. (2d) 105, 2 C.B.R. (3d) 303, 1990 CarswellBC 384 (B.C. C.A.) — considered

Royal Oak Mines Inc., Re (1999), 1999 CarswellOnt 792, 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]) — considered

Skeena Cellulose Inc., Re (2003), 43 C.B.R. (4th) 187, 184 B.C.A.C. 54, 302 W.A.C. 54, 2003 BCCA 344, 2003 CarswellBC 1399, 13 B.C.L.R. (4th) 236 (B.C. C.A.) — followed

Slater Steel Corp., Re (2004), 2004 CarswellOnt 5498 (Ont. C.A.) — considered

Smoky River Coal Ltd., Re (1999), 1999 CarswellAlta 491, 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94, 1999 ABCA 179 (Alta. C.A.) — considered

Westar Mining Ltd., Re (1992), 70 B.C.L.R. (2d) 6, 14 C.B.R. (3d) 88, [1992] 6 W.W.R. 331, 1992 CarswellBC 508 (B.C. S.C.) — considered

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Statutes considered:

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

s. 6 — referred to

s. 11 — considered

Securities Act, R.S.O. 1990, c. S.5
Generally — considered

s. 80 — considered

MOTION by debtor company subject to *Companies Creditors' Arrangement Act* for exemption from filing certain documents required by securities commissions.

***Lax J.*:**

1 Richtree Inc. is a reporting issuer in Ontario and in several other Canadian jurisdictions. It brings this motion requesting an exemption by way of extension from the requirement to file its audited financial statements and other continuous disclosure documents with the Ontario Securities Commission (the "OSC") and the equivalent regulatory authorities in British Columbia, Alberta, Saskatchewan, Manitoba, Newfoundland and Labrador and Nova Scotia. Following submissions, I dismissed the motion with reasons to follow. These are the reasons.

Background

2 At the time of the motion, Richtree had filed an Application with the Superior Court of Justice, Commercial List, and received creditor protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). This proceeding is ongoing.

3 On November 24, 2004, it made an Application under the Mutual Reliance Review System for Exemptive Relief Applications (the "MRRS System") for an exemption from the obligation to meet its filing requirements with the OSC. The MRRS System permits reporting issuers to request exemptions from multiple Canadian securities regulators with a single application. As Richtree had appointed the OSC as the principal regulator, its staff had primary carriage of the Application for Exemption. The exemptions sought were exemptions from the filing with the OSC the 2005 Q1 Interim Financial Statements and the 2005 Q1 Management's Discussion and Analysis by December 8, 2004; and, the 2004 Annual Financial Statements, the 2004 Management's Discussion and Analysis and the 2004 Annual Information Form by December 10, 2004.

4 Shortly before the formal filing of the Application for Exemption, OSC staff informed Richtree that they would not recommend that the OSC grant the exemption. On December 1, 2004, OSC staff confirmed its recommendation and also informed Richtree that staff of the other regulators would also recommend that their securities commissions refuse the request for exemption. The OSC staff offered to convene a joint hearing before a panel of the OSC, with the other jurisdictions participating by conference, or a hearing before the OSC if the other jurisdictions agreed to abide by the decision of the OSC. Richtree refused the hearing and brought this motion on December 7, 2004, which was the day before its first filings were due.

Analysis

5 Richtree concedes that the OSC has statutory jurisdiction to grant an exemption to a reporting issuer: *Securities Act*, R.S.O. 1990, c. S-5, s. 80. However, it submits that the court has inherent jurisdiction to grant this relief consistent with its discretionary powers under section 11 of the *CCAA* to accomplish the goal of facilitating the restructuring of a debtor company. It points

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to examples of stays in the nature of "tolling provisions". These are frequently granted in Initial *CCAA* Orders and constrain creditors or third parties from exercising rights so as to provide the necessary stability for the debtor company to restructure its affairs. It submits that the court has a variety of discretionary powers arising from its inherent jurisdiction to make orders to do justice between the parties and also to do what practicality demands. For this proposition, it relies on dicta of Farley J. in *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]) where he said at p.296:

> ... In light of the very general framework of the CCAA, judges must rely upon inherent jurisdiction to deal with CCAA proceedings. However, inherent jurisdiction is not limitless if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play. The same limitations are applicable to a Court's use of a discretion granted by statute. I appreciate that there may have been some blurring of distinction among discretion, inherent jurisdiction and general jurisdiction (including the common law facility). This combination is implicitly recognized in *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.* (1975), 57 D.L.R. (3d) 1 in Dickson J's analysis of inherent jurisdiction at pp. 4-5. ...

6 In *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.* [1975 CarswellMan 3 (S.C.C.)], Dickson J. emphasized that inherent jurisdiction does not empower a judge to negate an unambiguous expression of the legislature. Neither may it be exercised to conflict with a statute or rule. It is a special and extraordinary power to be exercised only sparingly and in a clear case and usually to maintain the authority and integrity of the court process.

7 The concept of "inherent jurisdiction" within *CCAA* proceedings is discussed in the recent decision of the British Columbia Court of Appeal in *Skeena Cellulose Inc., Re* (2003), 43 C.B.R. (4th) 187 (B.C. C.A.), at 211-212. The court concludes that when one analyzes cases such as *Royal Oak Mines Inc., Re*, as well as others referred to by Farley J. such as *Westar Mining Ltd., Re*, [1992] 6 W.W.R. 331 (B.C. S.C.), the court's use of the term "inherent jurisdiction", is a misnomer. In these cases, the courts are exercising a statutory discretion given by the *CCAA* rather than their inherent jurisdiction. This is an important distinction, which Farley J. recognizes in *Royal Oak Mines Inc., Re* in the passage quoted and in his reference to the decision of the Supreme Court of Canada in *Baxter*.

8 I agree with the analysis in *Skeena Cellulose* that when a court grants a stay of proceedings under section 11 or approves a plan of arrangement under section 6, the court is not exercising a power that arises from its nature as a Superior Court, but rather is exercising the discretion granted to it under the broad statutory regime of the *CCAA*. The relief that Richtree requests whether under the *CCAA* or the *Securities Act* is discretionary. The question that arises then is whether the statutory discretion granted to a court under the *CCAA* can be exercised in the face of section 80 of the *Securities Act*, which provides that it is the Commission that may grant or refuse the exemptions sought.

9 The answer is no. There is no provision of the *CCAA* that either addresses or contemplates an application to the court for exemption from the filing requirements of the *Securities Act*. The doctrine of paramountcy has been acknowledged to apply where the exercise of a court's discretion under the *CCAA* conflicts with the mandatory provisions of provincial legislation, see for example, *Smoky River Coal Ltd., Re* (1999), 12 C.B.R. (4th) 94 (Alta. C.A.), at 115; *Loewen Group Inc., Re* (2001), 32 C.B.R. (4th) 54 (Ont. S.C.J. [Commercial List]), at 58 However, it is worth noting that in neither case was it necessary to invoke the paramountcy doctrine. Here, as in the cases referred to, there is no inconsistency between federal and provincial law. The doctrine of paramountcy does not apply.

10 Further, where a provincial statute is given exclusive jurisdiction to determine a matter, the court's discretionary power under the *CCAA* cannot be used to override it. Hence, a broad receivership power under federal bankruptcy legislation confers no authority on a bankruptcy court to determine whether a receiver that carries on the business of a debtor is a successor employer. This is within the exclusive jurisdiction of the Ontario Labour Relations Board: *GMAC Commercial Credit Corp.-Canada v. TCT Logistics Inc.* (2004), 238 D.L.R. (4th) 677 (Ont. C.A.). On this point, the court was unanimous.

11 Richtree relies on Orders made in *CCAA* proceedings in *Slater Steel Corp., Re* [2004 CarswellOnt 5498 (Ont. C.A.)] and *Air Canada* where the court granted extensions of time for calling an annual general meeting of shareholders. This is commonly done in *CCAA* proceedings. It is quite a different thing to relieve a reporting issuer from providing timely and accurate financial

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information to members of the public where, as here, the company's shares continue to trade. At the time of its application for exemption from filing requirements, Slater's shares had been delisted from the Toronto Stock Exchange and were no longer trading. Further, the OSC, as lead regulator, had granted Slater a filing exemption, which is recited in the Order of May 5, 2004.

12 Richtree submits that the court should defer to the opinion of the directors of the company who are attempting to achieve the best results they can for the company and all of its stakeholders. I agree that the task of the directors is to focus their attention on assisting Richtree with its restructuring. However, the proper forum for debating the effect of the filing requirements on Richtree is not on this motion, but at the OSC. The legislature has decided that it is the proper forum for balancing the interests of the company and its stakeholders on the one hand and the interests of members of the public on the other. I conclude that the court has no jurisdiction under the *CCAA* to grant the exemptions sought.

13 Having said this, I wish to make some comments about the reasons that the Richtree directors have come to court. The company does not plan to comply with its filing requirements and the directors have two concerns. The only evidence before the court is a solicitor's affidavit, which deposes in paragraph 2:

> ... I understand that Richtree's directors are concerned that they could be required under applicable securities laws to notify the boards of any other public companies on which they serve or may in the future serve, of such filing requirement defaults. Moreover, I understand that Richtree's directors are concerned that they might be viewed as having acquiesced in a deliberate breach by Richtree of securities law and corporate legislation and thereafter suffer damage to their respective reputations.

14 As to the first concern, the Richtree directors are already required to disclose that they have been directors of a company that has made a plan of arrangement under the *CCAA*. Specifically, the rules of the Toronto Stock Exchange require directors to disclose this on a Personal Information Form for all companies seeking to list, or that currently list their shares for trading on the TSX.

15 The sole consequence of Richtree's failure to meet the filing requirements is that the company will be placed on the OSC's Default List. There is no requirement under Ontario securities law to disclose that an individual has been a director of a company that has been placed on the Default List. Although the OSC does place companies that are under *CCAA* protection on the Default List, there is no evidence that this has caused any harm to Richtree or indeed to other companies currently on the list, or to their directors.

16 As to the second concern, I was informed that the Richtree directors, or at least some of them, are on several boards, and that this raises concerns for them about their reputations as directors of these boards or other boards they may be invited to join. I find this to be a disquieting submission. As directors of Richtree and as directors of any other boards on which they may now or in the future serve, they have fiduciary duties that require them to act honestly and in good faith with a view to the best interests of the corporation. These duties are paramount. Reputational concerns of a personal nature play no role in assessing the alleged harm that may flow to a director from being a member of a board whose company is a defaulting issuer.

17 The purpose of section 11 of the *CCAA* is to provide the court with a discretionary power to restrain conduct against a debtor company so as to permit it to continue in business during the arrangement period: see, *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.), at 312. As observed there, the power is discretionary and therefore is to be exercised judicially.

18 Companies under *CCAA* protection are not immunized from complying with regulatory regimes. During a *CCAA* proceeding, directors are not immunized from carrying out their responsibilities or relieved of their obligations to serve the company and its stakeholders diligently. The order that is sought has nothing to do with Richtree's restructuring process. It is intended to grant the directors personal protection to their reputations. This is neither contemplated by section 11, nor are the directors entitled to this protection. Even if the court had the jurisdiction to grant the relief sought, I would not do so as this is an improper and injudicious exercise of the court's discretion under the *CCAA*.

19 For these reasons, the motion was dismissed. The OSC does not seek costs.

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Motion dismissed.

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TAB 10

2011 BCSC 450
British Columbia Supreme Court [In Chambers]

Angiotech Pharmaceuticals Inc., Re

2011 CarswellBC 841, 2011 BCSC 450, [2011] B.C.W.L.D. 4126, [2011] B.C.W.L.D. 4127, [2011] B.C.W.L.D. 4132, 201 A.C.W.S. (3d) 334, 76 C.B.R. (5th) 210

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 Angiotech Pharmaceuticals, Inc. and the other Petitioners Listed on Schedule "A" (Petitioners)

Paul Walker J.

Heard: April 6, 2011
Oral reasons: April 6, 2011
Docket: Vancouver S110587

Counsel: J. Dacks, M. Wasserman, D. Gruber, R. Morse for Angiotech Pharmaceutics, Inc.
S. Jones for Angiotech Pharmaceutics
J. Grieve, K. Jackson for Alvarez & Marsal Canada Inc.
R. Chadwick, L. Willis for Consenting Noteholders
M. Buttery for U.S. Bank National Association

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Business associations --- Specific matters of corporate organization — Shareholders — Meetings — General principles

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

Debtor company sought protection of Companies' Creditors Arrangement Act — Petitioners proposed amended plan to effect settlement of claims; implement recapitalization of subordinated notes; and enable petitioners to sustain sufficient current and future liquidity — Plan was unanimously approved by creditors and monitor — Petitioners brought application for order to sanction amended plan — Application granted — Plan should be sanctioned because it met statutory criteria set out in s. 61 of Act; it was fair and reasonable; and it was in best interests of creditors and public — Plan would enable petitioners to keep operating as going concerns; promote continued employment of many of petitioners' employees; allow creditors and others with economic interest in petitioners to derive far greater benefit than would result from bankruptcy or liquidation; and permit important medical products sold and distributed by petitioners to continue to be made available — Amendments to plan contemplating distribution of new common shares in aggregate amount of 3.5 per cent afforded greater benefit to all creditors who chose to and were qualified to take them — Amendments to plan calling for liquidity election provided greater benefits to creditors who were not able, or chose not, to participate in share offering — Proposed release contained in plan was rationally connected to purpose of plan, was necessary for implementation of plan, and met tests set out in jurisprudence.

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

Debtor company sought protection of Companies' Creditors Arrangement Act ("CCAA") — Petitioners proposed amended plan to effect settlement of claims; implement recapitalization of subordinated notes; and enable petitioners to sustain sufficient current and future liquidity — Plan was unanimously approved by creditors and monitor — Petitioners brought application for order to sanction amended plan — Application granted on other grounds — Court has jurisdiction pursuant to CCAA and Business Corporations Act to dispense with calling of meeting of existing shareholders in order to amend articles of Canadian petitioner — Section 6(8) of CCAA prohibits plan that calls for distribution to pay equity claim where non-equity claims cannot be paid in full — Evidence disclosed that this was not possible in present case — Even if it could be said that combined effect of ss. 6(8) and 6(2) of CCAA did not remove requirement for shareholders' meeting, requirement should be dispensed with in circumstances of case — To do otherwise, so that meeting was held, would cause persons who no longer had economic interest in company to acquire functional veto.

Table of Authorities

Cases considered by *Paul Walker J.*:

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

Canadian Airlines Corp., Re (2000), [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 2000 CarswellAlta 662, 2000 ABQB 442, 265 A.R. 201 (Alta. Q.B.) — referred to

Canadian Airlines Corp., Re (2000), 2000 CarswellAlta 919, [2000] 10 W.W.R. 314, 20 C.B.R. (4th) 46, 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, 2000 ABCA 238, 266 A.R. 131, 228 W.A.C. 131 (Alta. C.A. [In Chambers]) — referred to

Canwest Global Communications Corp., Re (2010), 70 C.B.R. (5th) 1, 2010 ONSC 4209, 2010 CarswellOnt 5510 (Ont. S.C.J. [Commercial List]) — followed

Muscletech Research & Development Inc., Re (2006), 25 C.B.R. (5th) 231, 2006 CarswellOnt 6230 (Ont. S.C.J.) — followed

Xillix Technologies Corp., Re (June 21, 2007), Doc. Vancouver S066835 (B.C. S.C.) — referred to

Statutes considered:

Business Corporations Act, S.B.C. 2002, c. 57
Generally — referred to

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

s. 6(2) — considered

s. 6(8) — considered

s. 61 — considered

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APPLICATION for order to sanction plan proposed by petitioners in proceeding under *Companies' Creditors Arrangement Act*.

Paul Walker J.:

1 The application before me is for an order to sanction the plan (as amended) proposed by the petitioners and approved by the monitor in the Angiotech CCAA proceeding.

2 I find that the proposed plan has several purposes, which include:

> (a) effecting a compromise, settlement, and payment of all affected claims;
>
> (b) implementing a recapitalization of subordinated notes; and
>
> (c) enabling the petitioners to sustain sufficient current and future liquidity in order to enhance their short and long term viability.

3 The plan was unanimously approved at a plan approval meeting of the creditors ("creditors' meeting") held and conducted by the monitor in Vancouver on April 4, 2011. I am satisfied that notice of the plan, the amended plan, and the creditors' meeting was widely disseminated in accordance with my previous orders.

4 The total value of the notes held by subordinated noteholders is approximately $266 million. It is noteworthy that the noteholders which held subordinated notes having a value of approximately $234 million voted in favour of the plan at the creditors' meeting.

5 No objection to the plan has been taken by any employee, past or present, or the existing common shareholders whose interests will be extinguished by the plan.

6 The plan as amended contains the following key elements, which are set out in the affidavit of K. Thomas Bailey sworn on March 31, 2011 at para. 31:

> (a) New Common Shares will be issued to Affected Creditors with Distribution Claims who have not made valid Cash Elections or Liquidity Elections (as defined below) and distributions of cash will be made to Convenience Class Creditors and Affected Creditors that have made valid Liquidity Elections;
>
> (b) the Subordinated Notes, the Subordinated Note Indenture and all Subordinated Note Obligations will be irrevocably and finally cancelled and eliminated except for the limited purposes provided in section 4.5 of the Plan;
>
> (c) all Affected Claims will be discharged and released;
>
> (d) the Existing Shares and options and the Shareholder Rights Agreement will be cancelled without any liability, payment or other compensation to Existing Shareholders in respect thereof;
>
> (e) Angiotech US will repay to Wells Fargo and the DIP Lender, as applicable, any and all outstanding Secured Lender Obligations;
>
> (f) Angiotech will make payment to the KEIP Participants of amounts owing under the KEIP at the time specified and in accordance with the terms of the KEIP;
>
> (g) Angiotech will make grants of New Common Shares and options to acquire New Common Shares pursuant to the terms of the MIP;
>
> (h) Angiotech's Notice of Articles will be amended to, among other things, create an unlimited number of New Common Shares in order to provide flexibility for the recapitalized Angiotech on a going forward basis;

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(i) Angiotech will transfer to the Monitor the aggregate of all Cash Elected Amounts and Liquidity Election Payments (as defined below) to be held in escrow in one or more separate interest-bearing accounts for distributions to Convenience Class Creditors and Affected Creditors that have made valid Liquidity Elections, as applicable;

(j) the Board of Directors of Angiotech will be replaced by a new Board of Directors; and

(k) the Petitioners, the Monitor, Blackstone, the Subordinated Note Indenture Trustee, the Advisors, Wells Fargo, the DIP Lender, the Subordinated Noteholders and, among others, present and former shareholders, affiliates, subsidiaries, directors, officers and employees of the foregoing will be granted a release and discharge from liability in connection with, among other things, the CCAA proceeding and the Plan.

7 I am satisfied from my review of the evidence that the plan, if implemented, would:

(a) enable the petitioners to continue to operate as going concerns;

(b) facilitate and promote continued employment of a substantial number of the petitioners' employees;

(c) allow creditors and other persons with an economic interest in the petitioners to derive a far greater benefit than would result from a bankruptcy or liquidation; and

(c) permit important medical products sold and distributed by the petitioners to continue to be made available to the public worldwide.

8 The amendments to the plan that now contemplate distribution of newly issued common shares in an aggregate amount of 3.5% afford greater benefit to all affected creditors who choose to and are qualified to take them.

9 As well, the amendments to the plan calling for a liquidity election provide greater benefits to creditors who are not able, or choose not, to participate in the share offering.

10 I am also satisfied that the Court has jurisdiction to dispense with the calling of a meeting of existing shareholders in order to amend the articles of the Canadian petitioner. I am satisfied that I have that jurisdiction pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*") and the *Business Corporations Act*, S.B.C. 2002, c. 57. I say that because I am of the view that s. 6(8) of the *CCAA* prohibits a plan that calls for a distribution to pay an equity claim where non-equity claims cannot be paid in full: *Canadian Airlines Corp., Re*, 2000 ABQB 442 (Alta. Q.B.) at paras. 143 and 145, aff'd at 2000 ABCA 238 (Alta. C.A. [In Chambers]). The evidence discloses that this is not possible in this case.

11 Even if it could be said that the combined effect of ss. 6(8) and 6(2) of the *CCAA* do not remove the requirement for a shareholders' meeting, I am satisfied that the requirement should be dispensed with in the circumstances of this case. To do otherwise, so that a meeting is held, would cause persons who no longer have an economic interest in the company to acquire a functional veto: *Xillix Technologies Corp., Re* (June 21, 2007), Doc. Vancouver S066835 (B.C. S.C.).

12 I am also satisfied that the proposed release contained in the plan is rationally connected to the purpose of the plan, it is necessary for the implementation of the plan, and it meets the tests set out in *Muscletech Research & Development Inc., Re* (2006), 25 C.B.R. (5th) 231 (Ont. S.C.J.); *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 92 O.R. (3d) 513 (Ont. C.A.); and *Canwest Global Communications Corp., Re*, 2010 ONSC 4209 (Ont. S.C.J. [Commercial List]).

13 The creditors who are protected by the the release were instrumental in facilitating the reorganization of the petitioners' affairs as a going concern. Further, their efforts led to the development of a plan that meets the objectives set out in the *CCAA*.

14 The reorganization facilitated by those creditors provides greater benefits to all of the creditors than would otherwise be realized if the petitioners had been liquidated.

15 In conclusion, I am satisfied that the plan should be sanctioned because:

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(a) it meets the statutory criteria set out in s. 61 of the *CCAA*;

(b) it is fair and reasonable; and

(c) it is in the best interests of the creditors and the public.

Application granted.

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TAB 11

2006 CarswellOnt 41
Ontario Superior Court of Justice

Paulson & Co. v. Algoma Steel Inc.

2006 CarswellOnt 41, [2006] O.J. No. 36, 144 A.C.W.S. (3d) 858, 14 B.L.R. (4th) 104, 79 O.R. (3d) 191

Paulson & Co. Inc. (Applicant) and Algoma Steel Inc. (Respondent)

Cumming J.

Heard: January 5, 2006
Judgment: January 9, 2006
Docket: 05-CL-6188

Counsel: Robert W. Staley, Robyn M. Ryan Bell for Applicant
James C. Tory, Susan Kushneryk for Respondent

Subject: Corporate and Commercial

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Business associations --- Specific corporate organization matters — Directors and officers — Meetings and resolutions — Miscellaneous issues

American company owned 19 percent of shares in Canadian corporation — Company's proposal for distribution of funds to shareholders was turned down by corporation board — Company asked board to call special meeting of shareholders in order to discuss replacement of board directors — Corporation scheduled meeting for four months later — Company alleged that corporation did not follow statutory requirements by not publicizing meeting appropriately and by delaying date of meeting excessively — Company brought application for order that company could call special meeting itself — Application dismissed — Corporation's scheduling of meeting reflected good faith business judgment and fell within range of reasonableness — Statutory requirements did not mandate requisitioned meeting to be held within any prescribed time — Corporation had called meeting in appropriate manner — Obligations relating to giving appropriate notice were ongoing duties that could be fulfilled at date closer to time of meeting — Matter to be settled did not deal with potential corporate wrongdoing, but rather, was merely chance for parties to debate two legitimate visions regarding stewardship of corporation.

Table of Authorities

Cases considered by *Cumming J.*:

Airline Industry Revitalization Co. v. Air Canada (1999), 1999 CarswellOnt 3020, 45 O.R. (3d) 370, 178 D.L.R. (4th) 740, 49 B.L.R. (2d) 254 (Ont. S.C.J. [Commercial List]) — referred to

FTS Worldwide Corp. v. Unique Broadband Systems Inc. (2001), 2001 CarswellOnt 4557 (Ont. S.C.J.) — referred to

Kerr v. Danier Leather Inc. (2005), 2005 CarswellOnt 7296, 11 B.L.R. (4th) 1, 77 O.R. (3d) 321 (Ont. C.A.) — referred to

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McGuinness v. Bremmer plc (1987), 1988 S.C.L.R. 226, 1988 S.L.T. 891 (Eng. C.A.) — referred to

Oppenheimer & Co. v. United Grain Growers Ltd. (1997), 1997 CarswellMan 531, 120 Man. R. (2d) 281, [1998] 2 W.W.R. 9, 36 B.L.R. (2d) 54 (Man. Q.B.) — referred to

Pente Investment Management Ltd. v. Schneider Corp. (1998), 1998 CarswellOnt 4035, 113 O.A.C. 253, (sub nom. *Maple Leaf Foods Inc. v. Schneider Corp.)* 42 O.R. (3d) 177, 44 B.L.R. (2d) 115 (Ont. C.A.) — referred to

Statutes considered:

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

Generally — referred to

s. 94(1)(a) — referred to

s. 95(2) — referred to

s. 96 — referred to

s. 96(1) — referred to

s. 96(2) — referred to

s. 96(6) — referred to

s. 99(2) — referred to

s. 100(1) — referred to

s. 105 — considered

s. 105(1) — considered

s. 105(3) — referred to

s. 105(3)(b) — referred to

s. 105(4) — referred to

s. 105(5) — referred to

s. 105(6) — considered

s. 106 — referred to

s. 106(3) — referred to

s. 111 — referred to

s. 112 — referred to

s. 112(1) — referred to

Canada-United States Tax Convention Act, 1984, S.C. 1984, c. 20

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Generally — referred to

Companies Act, 1985, 1985, c. 6
s. 368 — referred to

s. 368(8) — referred to

Companies Act, 1989, (U.K.), 1989, c. 40
Sched. 19 — referred to

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)
s. 212(2) — referred to

Treaties considered:

Canada-United States Income Tax Convention, 1980
Article X — referred to

APPLICATION by company for order allowing company to call special meeting of shareholders.

***Cumming J.*:**

The Application

1 This Application involves issues of first instance relating to the requisition of a meeting of shareholders pursuant to s. 105 of the Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16 [*OBCA*].

2 The applicant, Paulson & Co. Inc. ("Paulson"), a Delaware corporation, based in New York, carries on business as an investment advisor and hedge fund. Paulson has been the largest shareholder since November 2004, controlling 19% of the equity, in the respondent, Algoma Steel Inc. ("Algoma"), an offering corporation incorporated under the *OBCA* and listed on the Toronto Stock Exchange. Algoma operates an integrated business as a steel producer.

3 On November 1, 2005, Paulson requisitioned the directors of Algoma, pursuant to s. 105(1) of the *OBCA*, to call a special meeting of shareholders. The board of directors responded on November 21, 2005, scheduling the requested meeting for March 22, 2006. Paulson's application to this Court says: first, that the directors did not comply with the dictates of s. 105(3). Paulson says the directors did not "call a meeting" as required by law; secondly, that this Court does not have any power with discretion to relieve the board of directors of this failure; third, the Court should declare the directors did not "call a meeting" such that the requisitioning shareholder, Paulson, is free to call a meeting for February 22, 2006 pursuant to s. 105(4); and fourth, if Paulson is unsuccessful in respect of its submissions regarding s.105, that s.106 is operative to allow the Court to make an order "as the [C]ourt deems fit" whereby the Court should order the requisitioned meeting to take place February 22, 2006, rather than the presently scheduled date of March 22, 2006.

Background to the Application

4 From the outset of Paulson becoming a substantial shareholder in November 2004, there was apparent concern on the part of the Algoma board of directors. The corporation adopted a shareholders' rights plan November 16, 2004, which constituted a so-called 'poison pill' to frustrate takeover bids.

5 Paulson representatives first met with the senior management of Algoma in late November 2004. Mr. Michael Waldorf, Vice President, Senior Analyst and Senior Counsel of Paulson states in his affidavit in support of the applicant that Paulson had growing concerns over the next several months as to Algoma's consideration of strategic alternatives. There was further

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concern resulting from an announcement of August 3, 2005, of a special dividend of $6.00 per share payable August 31, 2005, and a normal course issuer bid for up to 3.3 million shares. Following this announcement, representatives of Paulson had a number of discussions with Algoma representatives. Paulson did not view the form and manner of this distribution as being tax efficient and in the best interests of shareholders. The distribution of some $240 million by way of an ordinary dividend was made August 31, 2005.

6 On October 21, 2005, Paulson proposed that a further $400 million should be distributed to shareholders by way of a so-called tax efficient corporate reorganization, together with a refinancing of Algoma's outstanding 11% Notes (which shall be referred to as the "Paulson proposal").

7 As mentioned above, Paulson had been critical of Board decision-making, in particular, the manner of distributing the special dividend of $6.00 per share declared by Algoma on August 31, 2005, given that Paulson claims that non-resident shareholders were subject to a 25% withholding tax and there was a 16% loss in market price for the shares after taking into account the dividend. (It is noted that the normative withholding tax rate of 25% imposed by s. 212(2) of the Canadian *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) is reduced substantially by Article X of the *Canada-United States Tax Convention (1980)* (enacted in Canada by the *Canada-United States Tax Convention Act, 1984*, S.C. 1984, c. 20) for a resident American shareholder in the position of Paulson. Given Paulson's expressed concern about the 25% rate, the suggested inference is that the share bloc controlled by Paulson may be held offshore by a non-resident of the United States).

8 Paulson also stated, in its letter of October 21, 2005, that if the board of directors was unwilling to carry out Paulson's proposed corporate reorganization and so advise by October 24, 2005 (later extended to October 25, 2005), Paulson would requisition a special meeting of shareholders and replace a majority of the directors with Paulson nominees with the main objective being to implement the Paulson proposal. Paulson also expressed that it had confidence in Mr. Denis Turcotte's operational capabilities as Chief Executive Officer and would want him to stay on as a member of the board.

9 On October 25, 2005, the Algoma directors met at a specially convened board meeting to consider the Paulson proposal. The board concluded it could not agree with the Paulson proposal, at least from a timing standpoint, as in the view of the board such a course of action would fail to ensure sufficient liquidity.

10 The board of directors issued a press release dated October 25, 2005, rejecting Paulson's demand, releasing the October 21, 2005, letter received from Paulson, and emphasizing that the Paulson proposal would drastically reduce Algoma's cash position and liquidity.

The Requisitioned Meeting of Shareholders

11 Paulson requisitioned a special meeting of shareholders of Algoma on November 1, 2005 (the requisition being received by Algoma November 2, 2005), pursuant to s. 105 of the *OBCA*, requesting the meeting be held prior to December 31, 2005. Schedule A to the requisition sets forth three subjects to be considered and dealt with at the meeting as considered to be appropriate.

12 Paulson's requisition seeks a meeting to consider first, a resolution to remove five existing directors, setting the number of directors at nine and electing directors to fill the vacancies; second, to consider refinancing existing debt on new terms; and third, to consider a transaction whereby retained cash of perhaps $400 million can be distributed to shareholders in a tax efficient manner, with shareholders being able to elect to receive cash dividends or shares.

13 Paulson's statement of support is set forth as Schedule B to the requisition. The criticism of the current, existing board centers upon an alleged failure to increase value for the shareholders in both the short and long term. In particular, Paulson says that the board "[d]istributed only part of excess cash in special dividend, least shareholder-friendly option with punitive tax consequences." Algoma had distributed some $ 240 million in August 2005, by way of the special dividend, which Paulson says attracted a 25% withholding tax for non-resident shareholders.

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14 Paulson proposes a corporate reorganization in Schedule B, exchanging 40% of the shares for $26.00 cash per share through a mix-and-max election of cash or shares to shareholders. Paulson forecasts that the reduction of outstanding shares would raise *pro forma* earnings per share significantly such as to increase shareholder value, with the market recognizing this increased value. At the same time, Paulson is confident that, after the reorganization, Algoma will have more than enough liquidity and capital resources for operating needs, the current capital expenditure program and all pension and post-retirement obligations to employees. This reorganization intends that any later sale of shares (perhaps through a takeover of Algoma) would result in capital receipts, with a lesser tax to selling shareholders than would be seen through a distribution of retained earnings as ordinary dividends.

15 Paulson publicly announced its requisitioned meeting and its intended agenda, adding also that it is intended Algoma's Chief Executive Officer, Mr. Denis Turcotte and the current union representatives remain on the board of directors.

16 Algoma publicly acknowledged the requisition of November 2, 2005, confirming it would conform with its legal obligations, adding that "Algoma's Board of Directors does not believe that the Paulson proposal represents a prudent course of action for the Company." On November 2, 2005, a further public announcement, announcing third quarter results, reiterated this position, stating "The Board intends to call the special meeting of shareholders and will recommend that shareholders vote against the Paulson proposal." A comprehensive presentation for investors as to Algoma's financial position and business outlook was posted on Algoma's website on November 8, 2005. This included an outline of the Paulson proposal and expressed concerns about the timing and structure of Paulson's proposal, rather than the concept of cash distributions. Paulson's tax strategy was seen as being unproven; it was advisable to obtain a tax ruling, which would take three months, the outcome of which is seen as uncertain. Algoma's web site presentation emphasizes that the board intends to maintain a prudent level of liquidity and to manage liquidity to Algoma's weak case scenario.

17 On November 16, 2005, Mr. Turcotte announced that the board of directors continues "to have the view that the capital reorganization that Paulson is proposing is not appropriate for Algoma at this time," saying that another cash distribution could be considered after "at least the next three to four quarters." It is apparent that by this time Mr. Turcotte had received the view of many investors that the Paulson proposal was not only appropriate but even represented conservative financing. Mr. Turcotte said that over "a longer period of time" the existing board intends to come to an approximate position as Paulson in respect of debt and cash on hand.

18 Algoma issued a press release on November 21, 2005, scheduling the meeting requisitioned by Paulson for March 22, 2006. The chairperson of the board, Mr. Ben Duster, said that the meeting date was selected to enable Algoma "to seek an advance tax ruling to clarify these potentially significant tax issues...[and] provide time for Algoma to investigate change of control and related issues with respect to the proposal."

19 The Application Record notes that the same day, November 21, 2005, the United Steelworkers of America stated at a news conference it had that day filed a notice of action in this Court "to block the attempt by...Paulson to force Algoma ... to distribute its cash reserves to shareholders." The claim seeks injunctive relief. Paulson responded the same day with the announcement that its proposal "merely returns excess capital to shareholders" saying that "Algoma has the highest percentage of cash per share of any North American publicly traded steel company." (This court claim by union members is not the subject of the application at hand and the plaintiffs therein did not participate in the hearing of this application.)

20 On December 1, 2005, Paulson publicly announced its proposed slate of five nominees for the board of directors.

21 Two alternative arguments are made in support of Paulson's position. First, Paulson says that Algoma has not complied with s.105; hence, Paulson submits the Court should declare that Paulson is entitled to call the meeting itself. The resolution of this issue appears to be an issue of interpreting s. 105.

22 Second, Paulson submits that even if s. 105 was complied with by Algoma, the Court should find that the proposed March 22, 2006 date is unreasonable and the Court should advance the date by virtue of exercising the Court's discretion under s. 106.

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Analysis

Section 105 of the OBCA

23 Section 105 of the *OBCA* reads as follows:

> **Requisition for shareholders meeting**
>
> **105.** (1) The holders of not less than 5 per cent of the issued shares of a corporation that carry the right to vote at a meeting sought to be held may requisition the directors to call a meeting of shareholders for the purposes stated in the requisition. R.S.O. 1990, c. B.16, s. 105(1).
>
> **Idem**
>
> (2) The requisition referred to in subsection (1) shall state the business to be transacted at the meeting and shall be sent to the registered office of the corporation. R.S.O. 1990, c. B.16, s. 105(2).
>
> **Duty of directors to call meeting**
>
> (3) Upon receiving the requisition referred to in subsection (1), the directors shall call a meeting of shareholders to transact the business stated in the requisition unless,
>
> (a) a record date has been fixed under subsection 95(2) and notice thereof has been given under subsection 95(4);
>
> (b) the directors have called a meeting of shareholders and have given notice thereof under section 96; or
>
> (c) the business of the meeting as stated in the requisition includes matter described in clauses 99(5) (b) to (d). R.S.O. 1990, c. B.16, s. 105(3).
>
> **Where requisitionist may call meeting**
>
> (4) Subject to subsection (3), if the directors do not within twenty-one days after receiving the requisition referred to in subsection (1) call a meeting, any shareholder who signed the requisition may call the meeting. R.S.O. 1990, c. B.16, s. 105(4).
>
> **Calling of Meeting**
>
> (5) A meeting called under this section shall be called as nearly as possible in the manner in which meetings are to be called under the by-laws, this Part and Part VIII. R.S.O. 1990, c. B.16, s. 105(5).
>
> **Repayment of Expenses**
>
> (6) The corporation shall reimburse the shareholders for the expenses reasonably incurred by them in requisitioning, calling, and holding the meeting unless the shareholders have not acted in good faith and in the interest of the shareholders of the corporation generally. R.S.O. 1990, c. B.16, s. 105(6).

24 Paulson submits that Algoma has not met its obligations under s. 105 of the *OBCA* to call the required meeting of shareholders upon receipt of Paulson's requisition. Accordingly, Paulson seeks an order declaring that Paulson is authorized to call and hold the requisitioned meeting of shareholders on February 22, 2006. Paulson also seeks an order facilitating the holding of the meeting, consequential to a finding favourable to Paulson, through compelling the management of Algoma to comply with ss. 96(1), 99(2), 100(1), 111 and 112 of the *OBCA*. In the alternative, Paulson requests an order requiring Algoma to call and hold the requisitioned meeting of shareholders on February 22, 2006.

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25 Under s. 105(3) and (4), upon receipt of a requisition received pursuant to s. 105(1), the directors are obliged to "call" the requisitioned meeting within 21 days or a requisitioning shareholder may itself call the meeting. The directors of Algoma responded to the requisition, received November 2, 2005, by publicly announcing the intended shareholders' meeting on November 21, 2005, being within 21 days of receiving the requisition. However, the meeting date is to be March 22, 2006. Paulson submits that the board of directors did not "call a meeting" as required by s. 105 (3) and (4).

26 I disagree. My reasons follow.

27 Paulson submits that to "call a meeting" requires more than simply a press release announcing the date of the meeting and the city in which the meeting is to be held. Paulson notes that s. 105(5) says the meeting "shall be called as nearly as possible in the manner in which meetings are to be called under the by-laws, ... Part [VII (dealing with shareholders' meetings)] and Part VIII [dealing with proxies and information circulars]." Paulson submits that the directors have not called a meeting as required by s. 105(1) unless they have sent the requisite formal notice of meeting as required by s. 96(1) at the same time (ie. November 21, 2005 in the instant situation), together with the required form of proxy as required by s. 111 and management information circular required by s.112(1).

28 Clearly, it is not sufficient to publicly schedule a meeting and never give the requisite notice (and form of proxy and management information circular) to shareholders *as required by the OBCA*. But does this mean that the requirement of "notice" (s. 96(1)) is imported into the word "call" in s. 105(1) such that notice must be given within 21 days of receiving the requisition? In my view, it does not.

29 The *OBCA* uses the words "call" (s. 105(1)), "called" (s. 106(3)), "notice" (s. 96(1)), "holding" (s.94 (1)(a)) and "held" (s. 106(3)) with the common, ordinary meaning understood in respect of those separate and distinctive words. These words have different meanings and connote distinctive actions. The *OBCA* requires several distinctive actions along a stipulated time line for a cumulative effect and single purpose: ie. a proper and fair meeting of shareholders.

30 Section 96 deals with the required notice of shareholders' meetings. For an offering corporation like Algoma, ss. 96(1) and (2) provide that the notice of a meeting is to be sent to shareholders entitled to vote and registered on the corporate records on the record date not less than 21 days, and not more than 50 days, *before* the meeting. Subsection 96(6) provides that the notice shall set forth the nature of the business in sufficient detail for shareholders to form a reasoned judgment thereon and the text of any special resolution or by-law to be submitted to the meeting.

31 Paulson points out that s. 105(6) dictates that the meeting "shall be *called*... in the manner in which meetings are to be called" by the notice requirements of s. 96 (emphasis added). Paulson points out that the wording does not say "shall be *held and conducted*". However, in my view, this wording is interpreted as meaning that a meeting called under s. 105(1) must ultimately meet the notice requirements of s. 96. Section 105(6) refers to "calling and holding the meeting". Those words are to be given their common and ordinary meaning. Holding the meeting means the acts of transacting the business at the scheduled time and location contemplated by the notice consequential to calling the meeting.

32 Subsection 105(3)(b) (dealing with an exceptional situation, not applicable to the matter at hand) references "called a meeting" as a separate act from having "given notice".

33 The time period stipulated by s. 96(1) works *backwards* from the date the meeting is to be held rather than forward from the date the meeting is called. Subsection 95(2) uses the same parameter for the setting by the directors of a record date for the purpose of determining the shareholders entitled to receive notice of the intended meeting of shareholders.

34 In my view, the *OBCA* does not require the requisitioned meeting to be held within any prescribed time. The meeting must be *called* within 21 days after receiving the requisition: s. 105(4). In my view, the board of directors did "call a meeting" within 21 days of receiving the requisition, as required by ss. 105(1) and (4), by announcing publicly, on November 21, 2005, that a special meeting of shareholders would take place in Toronto, on March 22, 2006, to consider the matters raised in the requisition of Paulson. The notice (proxy and management information circular) requirements of the *OBCA* will have to be met

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in due course (as, indeed, stated in the public announcement of the board on November 21, 2005). But the meeting has been "called" as required by the *OBCA*.

35 One must distinguish between calling a meeting, giving notice of the meeting and holding the meeting. To "call a meeting", as stipulated by s. 105(3), means establishing by resolution and announcing publicly the date on which the requisitioned meeting is to be held. Section 105(5) then says that a meeting called under this section "shall be called as nearly as possible in the manner in which meetings are to be called under the by-laws, this Part and Part VII."

36 While it is not necessary to the decision at hand, given the above finding, I add the following as an aside. In my view, if the directors' public notice of November 21, 2005 was defective, as submitted by Paulson, then the Court has the power under s. 106 of the *OBCA* to make such order as the Court deems fit to remedy the situation.

37 For the reasons given, I find that the respondent Algoma has complied with s. 105 of the *OBCA*.

Section 106 of the OBCA

38 I turn now to the second issue raised by the application of Paulson, being the alternative requested remedy through s. 106. Paulson submits that even if s. 105 has been complied with by Algoma (as I have found), the Court should find that the proposed March 22, 2006 date is unreasonable and for this reason the Court should advance the date from March 22, 2006 to February 22, 2006, by exercising the Court's discretion under s. 106. Section 106 provides:

> **Requisition by court**
>
> **106.** (1) If for any reason it is impracticable to call a meeting of shareholders of a corporation in the manner in which meetings of those shareholders may be called or to conduct the meeting in the manner prescribed by the by-laws, the articles and this Act, or if for any other reason the court thinks fit, the court, upon the application of a director or a shareholder entitled to vote at the meeting, may order a meeting to be called, held and conducted in such manner as the court directs and upon such terms as to security for the costs of holding the meeting or otherwise as the court deems fit. R.S.O.1990, c. B16, s. 106(1).
>
> **Power of court**
>
> (2) Without restricting the generality of subsection (1), the court may order that the quorum required by the by-laws, the articles or this Act be varied or dispensed with at a meeting called, held and conducted under this section. R.S.O. 1990, c. B.16, s. 106(2).
>
> **Effect of meeting**
>
> (3) A meeting called, held and conducted under this section is for all purposes a meeting of shareholders of the corporation duly called, held and conducted. R.S.O. 1990, c. B.16, s. 106(3).

39 The request for a requisition was made by Paulson on November 1, 2005 and received by Algoma on November 2, 2005. The directors have scheduled the requested meeting for March 22, 2006. This is some 140 days after the date of requisition, that is, almost five months later. At first impression, this length of time before the meeting is to be held seems excessive and unreasonable.

40 Section 105 of the *OBCA* recognizes a fundamental right of dissident shareholders holding at least five per cent of votes to requisition a meeting of shareholders. The underlying policy seeks to ensure that shareholders who can muster sufficient support to meet the five percent threshold, notwithstanding their minority position and an unwilling board of directors, are able to put forward matters for consideration by all of the shareholders entitled to vote. A share is a chose in action, a bundle of rights, including the right collectively to determine who will manage the corporation's business and affairs as a board of directors and to determine specific courses of action in the management of that business. This right in respect of corporate governance is analogous to the right to vote in elections and referenda to determine the composition and nature of public governments.

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41 This fundamental right in respect of corporate governance afforded by s. 105 provides an important and valuable remedy for minority shareholders. See *Airline Industry Revitalization Co. v. Air Canada* (1999), 45 O.R. (3d) 370 (Ont. S.C.J. [Commercial List]), at 386; see also *McGuinness v. Bremmer plc* (1987), 1988 S.L.T. 891 (Eng. C.A.) at 895; Geoffrey Morse, *Palmer's Company Law*, looseleaf (London: Sweet & Maxwell, 2005) vol. 2 at 7.406.1. Such a right is only meaningful if it can be exercised in a timely and expeditious manner.

42 Given my interpretation of s. 105, the scheduling of a requisitioned meeting is left to the business judgment of the directors to be determined by them acting honestly, in good faith and with a view to the best interests of the corporation.

43 The Court must defer to business judgments made by directors within that framework provided the directors' decision falls "within a range of reasonableness": see *Kerr v. Danier Leather Inc.*, [2005] O.J. No. 5388 (Ont. C.A.) at para. 157, quoting with approval from *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.) at paras. 64-67; see also *Airline Industry Revitalization Co. v. Air Canada*, *supra* at para. 54; *Oppenheimer & Co. v. United Grain Growers Ltd.* (1997), [1998] 2 W.W.R. 9 (Man. Q.B.).

44 As an aside, I mention that Parliament in the United Kingdom has moved away from a standard of 'reasonableness' in a like situation. In 1990, Schedule 19 to the *Companies Act 1989* (U.K.), 1989, c. 40 was proclaimed into force. Paragraph 9 of Schedule 19 amends s. 368 of the *Companies Act 1985* (U.K.), 1985, c. 6 to add s. 368(8), which provides that the directors of a corporation are deemed not to have convened a meeting of shareholders if the date set for the meeting is more than 28 days after the date of the notice convening the meeting (with the notice convening the meeting having to be within 21 days of the receipt of the requisition). Thus, in the United Kingdom a meeting must now be held within 49 days of any requisition. Prior to that amendment there was no statutory time limit for the actual date of the meeting: *Windward (Enterprises) UK Ltd., Re* [1983] 3 B.C.L.C. 293 at 295 *per* Nourse J.; *McGuinness v. Bremmer plc*, *supra*.

45 Scheduling a meeting under s. 105(1) of the *OBCA* can properly take into account the need for full disclosure and clarification of important legal or factual matters relevant to the business of the meeting. It is essential to the principle of 'shareholder democracy' that shareholders have sufficient information to form a reasoned judgment before they vote: *FTS Worldwide Corp. v. Unique Broadband Systems Inc.*, [2001] O.J. No. 5126 (Ont. S.C.J.).

46 The tax premise underlying the reorganization contemplated by the Paulson proposal was the prime motive for replacing directors at the time of making the requisition in November 2005. The record suggests that if the existing directors had simply accepted and acted upon the Paulson proposal of October 21, 2005, the requisition would not have been made and the current board would not now be facing the proxy fight at hand.

47 As of November 1, 2005, the main reason underlying the requisition to replace directors was because the existing board would not act upon the Paulson proposal, at least not without an advance tax ruling and not in the short term given the board's concerns related to liquidity.

48 There has been considerable water under the bridge since November 1, 2005. The record suggests that Paulson has now lost confidence, generally, in the current board in respect of ongoing strategic decision-making. The main thrust of the requisitioned shareholder meeting is now to replace five directors and take control of the board of directors for the future. It seems there are now perhaps irreconcilable differences in viewpoint as to the nature of board decision-making on a broader basis than simply the tax issues of the Paulson proposal. However, the prime reason for requisitioning in the first instance was because the current board refused to implement the Paulson proposal as set forth in Paulson's October 21, 2005 letter to the board.

49 At this point in time, Paulson relies upon the prospect of a so-called tax efficient further distribution of $400 million as an inducement to shareholders to elect Paulson's proposed slate at the intended special meeting of shareholders. The record indicates that many shareholders are favourable at first impression to the Paulson initiative. This is understandable. Few shareholders in any corporation would have a charitable impulse toward the tax revenue authority such as to want to give more than the minimum tax required by law. There is nothing sinister in lawfully minimizing one's tax burden.

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50 Moreover, the very purpose in being a shareholder in a for-profit corporation is, of course, to receive, in hand, the benefits of corporate profit. Shareholders have purchased their shares in pursuit of their own self-interest. There is not, of course, anything sinister in shareholders wanting distributions of cash in excess of what is reasonably seen by the board of directors they have elected as required to meet corporate obligations and purposes: ie. as to what quantitative retention of earned surplus is seen to be in the best interests of the corporation.

51 Algoma wishes to obtain clarification through an advance ruling of the tax issues raised by the Paulson proposal to enable the shareholders to have sufficient information to form a reasoned judgment on the matters on which they are voting at the requisitioned meeting.

52 Decisions at the requisitioned special meeting are best made by informed shareholders. The validity of the tax premise to the proposed corporate reorganization remains as one relevant consideration for shareholders in voting at the requisitioned meeting. The record suggests an advance tax ruling is a prudent course of action to the contemplated corporate reorganization as seen with the Paulson proposal. The present board of directors has also expressed concerns it might face a reassessment in the absence of an advance tax ruling with Algoma being liable for withholding tax plus penalties and interest. The board of directors of Algoma must, of course, properly take into account a broad spectrum of considerations in acting in the best interests of the corporation and all the shareholders when contemplating whether to implement any corporate reorganization and cannot act simply upon demand to accommodate the stated objectives of one shareholder, albeit a substantial and knowledgeable shareholder.

53 Moreover, to now set the meeting for February 22, 2006 (there is common ground this is the very earliest date from a practical and logistical standpoint to which the shareholders' meeting could be advanced) would move up the meeting by a mere 28 days. This is not a case where there is any perceived corporate wrongdoing by the current board; rather, it is a situation where the two contesting groups have honestly held differences as to what courses of action for the future by the board of directors are truly in the best interests of the corporation and all the shareholders.

54 In my view, considering all the particular circumstances of the application at hand, the board's action of November 21, 2005, in scheduling the meeting for March 22, 2006, was a good faith business judgment falling within the range of reasonableness, given that an advance tax ruling was reasonably forecasted to take three months and the tax issue relating to the proposed corporate reorganization by Paulson was considered by everyone to be a prime consideration for shareholders. In my view, and I so find, the date for the special meeting of shareholders' is properly left as scheduled, being March 22, 2006.

Disposition

55 Accordingly, for the reasons given, the application is dismissed.

Application dismissed.

End of Document

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TAB 12

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re General Growth Properties, Inc., Bankr.S.D.N.Y., March 24, 2010

209 B.R. 832
United States District Court,
D. Delaware.

In re MARVEL ENTERTAINMENT GROUP, INC., The Asher Candy Company, Fleer Corp., Frank H. Fleer Corp., Heroes World Distrbibution, Inc., Malibu Comics Entertainment Inc., Marvel Characters Inc., Marvel Direct Marketing Inc., and Skybox International Inc., Debtors.
OFFICIAL BONDHOLDERS COMMITTEE, LaSalle National Bank, as Indenture Trustee, Appellants,
v.
The CHASE MANHATTEN BANK, as Agent, Appellees.
In re MARVEL ENTERTAINMENT GROUP, INC., The Asher Candy Company, Fleer Corp., Frank H. Fleer Corp., Heroes World Distribution, Inc., Malibu Comics Entertainment Inc., Marvel Characters Inc., Marvel Direct Marketing Inc., and Skybox International Inc., Debtors.
OFFICIAL BONDHOLDERS COMMITTEE, LaSalle National Bank, as Indenture Trustee, Appellants,
v.
MARVEL ENTERTAINMENT GROUP, INC., The Asher Candy Company, Fleer Corp., Frank H. Fleer Corp., Heroes World Distribution, Inc., Malibu Comics Entertainment Inc., Marvel Characters Inc., Marvel Direct Marketing Inc., and Skybox International Inc., Appellees.

Bankruptcy Nos. 96–2067 HSB through 96–2077 HSB. | Civ.A. Nos. 97–145–RRM, 97–146–RRM. | May 14, 1997.

Chapter 11 debtors-in-possession, including parent company and certain of its subsidiaries, filed adversary complaint for declaratory and injunctive relief enjoining bondholders and indenture trustee from voting pledged shares to replace parent's board of directors. The Bankruptcy Court entered order finding that bondholders and indenture trustee were required to first seek and obtain relief from automatic stay. Bondholders and indenture trustee appealed. The District Court, McKelvie, J., held that: (1) bankruptcy court's order was final and appealable; (2) bankruptcy court's failure to enter separate order on debtors' motion for temporary restraining order (TRO) did not preclude district court from reviewing bankruptcy court's decision; and (3) automatic stay did not prevent bondholders and indenture trustee from voting pledged shares to replace debtor's board of directors, when bonds were issued by debtor's holding companies under separate indentures, secured in part by pledge of 80% of debtor's stock.

Vacated and remanded.

West Headnotes (11)

[1] **Bankruptcy**
⇦ Finality

Bankruptcy court's order enjoining bondholders and indenture trustee from voting pledged shares to replace parent's board of directors was final and appealable; order addressed discrete legal issue regarding application of automatic stay that would involve no additional fact-finding on remand, district court's review would promote judicial economy by potentially obviating need for hearing as to whether cause existed to lift stay, and bankruptcy court's order had significant impact on estate assets. 28 U.S.C.A. § 158(a)(1).

5 Cases that cite this headnote

[2] **Bankruptcy**
⇦ Finality

Bankruptcy court's failure to enter separate order on debtor's motion for temporary restraining order (TRO) did not preclude district court from reviewing bankruptcy court's decision finding that bondholders and indenture trustee were prevented by automatic stay from voting pledged shares to replace debtor's board of directors; transcript of hearing on TRO motion provided sufficient information to review bankruptcy court's decision which was otherwise final and appealable. Fed.Rules Bankr.Proc.Rule 9021, 11 U.S.C.A.

6 Cases that cite this headnote

[3] **Bankruptcy**
⇦ Decisions Reviewable

Appellate review is not necessarily precluded where lower court fails to set forth decision in separate order. Fed.Rules Bankr.Proc.Rule 9021, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 58, 28 U.S.C.A.

Cases that cite this headnote

[4] **Bankruptcy**
⇦ Interlocutory orders; collateral order doctrine

In determining whether to grant interlocutory appeal, requirement that there be substantial difference of opinion as to controlling issue of law is not requirement that need be rigidly applied, and does not preclude interlocutory review of cases where district court believes that there is no substantial ground for difference of opinion because bankruptcy court's decision is contrary to well-established law. 28 U.S.C.A. § 1292(b).

10 Cases that cite this headnote

[5] **Bankruptcy**
⇦ Proceedings, Acts, or Persons Affected

Automatic stay was not implicated by exercise of shareholders' corporate governance rights, and bankruptcy court thus erred in finding that automatic stay prevented bondholders and indenture trustee from voting pledged shares to replace Chapter 11 debtor's board of directors, where bondholders held bonds issued by debtor's holding companies under separate indentures, secured in part by pledge of 80% of debtor's stock. Bankr.Code, 11 U.S.C.A. § 362(a)(3).

6 Cases that cite this headnote

[6] **Bankruptcy**
⇦ Conclusions of law; de novo review

Bankruptcy court's decision as to applicability of automatic stay was legal conclusion over which district court would exercise plenary review. 28 U.S.C.A. § 158; Bankr.Code, 11 U.S.C.A. § 362.

1 Cases that cite this headnote

[7] **Bankruptcy**
⇦ Injunction or stay of other proceedings
Bankruptcy
⇦ Administration

Shareholders' right to compel shareholders' meeting for purpose of electing new board of directors subsists during reorganization proceedings, and election of new board of directors may be enjoined only under circumstances demonstrating "clear abuse."

1 Cases that cite this headnote

[8] **Corporations and Business Organizations**
⇦ Right to Vote in General

Shareholders' right to be represented by directors of their choice and thus to control corporate policy is paramount.

Cases that cite this headnote

[9] **Bankruptcy**
⇦ Creditors' and equity security holders' committees and meetings

Shareholders should have right to be adequately represented in conduct of debtor's affairs, particularly in such important matter as debtor's reorganization.

Cases that cite this headnote

[10] **Bankruptcy**
⇦ Injunction or stay of other proceedings

"Clear abuse" required to enjoin shareholders' meeting intended to elect new board of directors during reorganization proceedings requires showing that shareholders' action in seeking to elect new board of directors demonstrates willingness to risk rehabilitation altogether in order to win larger share for equity.

1 Cases that cite this headnote

[11] **Bankruptcy**

⚿ Injunction or stay of other proceedings

Fact that shareholders' action, in seeking shareholders' meeting for purpose of electing new board of directors during reorganization proceedings, may be motivated by desire to arrogate more bargaining power in negotiation of reorganization plan, without more, does not constitute clear abuse required to enjoin such election.

1 Cases that cite this headnote

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***834 OPINION**

McKELVIE, District Judge.

This is a bankruptcy case. Marvel Entertainment Group, Inc. ("Marvel") and certain of its subsidiaries are debtors-in-possession in Chapter 11 proceedings. Appellants Official Bondholders Committee ("the Bondholders Committee") and LaSalle National Bank ("LaSalle") appeal from the March 24, 1997 order of the United States Bankruptcy Court for the District of Delaware enjoining the exercise of shareholder voting rights to replace Marvel's board of directors. For the reasons set out below, the court will vacate the bankruptcy court's order and remand for further proceedings consistent with this opinion.

I. *Factual and Procedural Background*

The following facts are drawn from the parties' briefs and the record of proceedings below. Approximately 80% of Marvel's common stock is owned or controlled by three holding companies: Marvel Holdings, Inc. ("Marvel Holdings"), Marvel (Parent) Holdings, Inc. ("Marvel (Parent)"), and Marvel III Holdings, Inc. All three holding companies (collectively referred to herein as "the Marvel Holding Companies") are owned by Mr. Ronald O. Perelman. The balance of Marvel's common stock is held by public stockholders (18.84%) and entities owned or controlled by Mr. Perelman (2.35%).

In 1993 and 1994, the Marvel Holding Companies raised $894 million through the issuance of bonds. The bonds were issued pursuant to three separate indentures and were secured by a pledge of approximately 80% of Marvel's stock and by 100% of the stock of Marvel (Parent) and Marvel Holdings. An indenture trustee was appointed to act for the bondholders under the indentures. LaSalle is the current indenture trustee.

On December 27, 1996, Marvel and certain of its subsidiaries (collectively referred to herein as "the Debtors") filed separate petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. The Debtors' cases have been procedurally consolidated and are being jointly administered. On the same day, the Marvel Holding Companies also filed petitions for relief under Chapter 11 in the bankruptcy court. The Marvel Holding Companies' cases have also been procedurally consolidated and are also being jointly administered, although they are being administered separately from the Debtors' cases.

Shortly after the Debtors and the Marvel Holding Companies filed petitions for Chapter 11 relief, the Bondholders Committee was formed in the Marvel Holding Companies' cases to represent parties currently holding the bonds previously issued by the Marvel Holding Companies. After Marvel obtained an order in its case requiring any potential claims against Marvel to be filed within one month of its commencement of bankruptcy proceedings, LaSalle (hereinafter referred to as "the Indenture Trustee") filed several proofs of claims against Marvel on behalf of the bondholders so that they may recover against Marvel in the event Marvel is liable for any wrongdoing with respect to the amounts owed by the Marvel Holding Companies under the indentures.

On January 13, 1997, the Bondholders Committee and the Indenture Trustee moved to lift the automatic stay imposed by the Bankruptcy Code [1] in the Marvel Holding Companies' cases to allow the bondholders and the Indenture Trustee to foreclose on and vote the pledged shares of stock as a result of the Holding Companies' default under the indentures.

1 The Bankruptcy Code provides in relevant part:

> (a) ... a petition filed under section 301 ... of this title ... operates as a stay, applicable to all entities, of—
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate....

See 11 U.S.C. § 362(a)(3).

On February 26, 1997, after two days of evidentiary hearings, the bankruptcy court entered an order lifting the stay in the Marvel Holding Companies' cases to permit the bondholders and the Indenture Trustee to foreclose on and vote the pledged shares. In lifting the stay, however, the bankruptcy court noted that the issue of whether the automatic stay imposed in the Debtors' cases would be implicated by any subsequent action ***835** taken by the bondholders and the Indenture Trustee with respect to the pledged shares was not yet before the court.

On March 19, 1997, the Bondholders Committee and the Indenture Trustee notified the Debtors of the intent of the bondholders and the Indenture Trustee to vote the pledged shares to replace Marvel's board of directors. Subsequently, on March 24, 1997, the Debtors instituted an adversary proceeding in the Debtors' cases by filing a complaint for declaratory and injunctive relief and a motion for a temporary restraining order ("TRO") and a preliminary injunction enjoining the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors. Also on that day, Chase Manhattan Bank, as agent for the senior secured lenders in the Debtors' cases, commenced a similar adversary proceeding in the Debtors cases' wherein it sought substantially the same relief. Both the Debtors and Chase sought injunctive relief pursuant to §§ 362(a) and 105(a) [2] of the Bankruptcy Code.

2 Section 105(a) of the Bankruptcy Code provides in relevant part: "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *See* 11 U.S.C. § 105(a).

Later that day, the bankruptcy court held a hearing on the Debtors' and Chase's motions for a TRO. The court heard oral argument from the parties but did not hear testimony or admit any evidence. At the conclusion of the hearing, the court held that § 362(a)(3) prevented the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors until they first sought and obtained relief from the automatic stay pursuant to § 362(d) of the Bankruptcy Code. [3] The court denied the Debtors' and Chases' motions for a TRO pursuant to § 105(a) because neither the Debtors nor Chase made any showing of irreparable harm.

3 Section 362(d) of the Bankruptcy Code provides that, on request of a party in interest and after notice and a hearing, the bankruptcy court shall grant relief from the stay provided under § 362(a) by terminating, annulling, modifying, or conditioning such stay where, among other things, the party in interest demonstrates cause, including the lack of adequate protection of a property interest. *See* 11 U.S.C. § 362(d).

On March 28, 1997, the Bondholders Committee and the Indenture Trustee filed a notice of appeal and a motion for expedited review of the bankruptcy court's March 24, 1997 order. This court granted appellants' motion on April 1, 1997. On April 10, 1997, appellees Chase and the Debtors each moved to dismiss the appeal on the ground that this court lacks jurisdiction to entertain the appeal. On May 1, 1997, the court heard oral argument on appellees' motion and the merits of the appeal.

Shortly after the bankruptcy court issued its March 24, 1997 order, appellants filed a motion to lift the stay pursuant to § 362(d). A hearing on that motion is currently scheduled in bankruptcy court for June 6, 1997. In addition, a hearing

with respect to the relief sought by appellees in the adversary proceedings is currently scheduled for June 16, 1997.

II. *Discussion*

Before turning to the merits of this appeal, the court must address appellees' contention that the court cannot hear the appeal because it lacks jurisdiction.

A. *The Court's Jurisdiction Over the Appeal*

[1] Appellees contend that the court lacks jurisdiction to hear this appeal because the bankruptcy court's March 24, 1997 order is not a final order. District courts have jurisdiction to hear appeals from the final judgments, orders, and decrees of bankruptcy courts. 28 U.S.C. § 158(a)(1). The Third Circuit has repeatedly emphasized that considerations unique to bankruptcy proceedings require courts to adopt a pragmatic approach in determining the finality of bankruptcy orders. *Commerce Bank v. Mountain View Village, Inc.*, 5 F.3d 34, 36–37 (3d Cir.1993). The court has explained that bankruptcy cases frequently involve protracted proceedings and the participation of numerous parties. *In re F/S Airlease II, Inc. v. Simon*, 844 F.2d 99, 103–04 (3d Cir.1988). To avoid the waste of time and resources that might result from reviewing discrete portions of a ***836** case only after a plan of reorganization is approved, courts have permitted review of orders that in other contexts might be considered interlocutory. *Id.* at 104.

In determining the finality of bankruptcy orders, the Third Circuit has relied on such factors as the impact of the order on the assets of the estate, the preclusive effect of a decision on the merits, the need for additional fact-finding on remand, and whether the interests of judicial economy will be furthered. *Commerce Bank*, 5 F.3d at 37. Applying some of these factors in *United States v. Nicolet, Inc.*, 857 F.2d 202 (3d Cir.1988), the Third Circuit held that a district court's decision concerning the application of the automatic stay was a final, appealable order. In so holding, the court relied on factors such as the unique characteristics of the automatic stay, the purely legal nature of the district court's decision, and the fact that the decision at issue required no further work by the district court. *Id.* at 206; *see also Lomas Financial Corp. v. Northern Trust Co.*, 932 F.2d 147, 151 n. 2 (2d Cir.1991) (observing that a decision that the automatic stay applies is final as to that issue and is appealable).

Here, likewise, the court concludes that the bankruptcy court's order is final and therefore appealable. The bankruptcy court's order addresses a discrete legal issue—whether § 362(a)(3) prevents the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors—that would involve no additional fact-finding on remand. This court's review of the bankruptcy court's decision would also promote judicial economy. If the court does not hear this appeal, it will nevertheless be faced with the issue raised by this appeal on final appeal. During the interim, however, the bankruptcy court will have conducted a fact-intensive hearing as to whether cause exists to lift the stay. Thus, a decision by this court at this time that the automatic stay does not apply to prevent the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors would save judicial time and resources by obviating the need for the bankruptcy court to conduct that hearing. Finally, the bankruptcy court's order has a significant impact on the assets of the estate. Both sides in this dispute maintain that Marvel's financial well-being is dependent upon the composition of its board. Thus, the bankruptcy court's order either protects Marvel's assets or places them in jeopardy.

[2] The Debtors further contend that the bankruptcy court's order is not appealable because it fails to meet the requirements of Rule 9021 of the Federal Rules of Bankruptcy Procedure. Rule 9021, which makes Rule 58 of the Federal Rules of Civil Procedure[4] applicable to bankruptcy proceedings, provides that "[e]very judgment entered in an adversary proceeding or in a contested matter shall be set forth on a separate document." At the conclusion of the hearing on appellees' motions for a TRO, the bankruptcy court granted appellees' motions pursuant to § 362(a)(3) and directed that the record was "so ordered," but did not enter a separate order granting that relief.

4 Rule 58 provides in relevant part: "Every judgment shall be set forth on a separate document. A judgment is effective only when so set forth...."

[3] Appellate review, however, is not necessarily precluded where a lower court fails to set forth a decision in a separate order. For instance, in *Schrob v. Catterson*, 948 F.2d 1402, 1407 (3d Cir.1991), a district court orally denied a motion to dismiss at the conclusion of a hearing on the motion, informing the parties that it would not enter a separate written order because its ruling was too complicated to reduce to writing. Although the Third Circuit noted its disapproval of the district court's procedure, it stated that "a holding that it deprives us of appellate jurisdiction would exalt form over substance." The court concluded that the transcript of the

hearing on the motion provided enough information to review the district court's decision, and that therefore it would be inefficient to remand the case simply because the district court failed to enter a separate order.

Here, the transcript of the hearing on appellees' motions for a TRO provides sufficient information to review the bankruptcy court's decision which this court has concluded is otherwise final and appealable. Accordingly, *837 the bankruptcy court's failure to enter a separate order granting appellees' motion for a TRO does not preclude the court from reviewing its decision. *See also Burlington Northern R.R. Co. v. Huddleston,* 94 F.3d 1413, 1416 n. 3 (10th Cir.1996) (holding that the absence of a separate document will not prohibit appellate review where no question exists as to the finality of a lower court's decision).

Although the court has concluded that the bankruptcy court's March 24, 1997 order is final and appealable, the court observes that even if it had concluded otherwise it would nevertheless grant appellants leave to appeal. Under 28 U.S.C. § 158(a)(3), upon granting leave to appeal, district courts have jurisdiction to hear appeals from interlocutory bankruptcy orders. Rule 8003 of the Federal Rules of Bankruptcy Procedure, which governs motions for leave to appeal, provides that, "[i]f a required motion for leave to appeal is not filed, but a notice of appeal is timely filed, the district court or bankruptcy appellate panel may grant leave to appeal or direct that a motion for leave to appeal be filed." Fed. R. Bankr.P. 8003(c). Although appellants have not filed a motion for leave to appeal, the court will construe their timely notice of appeal as such a motion.

Neither § 158(a) nor Rule 8003 set forth criteria for district courts to evaluate in determining whether to grant leave to appeal interlocutory bankruptcy orders. In *In re Bertoli,* 812 F.2d 136, 139 (3d Cir.1987), the Third Circuit concluded that Congress intended district courts to be able to review interlocutory orders "for such cause as found by the district court" in that case. In deciding to hear an interlocutory bankruptcy order, the district court applied the standard set forth under 28 U.S.C. § 1292(b) governing interlocutory appeals to the courts of appeals from the orders of district courts. Under § 1292(b), an interlocutory order may be appealed where a district court certifies that 1) the order from which the appeal is taken involves a controlling question of law; 2) there is substantial ground for difference of opinion as to the controlling question of law; and 3) an immediate appeal may materially advance the ultimate termination of the litigation.

The bankruptcy court's order involves a controlling question of law. A controlling question of law at the very least encompasses a ruling which, if erroneous, would be reversible error on final appeal. *Katz v. Carte Blanche Corp.,* 496 F.2d 747, 755 (3d Cir.1974) (en banc). If the bankruptcy court's decision that § 362(a)(3) prevents the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors is erroneous, its decision would be reversible error if the bankruptcy court grants the relief appellees seek in the adversary proceedings on that basis.

An immediate appeal of the bankruptcy court's order may also materially advance the ultimate termination of the litigation in this case. As discussed above, a decision by this court that the bankruptcy court erred would obviate the need for the bankruptcy court to conduct a fact-intensive hearing as to whether cause exists to lift the stay. Additionally, such a decision by this court could also result in the speedy conclusion of the adversary proceedings. Appellees moved for a TRO under §§ 362(a) and 105(a). The bankruptcy court denied appellees' motions under § 105(a) because appellees failed to show irreparable harm. Thus, unless appellees demonstrate other grounds for injunctive relief, there may be little for the bankruptcy court to do on remand in the adversary proceedings except enter judgment in favor of appellants.

[4] With respect to the requirement that there be substantial difference of opinion as to the controlling issue of law, the court concludes that, although the application of this criterion makes sense where a district court must determine whether to certify a decision for appeal to a court of appeals, it cannot apply where, as here, a district court believes that there is no substantial ground for difference of opinion because the bankruptcy court's decision is contrary to well-established law. To conclude that a district court may grant leave to appeal where substantial ground for difference of opinion exists but not where the court believes that the bankruptcy court's decision is contrary to well-established law would create the absurd result that interlocutory bankruptcy decisions *838 involving close questions of law may be appealable but those that are clearly reversible may not. To the extent the Third Circuit has approved the standard set forth under § 1292(b) as a test for district courts to apply in determining whether to grant leave to appeal interlocutory bankruptcy orders, the court believes

that the Third Circuit would not endorse a rigid application of that standard where it would produce such a result.

Accordingly, for the reasons set out above, the court will deny appellees' motion to dismiss the appeal.

B. *The Bankruptcy Court's Decision*

[5] [6] The bankruptcy court held that the automatic stay imposed by § 362(a)(3) of the Bankruptcy Code prevents the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors unless they first seek and obtain relief from the stay. The bankruptcy court's decision is a legal conclusion over which this court exercises plenary review. *See In re Visual Indus., Inc.*, 57 F.3d 321, 324 (3d Cir.1995). The court concludes that the bankruptcy court's decision was erroneous.

[7] [8] [9] [10] [11] It is well settled that the right of shareholders to compel a shareholders' meeting for the purpose of electing a new board of directors subsists during reorganization proceedings. *In re Johns–Manville Corp.*, 801 F.2d 60, 64 (2d Cir.1986). The right of shareholders "to be represented by directors of their choice and thus to control corporate policy is paramount." *In re Potter Instrument Co., Inc.*, 593 F.2d 470, 475 (2d Cir.1979) (quoting *In re J.P. Linahan, Inc.*, 111 F.2d 590, 592 (2d Cir.1940)). Shareholders, moreover, "should have the right to be adequately represented in the conduct of a debtor's affairs, particularly in such an important matter as the reorganization of the debtor." *Johns–Manville*, 801 F.2d at 65 (quoting *In re Bush Terminal Co.*, 78 F.2d 662, 664 (2d Cir.1935)). As a result, the election of a new board of directors may be enjoined only under circumstances demonstrating "clear abuse." *See, e.g., Johns–Manville*, 801 F.2d at 64; *In re Heck's Properties, Inc.*, 151 B.R. 739, 759–60 (S.D.W.Va.1992); *In re Allegheny Internat'l, Inc.*, 1988 WL 212509, at *4 (W.D.Pa. May 31, 1988). "Clear abuse" requires a showing that the shareholders' action in seeking to elect a new board of directors "demonstrates a willingness to risk rehabilitation altogether in order to win a larger share for equity." *Johns–Manville*, 801 F.2d at 65. The fact that the shareholders' action may be motivated by a desire to arrogate more bargaining power in the negotiation of a reorganization plan, without more, does not constitute clear abuse. *Id.* at 64.

It follows from these principles that the automatic stay provisions of the Bankruptcy Code are not implicated by the exercise of shareholders' corporate governance rights. Indeed, if it were otherwise, there would be no need to determine whether shareholders' actions evidenced clear abuse. For instance, because the directors of a debtor-in-possession control and manage the debtors' operations, any election of a new board would be considered an attempt to exercise control over the assets of the estate and would thus be barred by § 362(a)(3). In each of the cases cited above, however, courts considered only whether shareholders' attempts to elect a new board constituted clear abuse.

Chase suggests that the plain meaning of the language "to exercise control over property of the estate," which was added to § 362(a)(3) by Congress in 1984, dictates the application of the automatic stay to an attempt by shareholders to elect a new board of directors. As appellants point out, however, if Congress had intended such a marked departure from well-established law, the legislative history of the 1984 amendment would contain some indication of that intention. The addition of the phrase "or to exercise control over property of the estate" was made pursuant to § 441(a)(2) of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L. No. 98–353, 98 Stat. 333, under the subheading "Subtitle H—Miscellaneous Amendments to Title 11." As noted by one court, Congress provided no explanation for adding the "exercise control" language to § 362(a)(3). *See United States v. Inslaw, Inc.*, 932 F.2d 1467, 1473 n. 3 (D.C.Cir.1991). Accordingly, the court cannot surmise that Congress intended the "exercise control" language to apply to an action ***839** by shareholders to elect a new board of directors. *See In re Cohen*, 106 F.3d 52, 58 (3d Cir.1997) ("The Supreme Court has observed that a court should 'not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.' ") (citation omitted).

The Debtors rely heavily on two cases in support of the automatic stay. In an oral decision in *In re Fairmont Communications Corp.*, No. 92–B–44861 (Bankr.S.D.N.Y. Mar. 3, 1993), the bankruptcy court applied § 362(a)(3) to prevent a creditor and shareholder of the debtor from appointing additional members to the debtor's board of directors pursuant to certain proxies that it had been granted to ensure repayment of its loan to the debtor. In holding that the automatic stay applied, however, the court noted that it was not "confronted with the conventional case of a shareholder seeking to invoke its corporate governance rights" because the rights the creditor/shareholder sought to exercise "stem[med] from its status as [the debtor's] largest unsecured creditor and [were] implicated only because [its] note [had] not been paid." Tr. at 14.

Similarly, in *In re Bicoastal Corp.*, 1989 Bankr.LEXIS 2046 (Bankr.M.D.Fla. Nov. 21, 1989), the bankruptcy court held that § 362(a)(3) prevented a creditor and preferred shareholder of the debtor from exercising its right to elect a majority of the debtor's board of directors that accrued when the debtor failed to timely repay the creditor/preferred shareholder's loan to the debtor. The court observed, however, that by reason of the creditor's dual status as preferred shareholder and creditor, "matters of corporate governing in the orthodox sense" were not implicated and that, if that "were the case, there [was] hardly any doubt that absent some showing of extraordinary circumstances, [the] Court [had] no jurisdictional power to interfere with corporate governance." *Id.* at *14–15. The court noted that "it was Congress' intent that the automatic stay permit [a] debtor to attempt a repayment or reorganization or simply to be relieved of the financial pressures that drove him into bankruptcy by granting the debtor a breathing spell from his creditors," *id.* at *17, and applied § 362(a)(3) because the creditor/shareholder was a creditor of the debtor.

The courts in *Fairmont* and *Bicoastal* thus applied the automatic stay provisions of § 362(a)(3) in order to prevent creditors of debtors from gaining control of the debtors' estates through the exercise of corporate governance rights. The Debtors argue that here, too, the bondholders are seeking to exercise rights accruing to them as creditors rather than traditional shareholder rights because the shares were pledged as security for the payment of the bonds issued by the Marvel Holding Companies. Appellants, however, did not acquire shareholder rights in Marvel as creditors of Marvel, but rather as creditors of the Marvel Holding Companies. Because the pledged shares were property of the Marvel Holding Companies' estates, appellants were required to seek and, indeed, obtained relief from the automatic stay in the Marvel Holding Companies case that prevented them from exercising control over those shares. The fact that they acquired shareholder rights in Marvel by exercising creditor remedies in the Marvel Holding Companies case is of no moment. Although the Debtors argue that the objective of the bondholders and the Indenture Trustee is to "seize control of the assets and properties of [Marvel] to effect a recovery on loans advanced," *see* Debtors' Ans. Br. at 21, the bondholders cannot exercise their shareholder rights in Marvel to obtain payment from Marvel of any claims they may have against the Marvel Holding Companies for their default under the indentures. Marvel is apparently not a party to the indentures and is thus not contractually obligated to repay the bondholders. It is true that the Indenture Trustee filed proofs of claims against Marvel on behalf of the bondholders so that they may recover against Marvel in the event Marvel is liable for independent wrongdoing with respect to the amounts owed by the Marvel Holding Companies under the indentures. The Debtors, however, have not articulated how the bondholders might exploit their right to elect a new board to collect on those potential claims. Thus, given the paramount right of shareholders to exercise corporate governance rights, the court believes that it would be inappropriate ***840** to apply the automatic stay merely because of speculation that a new board elected by the bondholders might take some action that would violate the automatic stay. Should a new board elected by the bondholders attempt to take any action that would run afoul of § 362(a), they can be enjoined from doing so. *See, e.g., In re Prudential Lines Inc.*, 928 F.2d 565 (2d Cir.1991) (enjoining sole shareholder from taking worthless stock deduction under § 362(a)(3) where deduction would be an attempt to exercise control over property of debtor's estate).

Finally, Chase suggests that Marvel is insolvent and that as a result the automatic stay applies. Chase cites dicta in *Johns–Manville* to the effect that, if a debtor is insolvent, it would probably be inappropriate to permit shareholders to call a meeting because they would no longer have equity in the debtor and thus be real parties-in-interest. Even if that proposition were correct, however, the bankruptcy court has never found that Marvel is insolvent. Accordingly, that issue is not a proper subject of this appeal.

III. *Conclusion*

For the reasons stated above, the court concludes that the bankruptcy court erred in holding that § 362(a)(3) prevents the bondholders and the Indenture Trustee from voting the pledged shares to replace Marvel's board of directors unless they first seek and obtain relief from the automatic stay. Chase urges the court to sustain the TRO issued by the bankruptcy court on the alternative ground that the bondholders and the Indenture Trustee should be enjoined under § 105(a), or at least remand this matter to the bankruptcy court for further consideration of appellees' motions for a TRO under § 105(a). The bankruptcy court, however, denied appellees' motions for a TRO under § 105(a) on the ground that they failed to show "irreparable harm," as required for injunctive relief under § 105(a), *see In re Wedgewood Realty Group, Ltd.*, 878 F.2d 693, 700–01 (3d Cir.1989), and appellees have not appealed that ruling. Accordingly, the court will vacate the bankruptcy court's March 24, 1997 order. The court will,

however, provide that the effect of this decision be delayed for 10 days in order to allow appellees to apply to the bankruptcy court for such relief as they may deem appropriate.

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TAB 13

151 B.R. 739
United States District Court, S.D. West Virginia.

In re HECK'S PROPERTIES, INC., Debtor in Possession.
Appeal of The OFFICIAL COMMITTEE OF EQUITY SECURITY
HOLDERS OF HECK'S, INC., Appellant. (Five Cases)
In re HECK'S, INC., Debtor in Possession. (Three Cases)
In re TAUBERG COMPANY, Debtor in Possession.
In re HECK'S PROPERTIES II, INC., Debtor in Possession.
Appeal of BERLACK, ISRAELS & LIBERMAN, Appellant.

Civ. A. Nos. 2:89–0226 to 2:89–0229, 2:89–0451 and 2:90–0223. | March 26, 1992.

Counsel for equity security holders' committee in Chapter 11 case sought compensation. The Bankruptcy Court, Ronald G. Pearson, J., partially denied compensation, and imposed sanctions, 112 B.R. 775, and counsel appealed. The District Court, Copenhaver, J., held that: (1) counsel were entitled to compensation for appeal by accountants, increase in associate fees, fee application preparation, application for appointment of operating trustee, and application to compel stockholders meeting; (2) counsel were not entitled to compensation for intervention in debtor's breach of contract action, analysis of accounting documents, summarization of pleadings, duplicative fraudulent conveyance research, preparation of written position statements, motion for setoff, and action against debtors' officers and directors; (3) officers and directors were entitled to indemnification from debtor for costs incurred defending state court action; and (4) remand was necessary to determine whether sanctions were warranted.

So ordered.

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William F. Dobbs, Jr., Jackson & Kelly, Charleston, WV, for Trade Committee.

Marc E. Richards, Mierson & Kuhn, New York City, for Members of the Bd. of Directors of Heck's, Inc.

John Nesius, Asst. U.S. Trustee, Charleston, WV.

John R. Isaac, Jr., Heck's, Inc., Guy F. Hanna, Heck's, Inc., Nitro, WV, P. Michael Pleska, Bowles, Rice, McDavid, Graff & Love, Charleston, WV, Scott L. Hazan, Otterbourg, Steindler, Housten & Rosen, New York City, Alvin J. Hardee, Jr., Credit Manager, Murray Ohio Mfg., Brentwood, TN, Charles F. O'Hanlon, III, Mellon Bank, N.A., Pittsburgh, PA, Charles I. Jones, Jr., Campbell, Woods, Bagley, Emerson, McNeer & Herndon, Charleston, WV, Joseph M. Scott, Jr., Stoll, Keenon & Park, Lexington, KY, Karl M. Henkels, Credit Manager, Outdoor Sports, Dayton, OH, for various interested parties.

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*743 MEMORANDUM ORDER

COPENHAVER, District Judge.

The appellant, Berlack, Israels & Liberman (hereinafter, "BI & L"), is now before the court in these consolidated appeals from three orders [1] entered by the United States Bankruptcy Court for the Southern District of West Virginia. The orders appealed from, BI & L contends, improperly denied it fees and expenses incurred during the course of its legal representation of the Equity Security Holders' Committee of Heck's, Inc., in the amount of $210,662.45, and imposed sanctions upon it in the amount of $149,178.25,[2] for a cumulative penalty of $359,840.70. The court notes that the fees and expenses denied are actually $214,362.45[3] and, when added to the sanctions of $149,178.25, the aggregate is $363,540.70.

1 The three orders appealed from include a February 21, 1990, 112 B.R. 775, "Final Fee Order" and corresponding 75–page memorandum opinion authored by United States Bankruptcy Judge Ronald G. Pearson (hereinafter, "Final Fee Order").

For the purposes of this appeal, appellant's objections to that order are consolidated with its appeal of a February 7, 1989, order entitled "Order Overruling Objection of the Equity Security Holders' Committee ..." (hereinafter, "First Indemnification Order"), and a March 29, 1989, order entitled "Order Approving Payment by the Debtor of Certain Legal Fees and Expenses Incurred by its Directors" (hereinafter, "Second Indemnification Order"). In those orders, the bankruptcy court directed Heck's to indemnify

its officers and directors for legal expenses incurred in defending litigation filed by BI & L, as counsel for the Equity Security Holders' Committee, against them in Putnam County Circuit Court.

2 Of the $149,178.25 sanctions imposed, $91,582.25 represented the amount which Heck's paid to indemnify its officers and directors for costs incurred in the defense of litigation filed by BI & L on behalf of the Equity Security Holders' Committee against the officers and directors alleging post-petition breach of fiduciary duty. The remaining $57,596.00 represented the amount of fees sought for work performed by BI & L partner, Robert Miller, which the bankruptcy court concluded was "rendered inconsistent with the requirements of Bankruptcy Rule 9011 and Administrative Order III, and which threatened the very possibility of reorganization." *See* Final Fee Order, 112 B.R. at at 808.

3 The $214,362.45 includes $3,800.00 in connection with the ABN litigation, *infra* pages 749–50, less an inadvertent computation error of $100.00 in the bankruptcy court's Final Fee Order as noted *infra* at page 754.

I. *Background*

On March 5, 1987, Heck's, Inc., and three of its subsidiaries filed voluntary petitions for bankruptcy relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.* (hereinafter, "the Code"). After the filing of the voluntary petitions, Heck's and its subsidiaries continued in the possession of their properties and the operation of their businesses as debtors-in-possession (hereinafter, "DIP" ***744** or "Heck's") pursuant to Sections 1107 and 1108 of the Code.

During the course of the Heck's bankruptcy case, three committees were appointed to represent creditors: (1) the Unsecured Trade Creditors' Committee which represented Heck's trade creditors (hereinafter, "Trade Committee"), (2) the Bank Committee which represented Heck's bank creditors (hereinafter, "Bank Committee"), and (3) the Equity Security Holders' Committee which represented Heck's common stockholders (hereinafter, "Equity Committee"). Appellant BI & L was, pursuant to order of the bankruptcy court, authorized to represent the Equity Committee as legal counsel during the pendency of the Heck's bankruptcy case. It is observed that the bankruptcy court, despite having approved the employment of BI & L by order of May 1, 1987, subsequently denied the permanent employment of BI & L as counsel for the Equity Committee, concluding that BI & L had acted inconsistently with Administrative Order III in conjunction with, *inter alia,* its billing rates and practices and the quality of services rendered. *See* Bankruptcy Court's Order of October 19, 1987, stayed by order of this court on November 2, 1987. On February 4, 1988, this court reversed the bankruptcy court's denial of the permanent employment of BI & L, finding that the circumstances presented did not warrant depriving the Equity Committee of the privilege of selecting and continuing with its chosen counsel.

The bankruptcy court's final fee order appealed from focuses largely upon actions taken by BI & L on behalf of the Equity Committee during a relatively brief period in the Heck's reorganization case, namely June, 1988, through October, 1988. BI & L contends that, during that period Heck's, as debtor in possession, and its other two official committees, the Bank and Trade Committees, were negotiating intensively in an effort to draft a non-consensual plan of reorganization, while excluding the Equity Committee from the negotiations to the detriment of the Heck's shareholders. During the course of those negotiations, BI & L contends, the debtor proposed a non-consensual plan of reorganization which would have diluted the shareholders' interests to 10% of the company, while granting Heck's senior management 5% of the stock of the reorganized company and other lucrative benefits.

According to BI & L, the Equity Committee was "outraged" by the proposed non-consensual plan, finding that it unfairly benefited management and the banks. Although negotiations were allegedly attempted between the Equity Committee and the debtor and its management, such negotiations proved to be of no avail, with BI & L asserting that senior management threatened to "cram down their self-serving plan on Heck's shareholders."

In light of the actions and positions taken by the debtor and the two other committees, BI & L contends that the Equity Committee, through BI & L, took immediate steps to protect its constituents' interests prior to a disclosure hearing which was scheduled to occur on October 12, 1988. These steps included "accelerated discovery" of the debtor and Bank and Trade

Committees, which discovery, BI & L states, "confirmed that ... projections contained in [Heck's] first Disclosure Statement and Plan of Reorganization were too optimistic." *See* Brief of BI & L, p. 13.

On September 19, 1988, the Equity Committee and three of its individual members/shareholders filed an action against Heck's in the Circuit Court of Putnam County, West Virginia, seeking an order to compel Heck's to hold an annual shareholders' meeting. The individual shareholders also brought a separate complaint in the same state court against senior management and certain of Heck's directors for post-petition breach of fiduciary duty and duty of loyalty and good faith. On October 4, 1988, the Equity Committee moved the bankruptcy court for the appointment of an operating trustee, based upon an analysis of the full magnitude of Heck's losses by the accountants for the Equity Committee, Laventhol & Horwath. BI & L served as counsel in pursuing all of these proceedings.

***745** According to BI & L, the filing of the Putnam County litigation ultimately resulted in "intensive and expedited settlement discussions" which culminated in an agreement being reached on a consensual plan of reorganization. It asserts that, under that agreement, the distribution of common stock to Heck's shareholders increased from 10% to 35%, and that, as part of that agreement, the Equity Committee withdrew, without prejudice, the Putnam County litigation and the motion for appointment of a trustee. BI & L also contends that it voluntarily agreed to reduce a portion of its fees by 20%, from $243,659.60 to $194,927.68, and that each of the parties, including the Bank Committee, agreed in turn to withdraw objections previously posed to BI & L's fee requests.

II. *General Issues*

In this appeal, BI & L contends that the bankruptcy court committed reversible error in denying substantial portions of the legal fees sought for work which BI & L performed on behalf of the Equity Committee, arguing that the bankruptcy court denied it due process in connection with its final fee application, failed to apply the proper legal standards in resolving the propriety of its fees, and based the subject fee denials upon faulty legal conclusions and findings of fact. BI & L further argues that the bankruptcy court's imposition of sanctions under Rule 9011 of the Code constitutes reversible error, contending that the bankruptcy court had no jurisdiction to subtract from its fees the amount which Heck's paid to indemnify its officers and directors and, further, that the officers and directors of Heck's had no right to indemnification in the first instance. Moreover, BI & L contends that the bankruptcy court could not properly sanction it pursuant to Code section 9011 for conduct and advice rendered to and on behalf of the Equity Committee in state court, and that the sanctions were improperly imposed by the bankruptcy judge without notice or a hearing, thereby depriving BI & L of due process.

In response to the arguments posed by BI & L, responsive briefs in opposition have been filed by the United States Trustee, and by the official Bank Creditors' Committee. Both contend, *inter alia,* that the bankruptcy judge's specific denials of fees sought by BI & L were properly predicated upon factual findings that such services were either duplicative, unnecessary, or unreasonable. Likewise, both assert that BI & L was not denied due process by the bankruptcy court's denial of fees, nor by the imposition of fee shifting and fee forfeiture sanctions against BI & L.

In resolving the issues presented in this appeal, the court will first consider the propriety of the bankruptcy court's denial of legal fees and expenses sought by BI & L, and, secondly, whether the bankruptcy judge's imposition of sanctions against BI & L was in error.

III. *Denial of Fees*

[1] **[2]** Compensation for legal services rendered in bankruptcy cases is governed by section 330 of the Bankruptcy Code which provides that a bankruptcy judge may award:

> [R]easonable compensation for actual, necessary services rendered by such ... professional person, or attorney as the case may be, and by any paraprofessional persons employed by such ... attorney ... based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; and ... reimbursement for actual, necessary expenses.

See 11 U.S.C. § 330(a). The professional requesting an award of fees for legal services rendered bears the burden of establishing that his services were actual, necessary and reasonable as required by section 330. *See In re Pettibone Corp.*, 74 B.R. 293 (Bkrtcy.N.D.Ill.1987); *In re Wildman*, 72 B.R. 700 (Bkrtcy.N.D.Ill.1987). Actual services are those services which were actually rendered,[4] while necessary services are those rendered by a professional in ***746** furtherance of an official committee's duties under section 1103 of the Code and in line with its constituents' interests in the case. *See In re Pettibone*, 74 B.R. 293; *In re Emons Industries, Inc.*, 76 B.R. 59 (Bkrtcy.S.D.N.Y.1987). If professional services are found to have been actual and necessary, the "reasonableness" of the fees sought may be evaluated in accordance with the standards set forth in *Harman v. Levin*, 772 F.2d 1150 (4th Cir.1985), and *Barber v. Kimbrell's, Inc.*, 577 F.2d 216 (4th Cir.1978), *cert. denied*, 439 U.S. 934, 99 S.Ct. 329, 58 L.Ed.2d 330 (1978).

4 That the services for fees sought by BI & L here were "actual" is not an issue in these appeals.

A. Determination of Necessary Services

Although both BI & L and the Bank Committee agree that, pursuant to section 330, professional services must be shown to have been actual, reasonable, and necessary, the parties differ as to how the "necessity" of such services is to be ascertained. According to BI & L, whether a service was "necessary" turns fundamentally upon whether such services were rendered in furtherance of the committee's statutory rights and duties under section 1103.

Pursuant to section 1103, an official committee may:

(1) consult with the trustee or debtor in possession regarding the administration of the case;

(2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of the plan;

(3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan;

(4) request the appointment of a trustee or examiner under section 1104; and

(5) perform such other services as are in the interest of those represented.

See Bankruptcy Code § 1103(c).

According to BI & L, the authority granted by section 1103 is quite broad, and "[i]f a committee determines to pursue any activity within the vast expanse of section 1103, and if the committee asks counsel for assistance, then counsel's services are 'necessary' and compensable." *See* BI & L's Brief, at p. 28. It argues that, although the bankruptcy court's final fee order in this case recognized the applicability of the necessary standard, the court "glossed over the fact that the Equity Committee directed BI & L to perform the services at issue." BI & L also argues that the bankruptcy court never inquired into the reasonableness of the services rendered but instead "denied fees with a broad brush."

Both the Bank Committee and United States Trustee argue, on the other hand, that it is the bankruptcy judge who, pursuant to section 330, has the discretion to determine the necessity of services rendered by BI & L and other professionals employed in

the case, based upon his own hindsight, experience, observations and expertise, inasmuch as the payment of the fees sought ultimately come from the debtor's estate.

[3] It is well-settled that legal services which are "necessary" under section 330 are those which are rendered to an official committee in connection with the committee's duties under section 1103. *In re Pettibone,* 74 B.R. 293, at 308. It is equally well-settled that the bankruptcy court retains ultimate responsibility for ensuring that the compensation awarded to professional persons falls within the parameters prescribed by section 330 of the Code, *see generally* 2 *Collier on Bankruptcy,* ¶ 328.02 at 328–8 (15th ed. 1986). Likewise, it is the court which must ultimately determine whether compensation sought is for actual, necessary and reasonable services. *See, e.g., In re Temple Retirement Community, Inc.,* 97 B.R. 333, 336 (Bkrtcy.W.D.Tex.1989); *In re Pettibone,* 74 B.R. 293 (Bkrtcy.N.D.Ill.1987).

The court in *In re Pettibone* rejected an argument identical to that posed by BI & L in this case that work is "necessary" merely because it was done at the behest of the committee client. *Id.* Finding that Sections *747 327 through 331 of the Code "explicitly provide for the court's active role throughout the employment and compensation process," the *Pettibone* court held:

> [T]he very fact that court review of fee applications is required by Section 330 indicates that it is the court that must determine necessity. If necessity were defined by the committee client, the requirements of Section 330 would be meaningless. Review by the court would then entail mere reading of an affidavit by the client that all work was done at its request. Such a result would defeat the purpose of court review under Section 330. The statutory scheme thus demonstrates that the Court must review after the fact all services for which compensation to professionals is sought. It is the court, not the client, that ultimately determines the necessity of particular work based upon hindsight and the court's experience, observations and expertise.

74 B.R. at 308, citing *In re Liberal Market, Inc.,* 24 B.R. 653 (Bkrtcy.S.D.Ohio 1982).

The court concludes that the question of whether services rendered by BI & L were "necessary" is one which was properly considered and passed upon by the bankruptcy judge in light of his experience, observations and expertise. To accept the argument posed by BI & L that necessity is determined by the directives of the committee for which the professional services were performed rather than by the bankruptcy court would be inconsistent with the statutory scheme set forth in the Code regarding the bankruptcy court's role in the employment and compensation process, and would defeat the fundamental purposes underlying section 330.

B. Section 330(a) Notice and Hearing

[4] BI & L contends that the bankruptcy court deprived it of due process in connection with its final fee application inasmuch as the court failed to hold a hearing before "slashing" BI & L's fees in the court's final fee order. BI & L insists that due process requires that such a hearing be held concerning fee applications submitted by professionals in a bankruptcy case, citing Code section 330(a)(1); *American Benefit Life Ins. Co. v. Baddock,* 544 F.2d 1291, 1300 (5th Cir.), *cert. denied,* 431 U.S. 904, 97 S.Ct. 1696, 52 L.Ed.2d 388 (1977); *In the Matter of Union Cartage Co.,* 56 B.R. 174, 178 Bkrtcy.N.D.Ohio 1986). BI & L further notes that the bankruptcy judge recognized the due process requirements relative to fee awards in cases such as this and stated in an order dated August 17, 1989, that:

> The Court is currently in the process of setting final rates of compensation for all professionals who have performed services in these cases and intends to provide notice of such rates and opportunity for response prior to any final order on compensation of professionals.... [I]t being the Court's intention to provide notice and opportunity for comment or hearing as outlined above, ...

See Bankruptcy Docket No. 3462.

The Bank Committee and Trustee argue, on the other hand, that the bankruptcy court gave BI & L all the process it was due in connection with its denial of fees, noting that, in an order dated September 22, 1989, the bankruptcy judge took under consideration the allowance of final fees of attorneys and other professionals working in the Heck's case, along with objections which had been posed to those requests. In the September 22nd order, the court directed that objections to professional fees previously requested should be filed in writing on or before 5:00 p.m. on October 6, 1989. *See* Bankruptcy Docket No. 3560.

The Bank Committee accordingly filed its objections to BI & L's fee requests, alleging, *inter alia,* unnecessary and improper work performed by BI & L, and a memorandum of law in support of its objections. In a subsequent order dated October 30, 1989, the bankruptcy judge took the fee objections under advisement and directed BI & L to respond to the fee objections on or before November 19, 1989.

BI & L did, in fact, file its response to the objections posed by the Bank Committee to BI & L's fee requests. It did not, however, request that a hearing be held on the objections which had been raised, its ***748** responses thereto, or on its final fee application which was filed contemporaneously with its response to the Bank Committee's objections. Thereafter, on February 21, 1990, the bankruptcy judge entered his final fee order and memorandum opinion which denied the legal fees and expenses which are central to this appeal.

Section 330(a) of the Code expressly provides that "after notice to any parties in interest and to the United States Trustee and a hearing ... the court may award to ... a professional person employed ... reasonable compensation for actual, necessary services." It is observed that "after notice and a hearing" as referenced in section 330(a) is specifically defined in section 102 of the Code as follows:

> (1) "after notice and a hearing", or a similar phrase—
>
> (A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but
>
> (B) authorizes an act without an actual hearing if such notice is given properly and if—
>
> (i) such a hearing is not requested timely by a party in interest; or
>
> (ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act.

11 U.S.C. § 102(1). Section 330(a) defines the phrase "after notice and a hearing" merely to mean after such notice as is appropriate in the particular circumstances and does not mean that there will be a hearing in the absence of a request therefor. 2 *Collier on Bankruptcy* ¶ 330.03 at 330–13 (15th ed. 1991).

The bankruptcy court having specifically advised counsel by its September 22, 1989, order that it was taking into consideration the allowance of final fees, and having further informed counsel that it was taking under advisement objections which had been filed to the fee applications and having directed that responses to those objections could be filed on or before November 19, 1989, BI & L was given reasonable and adequate notice under the circumstances. That a hearing was not thereafter provided to BI & L in conjunction with its final fee application did not deprive BI & L of due process inasmuch as it did not request such a hearing and inasmuch as it was given the opportunity to respond, and in fact did respond, to the objections which had been posed to its fee requests prior to the court's entry of the final fee order.

C. Denial of Fees and Expenses Aggregating $214,362.45

It is well-established that the bankruptcy court's findings of fact will not be disturbed unless clearly erroneous. *See* Bankruptcy Rule 8013. Under the "clearly erroneous" standard of review, "findings of fact will be affirmed unless [the appellate court's] review of the entire record leaves [it] with the definite and firm conviction that a mistake has been committed." *Harman v. Levin,* 772 F.2d 1150, 1153 (4th Cir.1985). The bankruptcy court's conclusions of law will, of course, be reviewed *de novo.*

1. ***Fees for Intervention in Breach of Contract Action***

[5] BI & L complains that the bankruptcy court improperly denied it legal fees related to its efforts to intervene in an action filed in the United States District Court for the Southern District of West Virginia by the debtor-in-possession against Algemene Bank, Nederland, N.V. (hereinafter, "ABN litigation"). In its motion filed August 7, 1987, the Equity Committee asserted an unconditional right to intervene in the ABN litigation under Rule 24(a)(1) of the Federal Rules of Civil Procedure and, alternatively, sought to intervene permissively pursuant to Rule 24(b)(2).

The bankruptcy court's final fee order noted that the Equity Committee's intervention into the ABN litigation was attempted "without leave of the bankruptcy court to permit expansion of counsel's appointment in the bankruptcy case, without notice to creditors of the proposed intervention, and without the capacity as a committee appointed under 11 U.S.C. § 1102 to ***749** assert a cause of action belonging to a debtor-in-possession who was already represented by counsel." The court stated:

> The DIP was asked to pay for numerous hours of time Equity Committee counsel spent in misguided and unnecessary intervention effort. In August and September, 1987, BIL billed $10,383.00; in October, 1987, $2,300.00; and in November, 1987, $1,500.00 for services relating to the ABN litigation. This Court denied each of the above fee requests because the DIP's interests were represented by counsel for the DIP and the work of the Equity Committee was duplicative of that of counsel for the DIP. Although the Equity Committee appealed the denial of the $10,383.00, no appeal was filed of the later denial of fees related to this issue.

See Final Fee Order, 112 B.R. at p. 789.[5]

5 By order of this court dated June 8, 1988, the amount of $10,383.00 was remanded to the bankruptcy court for reconsideration pending ruling by this court on the motion to intervene. Ultimately, the motion to intervene was rendered moot by virtue of this court's order of October 4, 1989, dismissing the ABN litigation pursuant to agreement of the parties.

In denying BI & L fees for services rendered incident to the intervention efforts, the court concluded that there was no basis for intervention of right under Rule 24(a) inasmuch as sections 1103 and 1109 of the Bankruptcy Code do not statutorily provide for a right on the part of the Equity Committee to intervene in such an action, nor does any other provision of law provide such a right. The bankruptcy judge also reasoned that "[t]he pursuit of the corporation's interests by the DIP precluded intervention as a matter of right under Rule 24(a)(2) because the stockholders' interests were being adequately represented."[6]

6 Intervention of right under Rule 24(a) is proper when

> (1) ... a statute of the United States confers an unconditional right to intervene; or (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

Rule 24(a), Fed.R.Civ.P.

As the bankruptcy court observed, section 1109 of the Bankruptcy Code provides that "a party in interest, including ... an equity security holder ... may raise and may appear and be heard on any issue in a case under this chapter." 11 U.S.C. § 1109. Noting that the courts are split on the issue of whether section 1109 confers standing upon a committee to initiate an adversary proceeding under Rule 7001, the bankruptcy court observed that where standing has been deemed conferred, "it is generally conditioned on the committee's bringing the suit on behalf of the debtor when the debtor is not adequately pursuing the cause of action," *citing Louisiana World Exposition v. Federal Ins. Co.*, 858 F.2d 233 (5th Cir.1988); *In re STN Enterprises*, 779 F.2d 901 (2d Cir.1985), *on remand*, 73 B.R. 470 (Bkrtcy.D.Vt.1987), *reversed on other grounds*, 99 B.R. 218 (D.Vt.1989). Because the bankruptcy court found that the debtor-in-possession was pursuing the ABN litigation and was adequately representing Heck's shareholders' interests, it concluded that, as pertains to services rendered by BI & L seeking intervention as of right, the fees sought should be denied.

Similarly, the bankruptcy court concluded that BI & L's efforts to permissively intervene in the ABN action were improper and not compensable out of the bankruptcy estate. In that regard, the court reasoned that Rule 24(b) renders permissive intervention appropriate only if "an applicant's claim or defense and the main action have a question of law or fact in common." The court noted that the complaint filed by the Equity Committee with its motion to intervene "states no claim at all!", *see* Final Fee Order, 112 B.R. at p. 790, and concluded, "[b]ecause the injury complained of was to the corporation, the cause of action, if one existed, was the DIP's to pursue for benefit of creditors and shareholders."

The bankruptcy court further noted that BI & L, on behalf of the Equity Committee, ***750** could properly have monitored the work performed by counsel for the DIP to ensure that proper actions were being taken by the DIP in furtherance of the litigation. Inasmuch as $3,000.00 of requested fees had already been allowed BI & L which was commensurate with the amounts paid to other firms which had billed for monitoring the DIP effort, the court denied compensation to BI & L for the remaining $10,383.00 which had been remanded for reconsideration by this court, and affirmed its previous denials in the amount of $3,800.00 which had not been appealed by BI & L.

In these consolidated appeals, BI & L asserts, without citation, that "abundant authority" exists to support the Equity Committee's request to intervene in the ABN litigation. Arguing that its work was "undeniably performed at the direction of the Equity Committee, which acted in furtherance of a legitimate duty and purpose," BI & L urges this court to find its fee requests relative to work performed on the intervention efforts to be compensable and to reverse the bankruptcy court's conclusion to the contrary.

The bankruptcy court's findings of fact relative to the compensability of fees sought in conjunction with the intervention efforts —namely that such efforts were unnecessary—was not clearly erroneous. The denial of compensation is affirmed.

2. *Fees Sought for BI & L's Analysis of Sullivan & Cromwell Documents Relating to Accounting Liability*

[6] BI & L argues that the bankruptcy court's denial of fees relative to the time spent by its attorneys reviewing documents produced by Sullivan & Cromwell and Peat Marwick Main & Co. in connection with an alleged accounting failure constitutes reversible error. Arguing that the bankruptcy court authorized the Equity Committee's request to take discovery relating to accounting system failures, BI & L asserts: "[h]aving received court approval, BI & L reviewed notes and related documents from hundreds of interviews conducted for Heck's by Sullivan & Cromwell." *See* BI & L Brief, at p. 39.

In considering the compensability of the $12,012.50 sought by BI & L for this work, the bankruptcy judge observed that one BI & L lawyer spent 8.9 hours while another spent 68.6 hours reviewing the subject documents, and that 26.3 hours generating $4,076.50 in billable dollars were specifically spent in preparation of a memorandum which "no one outside of BI & L ever saw ..." The court concluded that "neither the fee application of BIL nor its response to the Bank Committee's objection demonstrates the necessity of this work."

Although acknowledging that it had previously permitted BI & L to inspect the Sullivan & Cromwell documents, *see* Bankruptcy Docket Nos. 931–933, the bankruptcy court found that the amount of time spent on review by BI & L was "out of line with reason." *See* Final Fee Order, 112 B.R. at p. 791. The court allowed 15 hours of compensable time, or $2,250.00, and denied the remainder of fees charged in connection with the activity in the amount of $9,762.50 as unnecessary.

[7] The burden of proof in all fee matters is upon the applicant, *see, e.g., In re Lindberg Products, Inc.*, 50 B.R. 220, 221 (Bkrtcy.N.D.Ill.1985); *In re Harman Supermarkets*, 44 B.R. 918, 920 (Bkrtcy.W.D.Va.1984), and this burden is not to be taken lightly, "especially given that every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors or use by the debtor." *See In re Pettibone*, 74 B.R. at 299, citing *In re Hotel Associates, Inc.*, 15 B.R. 487, 488 (Bkrtcy.E.D.Pa.1981). Moreover, it has been recognized that attorneys are not to be fully compensated for spending an unreasonable number of hours on activities of little benefit to the estate, *see In re Wildman*, 72 B.R. 700, 713 (Bkrtcy.

N.D.Ill.1987), and that the bankruptcy court must determine what is the reasonable amount of time an attorney should have to spend on any given project. *In re Shades of Beauty,* 56 B.R. 946, 951 (Bkrtcy.E.D.N.Y.1986).

*751 The bankruptcy court's determination that the number of hours spent by BI & L with respect to the Sullivan & Cromwell documents in excess of fifteen hours was unnecessary was not clearly erroneous. The denial of such fees in the amount of $9,762.50 is affirmed.

3. *Fees Sought for Review and Summaries of Pleadings*

[8] The bankruptcy judge stated in his final fee order that "associates at BIL read and prepared daily summaries of virtually every document filed in this case." The court concluded that such activity was "beyond the scope of diligence," and that BI & L attorneys should have exercised greater discretion over the extent to which the summarization of pleadings was utilized. The bankruptcy judge, noting that the fee applications of BI & L as well as its response to the objections of the Bank Committee failed to show that all of the summaries prepared by BI & L associates were necessary, denied $20,000.00 of the $30,696.00 requested for reviewing and summarizing pleadings, with the denied amount representative of the time which the court found was "unnecessary work."

BI & L states that it assigned one associate to review "all documents and pleadings received by the firm and to write brief descriptions and analyses" for circulation to the Equity Committee and to the other BI & L attorneys working on the case. While BI & L points out that the bankruptcy court's finding that summaries were prepared "daily" was erroneous, it acknowledges that the summaries were prepared a few times each month.

In *In re Pettibone,* the court concluded that "fees are not allowable for simply reading the work product of another lawyer as a matter of interest," and that "[o]nly if such review is required to form some kind of response or to perform a particular task in the case will document review be compensable." 74 B.R. at 303. Here, the bankruptcy judge acknowledged that at least a portion of the time spent by BI & L associates was necessary and thus compensable. He determined, however, that less than one-half of the time charged for document review and summarization was necessary service. *See In re Pettibone,* 74 B.R. at 308. This court is unable to conclude that the bankruptcy court's finding in this regard was clearly erroneous.

4. *Fees Sought for Review of Net Operating Loss by Tax Partners*

[9] The bankruptcy court denied a portion of fees sought by BI & L in conjunction with the review of net operating loss material by one of BI & L's partners, Harvey Berenson. [7] The court reasoned that one of BI & L's associates, Steven Whitmore, also conducted a review of the same material and attended meetings with the DIP and other counsel to obtain changes in the Plan, and that, in its fee applications and response to objections by the Bank Committee, BI & L had failed to show why Berenson's work was necessary. [8] The court denied $4,140.00 in charges by Mr. Berenson as duplicative and unnecessary.

7 This review was conducted during November and December, 1988, and January, 1989.

8 BI & L's fee applications reflect that, on November 27, 1988, attorney Whitmore researched the net operating loss materials. *See* Fee Application at 2890. Attorney Berenson's review followed. Other BI & L attorneys also logged time for reviewing apparently the same materials and issues. *See* Fee Applications at 2272 and 2603.

[10] A debtor's estate should not bear the burden of duplication of services, and such duplication should be avoided by counsel on their own initiative by exercise of good "billing judgment." *See Pettibone,* 74 B.R. at 303. "If found in the record, duplication shall be disallowed by the court as unnecessary." *Id.,* citing *In the Matter of Liberal Market,* 24 B.R. 653, 664 (Bkrtcy.S.D.Ohio 1982).

BI & L observes that "the Equity Committee wisely instructed BI & L to keep abreast of certain tax issues critical to the plan formulation process," and that, consequently, BI & L used a tax partner "with extensive bankruptcy tax experience." According *752 to BI & L, the work was, by definition, necessary.

The court concludes that, although BI & L could reasonably have utilized the services of one attorney with "extensive bankruptcy experience," it has failed to sufficiently explain in its fee applications, in its response to the Bank Committee's objections, or in its brief in support of this appeal why the apparent duplication of services with regard to net operating losses was necessary. The burden of proof was upon BI & L to establish its entitlement to the fees in question and, having reviewed its fee applications for the months in question, the court is unable to conclude that the bankruptcy court's denial of Berenson's fees on the net operating loss issue as duplicative was clearly erroneous. The denial of fees of $4,140.00 is affirmed.

5. *Fees Sought for Fraudulent Conveyance and Preferential Transfer Research*

[11] The bankruptcy court denied a major portion of the fees sought by BI & L in conjunction with research performed by BI & L attorneys in April and May, 1988, on the issues of preferential transfer and fraudulent conveyances. In doing so, the court correctly observed that standing may be conferred upon a committee pursuant to § 1109(b) of the Bankruptcy Code to initiate or intervene in an adversary proceeding where the debtor has failed to bring an action or is inadequately representing the estate. It noted, however, that there is no implied right to do so where there is no evidence that the debtor has improperly failed to bring an action or is abusing its discretion in representing the estate.

The bankruptcy judge concluded that it was the duty of counsel for the debtor-in-possession to have conducted the preferential transfer/fraudulent conveyance research, and that in the Heck's case, the debtor apparently did, in fact, do so inasmuch as a plan filed in August, 1988, "compromised a preference claim against the Bank Committee." *See* Final Fee Order, 112 B.R. at 792, apparently referring to a claim against certain members of the Bank Committee. Concluding that a portion of the fees sought by BI & L for work performed by Arlene Koval, one of several BI & L attorneys who researched "appears to have been duplicative," and that BI & L had failed to explain in its response to the Bank Committee's fee objection how such work was not duplicative, the court denied $1,339.00 of the $5,125.00 of fees sought by BI & L for that work.

A review of the bankruptcy records reflects that, prior to Ms. Koval's recorded 10.3 hours of research on fraudulent conveyances, two other BI & L associates and one legal assistant had logged time reviewing cases and issues regarding preferential transfers and fraudulent conveyances, and had conferred with partner Robert Miller and one another at various times regarding the same. *See* Bankruptcy Docket Nos. 1989, 2071, 3596. BI & L argues, in opposition to the objections raised by the Bank Committee, that its time entries "have been deliberately misconstrued ... to suggest duplication." The research efforts by its attorneys was not duplicative, BI & L argues, because each of the attorneys was researching separate and distinct issues. Bankruptcy Docket No. 3693.

Having independently reviewed the subject fee statement entries regarding the preferential transfer and fraudulent conveyance research in question, the court observes that certain of the time entries do, as BI & L argues, indicate that different subissues pertaining to preferential transfer and fraudulent conveyance were researched by the several attorneys logging time for such work. Not all entries are so explicit, however, and it was not clearly erroneous for the bankruptcy judge to have denied as duplicative a portion of the fees sought for closely related research by three separate attorneys.

As noted previously, the burden of proof to show entitlement to fees is, in all fee matters, on the applicant. *See, e.g., In re Metro Transportation Co.*, 107 B.R. 50, 51 (E.D.Pa.1989); *In re Pettibone*, 74 B.R. at 299. The court concludes that the bankruptcy court's denial of $1,339.00 of the *753 $5,125.00 sought for such work was not clearly erroneous.

6. *Fees Sought for Preparation of Statements of Position*

[12] The bankruptcy court also denied compensation requests by BI & L for preparation of written statements of position which the court concluded "did not significantly affect the interests of equity security holders." Final Fee Order, 112 B.R. at

792. Specifically, $4,379.89 in fees was denied for those months in which the court found that "BIL also attended hearings and verbally announced the position of the Equity Committee," rendering the written position statements to have been duplicative and unnecessary work.

BI & L asserts that, at an earlier chambers conference, the bankruptcy judge "complimented BI & L on these position statements and urged other committees to use this format." It contends that, in addition to its efforts on behalf of the Equity Committee, the Trade Committee also prepared written position statements throughout the remainder of the case and that, to its knowledge, "the lower court did not penalize the Trade Committee's counsel for the same conduct."[9]

9 BI & L does not, however, provide this court with any record references by which it can be verified whether, and to what extent, the Trade Committee's counsel sought compensation for such services.

[13] Fees should be closely scrutinized with a view toward eliminating excessive or wasteful services and expenditures of professional time. *See In the Matter of Liberal Market, Inc.*, 24 B.R. 653, 658 (Bkrtcy.S.D.Ohio 1982). Having previously observed that unnecessary duplication of services should be avoided by counsel, it follows that if the court finds a duplication of effort on the part of professionals seeking compensation from the bankruptcy estate, fees sought in conjunction therewith should be disallowed by the court as unnecessary. *See In re Pettibone,* 74 B.R. at 303, citing *In the Matter of Liberal Market, Inc.*, 24 B.R. 653, 664 (Bkrtcy.S.D.Ohio 1982).

Finding that BI & L's fee statements, response to the Bank Committee's objections, and brief on appeal fail to adequately explain why both the written and oral presentation of position were not duplicative, the court concludes that the bankruptcy court's denial of $4,379.89 in fees sought for the preparation of written position statements was not clearly erroneous.

7. *Fees Sought for Analysis of Motion for Setoff*

The bankruptcy court denied $6,400.00 of the $8,000.00 in fees charged by BI & L for the Equity Committee's brief opposing the motion for setoff by Pittsburgh National Bank. The two and one-half page brief so filed was found by the court to have been filed late and to be "much less comprehensive than one filed by counsel for the Trade Committee, who charged much less for their work," the court further finding the BI & L brief to have been duplicative and unnecessary. This court, in its order of February 4, 1988, observed that substantial basis existed for somewhat similar findings by the bankruptcy court with respect to this same matter. The denial of fees to the extent of $6,400.00 is not clearly erroneous.

8. *Fees Sought for Appeal by Laventhol & Horwath*

[14] The bankruptcy court denied fees of $1,542.24 and expenses of $614.25 for court reporter and filing fees with respect to BI & L's participation in the joint appeal of the Equity Committee and its accountants, Laventhol & Horwath, of the bankruptcy court's order pertaining to Laventhol & Horwath's accounting fees. The bankruptcy court did so on each of two grounds, the first being that BI & L's representation was outside the scope of its authorized employment as counsel for the Equity Committee and the second being that BI & L's services were unnecessary to the representation of the Equity Committee. To the contrary, it appears that the Equity Committee did engage BI & L for the purpose of representing the Equity Committee with respect to its joint appeal with its accounting firm, which appeared ***754** separately by its own in-house counsel. BI & L Brief at 44–45. It further appears that the modest fees and expenses involved were necessary in order for the Equity Committee to protect its continuing professional relationship with its accountants, Laventhol & Horwath. In view of these circumstances, the denial of compensation and reimbursement in the total amount of $2,156.49 was clearly erroneous.

9. *Motion of BI & L to Reconsider Order of August 11, 1987*

Upon reconsideration of fees in the amount of $27,780.00 earlier denied by the bankruptcy court's order of August 11, 1987, the court allowed $8,168.00, but persisted in its denial of the balance of $19,612.00.[10] In addition, the bankruptcy court adhered to its denial of $1,500.00 in expenses. The court's reasons for its continuing denial are aptly set forth in its order of February

21, 1990, 112 B.R. at pages 805–806. The denial of such fees and expenses in the total amount of $21,112.00 was not clearly erroneous.

10 Each of the latter two figures is inadvertently misstated by $100.00 in the bankruptcy court's Final Fee Order, 112 B.R. at page 806.

10. ***Increased Rates Sought by Certain BI & L Associates***

[15] The bankruptcy court denied a portion of the rates of compensation for two BI & L associates for services rendered during the last half of the bankruptcy case. This portion consisted of the increases in hourly rates by $20.00 for one associate and $30.00 for the other, aggregating $4,606.80. The bankruptcy court found "[n]o justification ... for increasing the rate ... especially in light of the meritless motions pursued at the direction of lead counsel." The bankruptcy court neither specified the motions to which it referred nor did it assign any other reason for its denial. Inasmuch as the bankruptcy case progressed over a period of two and one-half years and the billing rates for those two associates would be expected to increase during that period, no adequate reason for the denial has been assigned. The court concludes that the denial of these fees in the total amount of $4,606.80 was clearly erroneous.

11. ***Fees Sought for Fee Application Preparation***

[16] BI & L requested $36,758.80 for time spent in preparation of fee applications. For this purpose, the bankruptcy court limited each professional employed in the case to 3% of the total fees allowed to such professional. Based on total net compensation allowed BI & L of $336,447.67, the bankruptcy court allowed 3% or $10,093.43, and denied the remaining $26,665.37. The limitation of all professionals to the 3% standard in a case with fees of the magnitude of those presented here is deemed reasonable.[11] *See In re Pettibone,* 74 B.R. 293, 304 (Bkrtcy.N.D.Ill.1987); *In re Wildman,* 72 B.R. 700, 710–11 (Bkrtcy.N.D.Ill.1987).

11 The use of a percentage figure serves the utilitarian purpose of eliminating fee application preparation requests to the extent they relate to activities found noncompensable.

Inasmuch as the net compensation to which BI & L is entitled by virtue of the other rulings on this appeal has increased by $143,208.69, the allowable fees for this purpose are correspondingly increased by 3% of that sum, being $4,296.26. Additionally, the $91,528.25 in indemnification sanctions elsewhere dealt with on this appeal should not be used, as did the bankruptcy court, to lower the figure on which the 3% is calculated. Accordingly, 3% of $91,582.25, or $2,747.47, is also restored. The sum denied is thus reduced from $26,665.37 to $19,621.64.

12. ***Fees Sought for Pre–Disclosure Statement Hearing Litigation***

The bulk of BI & L's fees were denied for work undertaken during a twenty-six day period in September and October, 1988, prior to a scheduled disclosure statement hearing which was to be held on October 12, 1988. A review of the bankruptcy court's order and the briefs filed by the parties reflects that $98,317.50 in fees and *755 $1,299.90 in expenses, aggregating $99,617.40, were denied for that period. No enumeration of particular services rendered and fees denied in conjunction with those services is found, however, within the final fee order or the briefs submitted by the parties to this appeal.[12]

12 In similar sweeping fashion, the bankruptcy court denied fees of BI & L for the services of its partner and lead counsel in this case, Robert Miller, for the period from June 1, 1988, to September 30, 1989, in the amount of $57,596. *See, infra,* p. 770.

During the pre-disclosure statement period, BI & L served upon the DIP, the Trade Committee and the Bank Committee various motions, notices, objections and discovery requests, the "great majority" of which the bankruptcy judge ultimately concluded had been filed "purely for reasons of harassment, delay and intimidation." *See* Final Fee Order, 112 B.R. at 804.

In considering the compensability of BI & L's fee requests for September and October, 1988, the bankruptcy judge specifically analyzed, and in turn denied, all fees sought by BIL for work performed in conjunction with the filing on October 6, 1988,

of an emergency motion in bankruptcy court for the appointment of an operating trustee, and for the two actions filed on September 19, 1988, in the Circuit Court of Putnam County, West Virginia (hereinafter, "Putnam litigation"). The Putnam litigation was filed by the Equity Committee and its members, Steven Mizel, Willard H. Erwin, Jr., and Allen S. Tauber, who were also individual stockholders. One action was a petition to compel Heck's to hold an annual stockholders' meeting pursuant to W.Va.Code § 31–1–18(c), and the other was a complaint against the officers and directors of Heck's which alleged post-petition breach of fiduciary duty, loyalty and good faith.

(a) Application for Appointment of Operating Trustee

[17] The bankruptcy judge determined that work performed by BI & L relative to the emergency motion for appointment by the bankruptcy court of an operating trustee filed six days prior to the scheduled hearing on the disclosure statement was "purely for reasons of harassment, delay and intimidation." Accordingly, all fees requested by BI & L in conjunction with that effort were denied. *See* Final Fee Order, 112 B.R. at 804. [13]

13 Also filed was a motion for an expedited hearing on the issue, an affidavit of Laventhol & Horwath, accountants for the Equity Committee, and a memorandum of law. According to the bankruptcy judge's memorandum order, the motion for expedited hearing was granted and a hearing scheduled for October 11, 1988.

In support of its filing of the trustee motion, the Equity Committee submitted the affidavit of Melvin Rosenstrauch, a certified public accountant from the New York accounting firm of Laventhol & Horwath, which indicated that Heck's operating losses had dramatically accelerated in the period of June through September, 1988. The losses, the motion asserted, were due in part to a failed inventory purchase program which led to severe merchandise markdowns and dramatic decreases in gross margins, and to the inability of Heck's management to sell its merchandise at adequate levels of sales and gross margins to generate profitability. *See* Bankruptcy Docket No. 2490, citing Rosenstrauch Affidavit at ¶¶ 5–6. According to Rosenstrauch's affidavit, a combination of such factors led him to conclude that substantial operating losses would continue and that Heck's would shortly be forced into liquidation unless fundamental changes were immediately made in Heck's management and operations. *Id.* The Equity Committee further asserted that the facts and conclusions set forth by Rosenstrauch constituted "cause" for the immediate appointment of a Chapter 11 operating trustee on the grounds of incompetence or gross mismanagement of the affairs of the debtors by current management, 11 U.S.C. § 1104(a)(1), or, alternatively, as being in the interest of Heck's creditors and shareholders. 11 U.S.C. § 1104(a)(2). *See* Trustee motion at ¶ 5.

In denying all fees sought by BI & L for work on the trustee motion and supporting materials, the bankruptcy judge observed *756 that Maarten Hemsley, Chief Financial Officer of Heck's, Inc., had filed a counter-affidavit in opposition to the trustee motion and accompanying Rosenstrauch affidavit, wherein Hemsley asserted that the conclusions of the Equity Committee and its accountants had damaged public and supplier confidence in Heck's and that the Rosenstrauch affidavit had set forth incorrect financial conclusions and projections due to inadequate communication with the DIP's accounting professionals. The bankruptcy judge further noted that Hemsley complained in his affidavit that counsel for the Equity Committee, by not filing the trustee motion under seal, caused to be published confidential financial information about the DIP in breach of a confidentiality agreement between the DIP and the Equity Committee's accountants. *See* Final Fee Order, 112 B.R. at 797, citing in support Bankruptcy Docket No. 2515, Exhibit E, paragraph 9. Exhibit E, however, is not a confidentiality agreement between those parties; rather, it merely contains the unilateral statement by Hemsley that certain information being furnished by him to various parties is "confidential."

Shortly after the filing of the trustee motion and the Putnam litigation, settlement discussions ensued between the parties in interest which resulted in an agreement being reached on a consensual plan of reorganization. According to BI & L, under that agreement, the distribution of common stock (including warrants) to Heck's shareholders increased from 10% to 35% of equity. The bankruptcy judge concluded, however, that the settlement in reality added little to the provisions already made for the shareholders. *See* Final Fee Order, 112 B.R. at 803–804. On the date of the October 11, 1988, expedited hearing on the

trustee motion, BI & L announced to the bankruptcy court that the Equity Committee had entered into a compromise with the Trade and Bank Committees and the DIP that the trustee motion as well as the Putnam County litigation was being voluntarily withdrawn and that the hearing was unnecessary.

The merits of the Equity Committee's trustee motion were thus never resolved due to the settlement. Consequently, no hearing was held in order to resolve the factual disputes raised by the Hemsley and Rosenstrauch affidavits. In denying all fees sought by BI & L in conjunction with the filing of the trustee motion and supporting materials, the bankruptcy judge did not undertake to analyze the actions of the Equity Committee's counsel in relation to the powers and duties vested in the committee under 11 U.S.C. § 1103(c)(4), pursuant to which such a committee is expressly empowered to seek appointment of a trustee, nor in relation to the standards set forth in 11 U.S.C. § 1104 relative to a resolution on the merits. Instead, only selected portions of the Hemsley affidavit are referenced in support of the conclusion that the trustee motion was "filed without reasonable preparation by BI & L," and "purely for reasons of harassment, delay and intimidation." Final Fee Order, 112 B.R. at 804. The final fee order purports to base the denial of fees upon the bankruptcy judge's tacit acceptance of the Hemsley affidavit over that of the Equity Committee's accountants, and the bankruptcy judge's speculation as to how the merits of the trustee motion would have been ruled upon had it not been voluntarily withdrawn as a result of the parties' settlement.

[18] Chapter 11 of the Bankruptcy Code is designed to allow the debtor-in-possession to retain management and control of the debtor's business operations unless a party in interest can prove that the appointment of a trustee is warranted. *See, e.g., In re Ionosphere Clubs, Inc.*, 113 B.R. 164 (Bkrtcy.S.D.N.Y.1990). The appointment of a trustee in a chapter 11 case is an extraordinary remedy, and there is a strong presumption that the debtor should be permitted to remain in possession absent a showing of need for the appointment of a trustee. *Committee of Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239, 241 (4th Cir.1987).

Pursuant to the express provisions of 11 U.S.C. § 1103(c)(4), however, a committee appointed under section 1102 may "request the appointment of a trustee or examiner under section 1104 ..." Section 1104 of ***757** the Code provides the standards to be followed by the court in determining whether appointment of a trustee is warranted:

> (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee—
>
> (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a)(1) & (2). The Fourth Circuit has observed that the concepts of incompetence, dishonesty, gross mismanagement and fraud as contemplated by section 1104(a)(1) all cover a "wide range of conduct," and that "[i]mplicit in a finding of incompetence, dishonesty, etc., for purposes of section 1104(a)(1), is whether the conduct shown rises to a level sufficient to warrant the appointment of a trustee." *Dalkon Shield Claimants*, 828 F.2d at 242.

[19] In situations in which a creditor or party in interest is of the view that a debtor-in-possession is improperly exercising the trustee's powers accorded under the Code, the proper course is to petition the bankruptcy court for appointment of a trustee or examiner. *See In re Brookfield Clothes, Inc.*, 31 B.R. 978 (S.D.N.Y.1983). Here, the Equity Committee sought such an appointment after its court-appointed accountants, Laventhol & Horwath, advised the committee that Heck's was, among other things, suffering massive losses and that its current management was unable to make reliable financial forecasts. On the basis of that information and upon the direction of the Equity Committee, BI & L acted well within the committee's statutory authority set forth in 11 U.S.C. § 1103 to seek the appointment of a trustee. Indeed, BI & L persuasively maintains that subsequent events

have proven that Laventhol was right inasmuch as approximately two months after confirmation of the plan in 1989, Heck's "decided to abandon its retail operations and 'sold' all of its retail operations for $1 more than its debt." BI & L states:

> As reported in Heck's 1990 proxy statement, it did so because the retail stores continued to lose money —suffering operating losses of $9.8 million for the third quarter ending November 25, 1989. Heck's management admitted that the company would likely have been forced into liquidation if the "sale" did not occur.

See Brief of BI & L at p. 12, n. 7.

Inasmuch as the Equity Committee had the statutory right to seek the appointment of a trustee under 11 U.S.C. §§ 1103 and 1104, and finding no adequate factual basis upon which to conclude that the committee's efforts were motivated by an improper rather than legitimate purpose, the court concludes that BI & L's efforts in that regard were compensable and that the bankruptcy court's conclusion otherwise must be reversed.

(b) Application to Compel Annual Stockholders Meeting

[20] The bankruptcy court also denied all fees requested by BI & L for actions taken in Putnam County Circuit Court which sought in part to compel the holding of an annual stockholders' meeting. In doing so, the bankruptcy judge acknowledged that stockholders have a right to meet and elect directors during reorganization, and that a bankruptcy court should not lightly employ its equitable powers to block an election of a new board of directors. *See* Final Fee Order, 112 B.R. at 798. The bankruptcy judge concluded, nonetheless, that, inasmuch as Congress has given district courts jurisdiction of the Chapter 11 process, "[w]here the purpose of the action to call a meeting of shareholders ***758** is to preempt the Chapter 11 reorganization process itself, courts must exercise common sense control." *Id.* The court, without citing decisional support for its conclusion, then held:

> This Court holds that where a debtor in possession properly and in good faith places before the court a plan which proposes to dilute or extinguish the interests of its existing shareholders, then the right to select the directors of that debtor in possession is in litigation under the exclusive jurisdiction of the district court, inextricably tied to the confirmation process. Where a properly filed plan is before the court, and the right to issue voting stock and select directors is being litigated in the confirmation process, the exclusive jurisdiction of the federal court precludes an official committee in the case or its court-appointed professionals from attacking the plan in state court. To allow the shareholders under these conditions to elect directors at a meeting of shareholders would frustrate Congress' grant of exclusive jurisdiction to the district courts in 28 U.S.C. § 1334 and would subvert the bankruptcy process.

See Final Fee Order, 112 B.R. at 801 (footnote omitted).

Based upon the conclusion that "an equity committee has no right to put the reorganization process at risk by a state court proceeding," the bankruptcy judge thus determined that Equity Committee counsel has no right to demand payment for initiating the proceeding for the purposes of compelling a shareholders' meeting. The final fee order thus denied all compensation to BI & L in conjunction with the effort to compel a shareholder meeting as improper and thus unnecessary. *Id.* at 801.

In support of its request in state court for Heck's to call and hold an annual shareholders' meeting, the Equity Committee, through its counsel, relied upon both W.Va.Code § 31–1–18 and the by-laws of the Heck's corporation. *See* Verified Application for Summary Order Compelling Heck's, Inc. to Call and Hold an Annual Shareholders' Meeting, attached as exhibits to Adversary Proceeding No. 88–0152. The state statute relied upon by the Equity Committee provides in pertinent part:

(b) An annual meeting of the shareholders or members shall be held at such time as may be stated in, or fixed in accordance with, the bylaws. Failure to hold the annual meeting at the designated time shall not work a forfeiture or dissolution of the corporation.

(c) In the case of a business corporation, if the annual meeting is not held within any thirteen-month period, the circuit court of the county wherein the place of the principal office of the corporation is located, or the circuit court of Kanawha county in the case of corporations not having a principal office in this State, may, on the application of any shareholder, summarily order a meeting to be held.

W.Va.Code § 31–1–18(b) & (c).

Article II, section 1 of Heck's by-laws provides further support for the Equity Committee's position regarding the necessity of annual meeting of shareholders:

> Section 1. *Annual Meetings.* The annual meeting of the stockholders shall be held on the fourth Monday in April of each calendar year ..., at 11 o'clock in the forenoon, or as soon thereafter as the stockholders shall assemble, at the principal office of the Corporation at HUB Industrial Park, McJunkin Road, Nitro, West Virginia, Putnam County, West Virginia, or such other place, either within or without the State of West Virginia, as the Board of Directors shall, from time to time, determine.

See attachments to Adversary Proceeding No. 88–0152.

In its application to compel a shareholder meeting, the Equity Committee and several individual shareholders asserted that the last shareholder meeting of Heck's had been called on April 28, 1986, approximately twenty-nine months prior to the filing of the application. Arguing that Heck's was thus in clear violation of both West Virginia law and its own corporate by-laws, the Equity Committee sought an order from the Circuit Court of Putnam County to ***759** compel the holding of such a meeting in accordance with W.Va.Code § 31–1–18(b) and (c).

No cases have been found to support the conclusion set forth in the final fee order that the shareholders' right to select directors of the corporation falls within the exclusive jurisdiction of the district court. To the contrary, the Second Circuit has acknowledged the "well-settled rule that the right to compel a shareholders' meeting for the purpose of electing a new board of directors subsists during reorganization proceedings." *In re Johns–Manville Corp. v. Equity Security Holders Committee,* 801 F.2d 60, 64 (2d Cir.1986), citing *In re Bush Terminal Co.,* 78 F.2d 662, 664 (2d Cir.1935); *In re Saxon Industries,* 39 B.R. 49, 50 (Bkrtcy.S.D.N.Y.1984); and *In re Lionel Corp.,* 30 B.R. 327, 330 (Bkrtcy.S.D.N.Y.1983).

In *Manville,* a Chapter 11 debtor sought injunctive relief in bankruptcy court seeking to enjoin an action filed in Delaware state court by an equity committee. In the state action, the equity committee sought to compel the debtor to hold a shareholders' meeting as required by a Delaware statute requiring such meetings annually. 801 F.2d 60. In enjoining the state court action, the *Manville* bankruptcy court reasoned that "any shareholder meeting and ensuing proxy fight has the potential to derail the entire Manville reorganization with devastating consequences," or would "at least ... delay or halt plan negotiations." 801 F.2d at 64. Similarly, the district court upheld the injunctive relief granted by the bankruptcy court, concluding that the equity committee had been motivated by a desire to "torpedo the reorganization or to acquire a bargaining chip in aid of its negotiation power." *Id.*

In resolving the propriety of the injunctive relief granted by the bankruptcy court and affirmed by the district court, the Second Circuit recognized in *Manville* that the right of shareholders to govern their corporation is a prerogative ordinarily uncompromised by reorganization, and that, as a consequence, "a bankruptcy court should not lightly employ its equitable power to block an election of a new board of directors." 801 F.2d at 64. The Second Circuit also concluded that the equity committee's right to compel a shareholders' meeting under Delaware state law "may be impaired only if the Equity Committee is guilty of 'clear abuse' in attempting to call one." 801 F.2d at 64, citing *In re J.P. Linahan, Inc.,* 111 F.2d 590, 592 (2d Cir.1940). The Second Circuit concluded:

> [W]e cannot agree that the Equity Committee's professed desire to arrogate more bargaining power in the negotiation of a plan—in contrast to some secret desire to destroy all prospects for reorganization—may in itself constitute clear abuse.
>
> ....
>
> [T]he shareholders' mere intention to exercise bargaining power—whether by actually replacing the directors or by "bargaining away" their chip without replacing the board, as the district court suggests they may have wished to do—cannot without more constitute clear abuse. Unless the Equity Committee were to bargain in bad faith—*e.g.* to demonstrate a willingness to risk rehabilitation altogether in order to win a larger share for equity—its desire to negotiate for a larger share is protected.

801 F.2d at 64–65. [14]

14 The Second Circuit thus remanded the question of "clear abuse," noting that the lower court should not focus upon the equity committee's conceded desire to enhance its bargaining position, but should instead "analyze the real risks to rehabilitation posed by permitting the equity committee to call a meeting of shareholders for the purpose of compelling reconsideration of Manville's presently proposed plan." 801 F.2d at 69. On remand, the bankruptcy court found that the committee's actions in seeking to compel a shareholders' meeting were clear abuse, finding that the committee acted in "utter disregard of the devastating consequences of its conduct," and that it was "willing to risk the Debtor's rehabilitation altogether," motivated by an "intent to jeopardize the reorganization." *See* 66 B.R. 517, 542 (Bkrtcy.S.D.N.Y.1986).

[21] Here, the bankruptcy court concluded that the Equity Committee had "no right to put the reorganization process at risk by a state court proceeding," and thus denied, as improper and unnecessary, all ***760** fees requested by BI & L for services provided to the Committee in conjunction with the application to compel a shareholders' meeting. The teaching of *Manville,* however, dictates a different result. Pursuant to the rationale of *Manville,* even if the Equity Committee's efforts were motivated by a desire to arrogate more bargaining power to itself and to use the threat of a new board "as a lever vis-a-vis other interested constituencies and vis-a-vis the current ... board," such conduct, without more, simply does not constitute the clear abuse sufficient to preclude the stockholders from exercising their right, under state law, to elect a new board of directors. *See Johns–Manville,* 801 F.2d at 65. As held in *Manville,* in order to find clear abuse on the part of the Equity Committee and its counsel, their action in seeking to compel a shareholders' meeting must have been motivated by a bad faith desire to risk rehabilitation altogether rather than merely an effort to achieve greater bargaining power or to advance a plan more favorable to equity. Finding no basis upon which to conclude that the Equity Committee's action, and in turn the services of BI & L, in seeking to compel a shareholders' meeting manifested clear abuse or a bad faith "willingness to risk rehabilitation altogether in order to win a larger share for equity," the bankruptcy court's denial of fees to BI & L in that regard is reversed.

(c) State Court Action Against Officers and Directors

The bankruptcy court also denied all fees and expenses sought by BI & L in conjunction with the filing of a complaint in Putnam County, West Virginia, by the Equity Committee and several individual shareholders against Heck's officers and directors. In doing so, the bankruptcy judge observed that the Putnam litigation concerned allegations of breach of fiduciary duty, loyalty and good faith against the officers and directors, and that the Equity Committee had cited, in support of those allegations, "many actions which the directors took as part of their efforts to advance a confirmable Chapter 11 plan." *See* Final Fee Order, 112 B.R. at 802. [15] The bankruptcy judge concluded:

15 Particularly, the bankruptcy judge noted that the Equity Committee and individual shareholder plaintiffs had alleged that Heck's senior management was proposing a self-serving plan which diluted shareholder interests, that the plan proposed would wrongfully entrench the defendant officers and directors in the reorganized corporation as a result of lucrative management contracts provided

for thereunder. The complaint also cited the defendant officers and directors as having failed to pursue preference and fraudulent conveyance claims against certain banks. *See* Final Fee Order, 112 B.R. at 802.

The plan litigation process in this Court was the only forum in which Equity Committee's counsel could properly raise concerns about the above issues as they related to shareholders' treatment under the Plan or management's stewardship of the corporation. This is not to say that the individual shareholders have no right to obtain private counsel and bring a state action against directors and officers for actual wrongdoing. That question is not before the Court in this case. The Equity Committee agreed to drop its state damage action 25 days after it was filed as part of an attempt to have this Court approve 80% of BIL fees billed during the June–October, 1988 period. The sole motivation for bringing this complaint seems to have been to obstruct the Plan confirmation process.

See Final Fee Order, 112 B.R. at 802.

Stating in the final fee order that a review of Bankruptcy Code §§ 1103(c) and 1109(b) renders it clear that BI & L had led the Equity Committee outside the parameters of its authorized mission, violated the district court's exclusive jurisdiction, and introduced unnecessary expense and confusion into the case, the bankruptcy court held that BI & L's work in bringing the directors' action was frivolous, improper, and brought for an improper purpose. All fees sought by BI & L in conjunction with the directors' action were thus denied as unnecessary. *See* Final Fee Order, 112 B.R. at 803.

No authority is cited by the bankruptcy court in support of its holding that it was the only forum in which the Equity Committee ***761** could make claims against Heck's officers and directors for breach of state law fiduciary duties owed Heck's shareholders. Although BI & L acknowledges that a review of case law establishes that state court litigation against officers and directors of a Chapter 11 debtor may be enjoined by the bankruptcy court once filed, BI & L contends that cases such as *A.H. Robins Co., Inc. v. Piccinin,* 788 F.2d 994, 1007 (4th Cir.1986), *cert. denied,* 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1987); and *Johns–Manville Corp. v. Asbestos Litigation Group,* 33 B.R. 254, 262–63 (Bkrtcy.S.D.N.Y.1983), clearly recognize that such suits may be brought in state court and are not within the exclusive jurisdiction of the bankruptcy or federal district courts.

In *A.H. Robins v. Piccinin,* a Chapter 11 debtor filed an adversary proceeding naming as defendants the plaintiffs in several suits which were pending in various state and federal courts. 788 F.2d 994. The adversary proceeding initiated by Robins sought injunctive relief in district court in order to restrain the prosecution of the state actions against its co-defendants. [16] In certain of the cases where injunctions were issued, the co-defendants included Robins management who, the court noted, were "entitled to indemnification by the debtor under the corporate by-laws and the statutes of Virginia...." 788 F.2d at 1007.

16 Prior to filing for Chapter 11 relief, A.H. Robins had been sued in thousands of cases for injuries allegedly resultant from the use of the Dalkon Shield contraceptive device. In approximately one-half of the cases, other defendants, including corporate management, were named as defendants along with Robins. After the filing of Robins' Chapter 11 petition, a number of plaintiffs in suits where defendants other than Robins were named sought to sever their actions against Robins and proceed against the remaining named defendants. Adversary proceedings brought to enjoin plaintiffs in eight such suits from proceeding to litigate against Robins' co-defendants were at issue in the *Piccinin* case. *See* 788 F.2d at 996–97.

Relying upon the rationale of *In re Johns–Manville Corp.,* 33 B.R. 254 (Bkrtcy.S.D.N.Y.1983) in which various state court actions against officers, directors, and employees of a Chapter 11 debtor were enjoined by a New York bankruptcy court, [17] the Fourth Circuit concluded that the issuance of injunctive relief was proper. The *Piccinin* court reasoned in part that successful suits against Robins managers, who were entitled to indemnity under corporate by-laws and insured status under Robins' insurance policy, would adversely affect the property of the debtor to the detriment of the debtor's creditors as a whole. [18]

17 The Fourth Circuit noted that, in *Johns-Manville,* the bankruptcy court had found that:

> In the event of a recovery against the past or present officers, directors or employees of Manville in any of the pending 1,000 cases, Manville's insurers may be called upon to indemnify such officers, directors and employees under the provision of the policies issued by them to Manville. If such insurers are called upon to make such indemnification payments, those payments may cause an asset of the Manville estates to be diminished.

788 F.2d at 1006, citing 33 B.R. at 261.

18 The court concluded:

> It seems incontestable that, if the suits are permitted to continue ... any effort at reorganization of the debtor will be frustrated, if not permanently thwarted. It is obvious from the record that if suits are permitted to proceed against indemnitees on claims on which the indemnitees are entitled to indemnity by Robins, either a binding judgment against the debtor will result or ... inconsistent judgments will result, calling for the exercise of the court's equitable powers.

788 F.2d at 1008.

Implicit in the *Manville* and *Piccinin* decisions is the recognition that litigation may be initiated against the officers and directors of a Chapter 11 debtor in state court during the course of reorganization proceedings, and no basis is found within the rationale of either decision to suggest that the granting of injunctive relief in those cases was in any way predicated upon a determination that such actions violated the exclusive jurisdiction of the bankruptcy or district courts. It is seen, however, that neither the *Manville* or *Piccinin* decision concerned the precise issue now before the court, namely, the propriety of an official committee's filing, without leave of the bankruptcy court, a state court action ***762** against the officers and directors of the debtor during the course of the reorganization process.

The Second Circuit has observed that the Bankruptcy Code provides the trustee with explicit power to sue and that the trustee can thus initiate suit without court approval to avoid a preferential transfer of assets, "although it is considered the better practice to secure an order of the court for leave to sue." *In re STN Enterprises v. Noyes,* 779 F.2d at 904, citing 4 *Collier on Bankruptcy,* ¶ 547.52[3], at 547–180 (15th ed. 1979). The Second Circuit has also recognized that the Bankruptcy Code contains no explicit authority for creditors' committees to initiate adversary proceedings, but notes:

> Most bankruptcy courts that have considered the question have found an implied, but qualified, right for creditors committees to initiate adversary proceedings in the name of the debtor in possession under 11 U.S.C. § 1103(c)(5) and 1109(b), or in reliance on an implied continuation of creditors' committee powers under the pre–1978 Code. These courts have allowed creditors' committees to initiate proceedings only when the trustee or debtor-in-possession unjustifiably failed to bring suit or abused its discretion in not suing to avoid a preferential transfer. We agree with these bankruptcy courts that 11 U.S.C. § 1103(c)(5) and 1109(b) imply a qualified right for creditors' committees to initiate suit with the approval of the bankruptcy court.

779 F.2d at 904 *citing Matter of Joyanna Holitogs, Inc.,* 21 B.R. 323, 326 (Bkrtcy.S.D.N.Y.1982); *In re Toledo Equipment Co., Inc.,* 35 B.R. 315, 317–20 (Bkrtcy.N.D.Ohio 1983); *Matter of Monsour Medical Center,* 5 B.R. 715, 718 (Bkrtcy.W.D.Pa.1980).

In *STN Enterprises,* the Second Circuit remanded for further consideration of the unsecured creditor committee's allegations that the debtor in possession had unjustifiably failed to initiate a suit against the corporate director, stating:

> In order to decide whether the debtor unjustifiably failed to bring suit as to give the creditors' committee standing to bring an action, the court must also examine, on affidavit and other submission, by evidentiary hearing or otherwise, whether an action asserting such claims(s) is likely to benefit the reorganization estate.

779 F.2d at 905, citing *Toledo Equipment Co., Inc.,* 35 B.R. at 320.

The Second Circuit further indicated that, upon remand, the bankruptcy or district court should consider the probabilities of legal success in the suit sought to be initiated, and the probable recovery therefrom as well as "whether it would be preferable to appoint a trustee in lieu of the creditors' committee to bring suit ... and the terms relative to attorneys' fees on which suit might be brought." 779 F.2d at 905. The court reasoned:

> The creditors who compose the committee might agree themselves to be responsible for all attorneys' fees, but if they would seek to impose such fees on other creditors or the chapter 11 estate, whether by

> contingent fee arrangement or otherwise, that would obviously affect the cost-benefit analysis the court must make in determining whether to grant leave to sue. Hence fee arrangements should not only be made a matter of record but should be carefully examined by the court as it makes that determination.

779 F.2d at 905.

Similarly, in *In re Toledo Equipment Co., Inc.*, an unsecured creditor's committee filed an adversary complaint seeking to recover allegedly preferential transfers. 35 B.R. 315. Although concluding that the creditors' committee did not have standing to bring such an action under the facts before it, the court nonetheless recognized that the Code establishes creditors committees for the purpose of protecting the rights of the committee's constituents and similarly situated creditors, and that to allow such committees to bring such actions where appropriate would correspond with the Code's intention that the committee protect the rights of its members, "especially where the debtor-in-possession's inactivity ***763** impinges on those rights." 35 B.R. at 318. The court also observed:

> It should be noted that there is nothing in those sections [§§ 1103 & 1109] which prevents a Committee from filing an adversary complaint. The Code does not limit the committee's authority to issues which arise only in the context of the primary bankruptcy case.

35 B.R. at 319, citing *Matter of Marin Motor Oil, Inc.*, 689 F.2d 445 (3rd Cir.1982).

As did the Second Circuit in *STN Enterprises,* the bankruptcy court in *In re Toledo Equipment* explained that a creditor committee's standing to bring an action is triggered "only if it would benefit the estate and if the debtor-in-possession has unjustifiably failed to prosecute the case." 35 B.R. at 319. Noting that a committee's inherent motive in bringing a suit is the desire to recover funds from which creditors can be paid, the court recognized that conflicts may exist between the creditor's right to be paid and the debtor-in-possession's effort to reorganize, and that, pragmatically, the problem was "whether the creditor's committee may instigate an action on behalf of the estate, subject to subsequent objection, or whether it should be required to apply with the Court for leave to file the action." *Id.*

Recognizing that resolution of the issue before it required a balancing of the competing interests in order to determine whether or not the debtor-in-possession's failure to bring the action was justifiable, the *Toledo Equipment* court held:

> If the unsecured creditor's committee were permitted to institute a suit against a creditor without a prior determination as to the propriety of the debtor-in-possession's failure to sue, the resulting suit could seriously jeopardize the debtor's relationship with the creditor, and thereby jeopardize the chances for successful reorganization. If the committee were required to seek prior Court approval, a determination as to the debtor's failure to act could be made before the debtor-creditor relationship was endangered. In view of the relative merits of each alternative, it must be concluded that a creditor's committee should be required to seek Court approval prior to beginning an action on behalf of the estate. This requirement would not deprive the committee of any right to raise and be heard on any issue. It would only require a prior determination of whether or not the right exists.

35 B.R. at 320.

[22] In the present case, the Equity Committee and individual shareholders, through BI & L, filed a state court action against the officers and directors of Heck's without seeking prior leave of the bankruptcy court. As a consequence, the bankruptcy court was deprived of the opportunity to weigh the relative risks and benefits of the action to the reorganization estate, and to consider, *inter alia,* whether it would be preferable to appoint a trustee in lieu of the committee to bring suit. *See, e.g., In re STN Enterprises,* 779 F.2d at 905. *See also, In re Savino Oil & Heating Co., Inc.,* 91 B.R. 655 (Bkrtcy.E.D.N.Y.1988); *In re Evergreen Valley Resort, Inc.,* 27 B.R. 75 (Bkrtcy.D.Me.1983). Although the cases discussed have involved actions taken on behalf of creditor committees, the court perceives no reason to apply a different rule to the Equity Committee here.

Moreover, had the Equity Committee and its counsel sought leave of court to file the Putnam County action against the officers and directors, the bankruptcy court would likewise have had an opportunity to consider the terms relative to the attorneys fees sought by BI & L in conjunction with the officers and directors action, namely, its intent to ultimately seek to impose such fees on the Chapter 11 estate, in making its cost-benefit analysis. *Id.*

The Equity Committee, in striking off on its own, commenced a fruitless action that was abandoned in just three weeks in favor of a settlement that left the very same officers and directors fully entrenched and wholly untouched. Inasmuch as the Equity Committee failed to seek leave of court prior to instituting that action, the denial of *764 fees to BI & L in connection therewith was not clearly erroneous.

The bankruptcy court has not allocated the fees and expenses sought by BI & L in the total amount of $99,617.40 among the action against the officers and directors, the trustee motion, the shareholder meeting petition and other services. The parties to this appeal, however, consisting of the Equity Committee, BI & L, the United States Trustee and the Bank Creditors Committee, have stipulated that $13,172.00 is applicable to the action against the officers and directors and the balance of $86,445.40 is applicable to the trustee motion and shareholder meeting petition and other BI & L services. In accordance with the court's resolution of those matters on appeal, BI & L is entitled to receive $86,445.40 therefor and is denied the balance of $13,172.00.

IV. *Sanctions*

A. The $91,582.25 Indemnification

The bankruptcy judge, citing Bankruptcy Rule 9011, not only denied fees to BI & L relative to all aspects of the Putnam County litigation and the motion to appoint an operating trustee, but also reduced fees otherwise deemed allowable in the sum of $91,582.25. According to the final fee order, that amount represented the sum which Heck's was required to pay in order to indemnify its officers and directors for attorney fees to defend the Putnam County damage action against them. *See* Final Fee Order, 112 B.R. at 803, 804.

The parties to this appeal have stipulated that the indemnification of $91,582.25 is allocable as follows: $82,482.25 to the action against the officers and directors and $9,100.00 to the other matters. In addition, BI & L and the Equity Committee further agree that the reasonableness of the amount of the indemnification is not contested.

In this appeal, BI & L presents a three-fold argument in opposition to the imposition of sanctions by the bankruptcy judge. BI & L first argues that the bankruptcy court exceeded its jurisdiction and the boundaries of Rule 9011 in sanctioning it for conduct in the state courts and in advising its client. Secondly, BI & L contends, it was improperly sanctioned in a sum equal to the $91,582.25 for which the DIP indemnified its officers and directors, arguing that the officers and directors had no right to indemnification in the first instance. Finally, BI & L contends, it was denied due process with respect to the sanctions levied in the final fee order inasmuch as the bankruptcy court failed to give BI & L either notice or an opportunity for hearing before imposing sanctions under Rule 9011.

1. *Bankruptcy Rule 9011*

Rule 9011 is relied upon by the bankruptcy judge in support of his denial of fees otherwise allowed to BI & L in the amount of $91,582.25. Rule 9011 is derived from Rule 11 of the Federal Rules of Civil Procedure, *see generally* 9 Collier on Bankruptcy, ¶ 9011.02. [19]

19 Rule 9011 provides in pertinent part:

> *(a) Signature.* Every petition, pleading, motion and other paper served or filed in a case under the Code on behalf of a party represented by an attorney, ... shall be signed by at least one attorney of record in the attorney's individual name, whose office address and telephone number shall be stated. A party who is not represented by an attorney shall sign all papers and state the

party's address and telephone number. The signature of an attorney or party constitutes a certificate that the attorney or party has read the document; that to the best of the attorney's or party's knowledge, information and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation or administration of the case.

The rule further provides that if a document is signed in violation of the rule, the court on motion or on its own initiative "shall impose on the person who signed it, the represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the document, including a reasonable attorney's fee." Bankruptcy Rule 9011.

*765 [23] A plain reading of Bankruptcy Rule 9011 supports BI & L's position that the bankruptcy court could not properly predicate its imposition of sanctions against BI & L for actions taken in state court or upon conduct in which no pleading, petition, motion or other paper was improperly filed in bankruptcy court. As the Fourth Circuit noted in a case concerning the scope of Rule 11, from which Bankruptcy Rule 9011 is taken: [20]

20 It is recognized that "cases interpreting Rule 11 are equally applicable to Bankruptcy Rule 9011." *See Matter of King*, 83 B.R. 843, 846 (Bkrtcy.M.D.Ga.1988); *Styler v. Tall Oaks, Inc.*, 93 B.R. 263, 266 (Bkrtcy.D.Utah 1988).

By its terms, Rule 11 provides for sanctions when a pleading is signed "in violation of this rule." At the time a state court pleading is signed, the signing attorney is not subject to the Federal Rules of Civil Procedure. Therefore, a pleading signed in a state court proceeding which is later removed to federal court clearly cannot be signed in violation of Rule 11. *Kirby v. Allegheny Beverage Corp.*, 811 F.2d 253, 257 (4th Cir.1987). *See also, Hurd v. Ralphs Grocery Co.*, 824 F.2d 806, 808 (9th Cir.1987) (under Rule 11, "sanctions cannot be imposed ... for filing a paper in state court"); *Brown v. Capitol Air, Inc.*, 797 F.2d 106, 108 (2d Cir.1986) (Rule 11 "does not purport to authorize sanctions for actions taken in state courts").

Accordingly, the bankruptcy court's reliance upon Rule 9011 as support for the imposition of sanctions against BI & L is misplaced to the extent that the allegedly improper actions taken and papers filed by BI & L occurred entirely in Putnam County Circuit Court rather than in the bankruptcy court. It is seen, however, that a number of pleadings were eventually filed by BI & L in bankruptcy court pertaining to the pendency of the state court application to compel a shareholders' meeting and to the state damage action against Heck's officers and directors. *See* Bankruptcy Docket No. 2859, Adversary Proceeding No. 88–0152. [21]

21 Bankruptcy Docket No. 2859 pertained to both the Equity Committee's application for a shareholders' meeting and its complaint against the Heck's officers and directors, and is entitled "Response of Official Committee of Equity Security Holders and Berlack, Israels & Liberman in Support of Standing to File Shareholders' Meeting Motion and Verified Complaint Against Heck's Officers and Directors in West Virginia State Court." Adversary Proceeding No. 88–0152, on the other hand, pertained solely to the Equity Committee's application in state court to compel a shareholders' meeting, eventually removed by Heck's to federal court. Following removal, four separate pleadings were filed by BI & L on behalf of the Equity Committee in that proceeding.

[24] Nonetheless, only those bankruptcy court pleadings pertaining to the state action against the officers and directors, which this court has previously concluded were improperly taken by BI & L on behalf of the Equity Committee, may serve as a basis for sanctions under Rule 9011. Having previously concluded that BI & L did not improperly act on behalf of the Equity Committee in seeking to compel a shareholders' meeting in state court, no pleadings subsequently filed in federal or bankruptcy court pertaining to that action may properly serve as a basis for sanctions under Rule 9011. Only one bankruptcy court pleading has been identified to the court which pertains to the Equity Committee's improper filing of the officers and directors action in state court, without leave of the bankruptcy court. *See* Bankruptcy Docket No. 2859.

[25] [26] [27] It is well-recognized, however, quite apart from Rule 9011, that courts have the inherent authority to impose sanctions upon counsel who is found to have acted in bad faith, vexatiously, wantonly or for oppressive reasons, *see, e.g., Roadway Express, Inc. v. Piper*, 447 U.S. 752, 100 S.Ct. 2455, 65 L.Ed.2d 488 (1980); *Alyeska Pipeline Services Co. v. Wilderness Services*, 421 U.S. 240, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975), and that courts may impose excess costs, expenses and fees, pursuant to 28 U.S.C. § 1927, upon counsel who multiplies the proceedings in an action "unreasonably and vexatiously." *See* 28 U.S.C. § 1927. *See also, Blair v. Shenandoah* *766 *Women's Center, Inc.*, 757 F.2d 1435, 1437 (4th Cir.1985); *Jones v.*

Pittsburgh National Corp., 899 F.2d 1350, 1358 (3rd Cir.1990); *Peoro v. Eisenman*, 793 F.2d 1048 (9th Cir.1986). [22] Although the bankruptcy court referred only to Rule 9011 for the imposition of sanctions upon BI & L, it is quite clear that such sanctions may be properly levied to the extent that BI & L's conduct, relative to the bringing of the directors' action in state court without leave of the bankruptcy court, rose to that level of misconduct required to support the imposition of sanctions under either the court's inherent authority or under § 1927.

22 The statute, 28 U.S.C. § 1927, provides:

> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

28 U.S.C. § 1927 (1982).

2. *Heck's Authority to Indemnify*

[28] BI & L further contends that the officers and directors had no right to indemnification in the first instance and, consequently, no proper expense was borne by the Heck's estate with regard to the indemnification issue which would justify the bankruptcy court's decision to sanction BI & L for the expense of indemnification.

The bankruptcy court's order directing the indemnification was made following Heck's application seeking authority to pay the attorneys' fees and expenses of Myerson & Kuhn, counsel for Heck's officers and directors in the Putnam litigation, as an expense of administration pursuant to section 503(b)(1)(A) of the Bankruptcy Code. In support of its application, Heck's noted that its Articles of Incorporation, Article VII, as amended June 29, 1966, give the officers and directors of Heck's an absolute right to indemnification, [23] and, further, that such indemnification provisions are wholly consistent with West Virginia law. *See* Bankruptcy Docket no. 2906; *See also* W.Va.Code § 31–1–9. [24]

23 The provision of the Articles of Incorporation relied upon provide for indemnification of an officer, director or employee "against any and all liability and reasonable expense that may be incurred by him in connection with or resulting from any claim, action, suit, or proceeding ... in which he may become involved, as a party or otherwise, by reason of his being or having been a director, officer or employee of the corporation...." *See* Bankruptcy Docket No. 2906.

24 West Virginia Code § 31–1–9 provides in pertinent part that a corporation shall have power to "indemnify any person who was or is a party or is threatened to be made a party to any ... action or proceeding ... by reason of the fact that he is or was a director, officer, employee or agent of the corporation," and that "expenses (including attorney fees) incurred in defending a civil or criminal action ... may be paid by the corporation in advance of the final disposition of the action." W.Va.Code § 31–1–9.

Numerous courts have denied administrative expense priority under § 503(b)(1)(A) to corporate officials seeking indemnification under the provisions of corporate by-laws when it is determined that the acts or services which gave rise to the claims occurred before rather than after the filing of the petition for relief in bankruptcy. *See, e.g. In re Philadelphia Mortgage Trust*, 117 B.R. 820 (Bkrtcy.E.D.Pa.1990), *citing In re Amarex*, 853 F.2d 1526 (10th Cir.1988); *In re Christian Life Center*, 821 F.2d 1370 (9th Cir.1987); *Guaranty National Ins. Co. v. Greater Kansas City Transp. Inc.*, 90 B.R. 461, 462–63 (D.Kan.1988); *Matter of Baldwin–United Corp.*, 43 B.R. 443 (S.D.Ohio 1984); *In re Consolidated Oil & Gas, Inc.*, 110 B.R. 535 (Bkrtcy.D.Colo.1990); and *In re Amfesco Industries, Inc.*, 81 B.R. 777, 780–85 (Bkrtcy.E.D.N.Y.1988).

In *Baldwin–United Corp.*, the case relied upon by BI & L, the court considered whether indemnification of corporate directors for legal expenses incurred in defending suits which challenged their activities while serving the corporation would be entitled to administrative expense priority under § 503. 43 B.R. 443, 447. [25] In analyzing ***767** the issue, the court divided the directors seeking indemnification into two groups, one comprised of the corporation's former directors and one consisting of the present directors.

25 In *Baldwin,* the by-laws of the debtor provided, *inter alia,* that the company "may indemnify ... any person who was or is a party ... to any ... suit ... by reason of the fact that he is or was a director, officer, employee or agent of the company." *See* 43 B.R. at 446.

In denying administrative priority to the claims of the former officers and directors, the *Baldwin* court noted that the claim did not arise from a transaction with the debtor-in-possession and that the obligation to indemnify had fully matured pre-petition in that the former officers and directors' performance for the debtors was complete at the time the petitions were filed. *Id.* at 454. As to the present directors, the court remanded the issue for a determination by the bankruptcy court as to whether the test set forth in *In re Mammoth Mart,* 536 F.2d 950 (1st Cir.1976), a leading case concerning administrative expense priority, had been met. On remand, the bankruptcy court was to consider whether the claim (1) arose from a transaction with the debtor-in-possession and (2) was beneficial to the debtor-in-possession in the operation of the business. 43 B.R. at 461, citing *Mammoth Mart,* 536 F.2d at 954.

In *Consolidated Oil & Gas,* a Colorado bankruptcy court concluded that claims of former officers and directors for indemnification of fees and expenses incurred in a mismanagement suit commenced after the bankruptcy case was filed were not entitled to administrative expense priority, finding that the officers and directors did not perform any services for the debtor-in-possession or provide other post-petition consideration. 110 B.R. at 538. The court noted that the claimants rendered only pre-petition services to the debtor, and that its denial of administrative expense priority was consistent with the holding in *In re Amfesco,* 81 B.R. 777 (Bkrtcy.E.D.N.Y.1988).

In the *Amfesco* case, former directors of a bankruptcy debtor sought indemnification of legal expenses under the debtor's articles of incorporation. The *Amfesco* court denied administrative expense priority notwithstanding the provisions of the articles of incorporation, reasoning that:

> All of the operative facts, legal relationships, and conduct of the Applicants upon which is based the threatened litigation occurred pre-petition. The indemnification agreement entered into between the Applicants and the Debtors occurred pre-petition. Any duty of the Debtors arises from services provided to the pre-petition Corporation not for services rendered post-petition to the Debtors-in-Possession. As such, the Applicants' legal fees claim arises from their pre-petition services rather than any post-petition services.

81 B.R. at 784, citing *In re Christian Life Center,* 821 F.2d 1370, at 1374 (9th Cir.1987). *See also, In re Philadelphia Mortgage Trust,* 117 B.R. 820, 830 (Bkrtcy.E.D.Pa.1990).

In the present case, the Putnam litigation was instituted on September 19, 1988, by the Equity Committee against Heck's officers and members of its Board of Directors, John R. Isaac, Jr, Maarten D. Hemsley, Katy M. Hurley, and William K. Bragg, Jr., all of whom were engaged by Heck's after the Chapter 11 case was filed, and two other directors, Brenda Cole and Gerald A. Eppner, alleging post-petition breach of fiduciary duty, loyalty and good faith on the part of the officers and directors in "caus[ing] Heck's to file, and to seek confirmation of, a plan of reorganization (the "Plan") which would financially devastate Heck's shareholders, while providing a windfall to senior management ..." *See* Bankruptcy Docket No. 2859. A plain reading of the Putnam County complaint reveals that the actions complained of on the part of the officers and directors did not concern pre-petition conduct or services, but rather conduct and services rendered to the debtor-in-possession post-petition. *See* Verified Complaint, attached as exhibit to Bankruptcy Docket No. 2859, at ¶ 14 ("The automatic stay pursuant to Section 362 of the Bankruptcy Code, 11 U.S.C. § 362, is inapplicable to this Complaint, *since the acts and transactions which form the basis of this Complaint occurred after the Filing Date* ") (emphasis supplied).

***768** Inasmuch as the claim against the officers and directors of Heck's related solely to post-petition conduct and services, the bankruptcy judge properly concluded that the officers and directors were entitled to indemnification under Heck's Articles of Incorporation and could be afforded administrative cost priority under § 503(b)(1)(A).

3. *Due Process re Sanctions*

BI & L further argues that the bankruptcy court did not provide it with notice that sanctions under Rule 9011 were being considered in connection with its final fee application, nor conduct a hearing on the propriety of such sanctions prior to entry of the final fee order. The imposition of sanctions, BI & L thus argues, violated its right to due process of law and was further violative of the bankruptcy court's own procedural order entered on August 17, 1989.

a.

[29] With regard to the $91,582.25 sanction based on indemnification of Heck's officers and directors, it is noted that the bankruptcy court stated in a footnote to its final fee order that "[a]t pages 21 and 22 of the transcript of a December 20, 1988 hearing on various objections to BIL fees, the Court informed BIL that consideration was being given to this assessment." *See* Final Fee Order, 112 B.R. at 803, n. 76. During the course of that hearing, BI & L's intent to voluntarily reduce a portion of its fees by 20% was addressed, at which time the bankruptcy judge stated as follows:

> Not only do I feel it is appropriate for the Equity Committee to reduce its fees as you have voluntarily chosen to do, but I am considering assessing the committee itself for the additional expenses that have been incurred by the Debtor in bringing a cause of action that we have not been asked to rule on the merits....
>
> Frankly, I am not sure that a voluntary reduction of fees, as you have suggested, is adequate, in light of the fact that counsel for the Debtor reports to me he is expecting the Debtor to be requested to reimburse the officers for the expenses of retaining counsel to defend a suit that I, frankly, do not know on what basis you brought.
>
> I would submit to you that it appears entirely possible to me that Heck's should be required to reimburse those expenses only after we have offset them from fees you have asked for in the case.

See Bankruptcy Docket No. 2843.

After the bankruptcy judge's statement on the record on December 20, 1988, the court entered its order of August 17, 1989, as earlier noted, stating as follows:

> The Court is currently in the process of setting final rates of compensation for all professionals who have performed services in these cases and intends to provide notice of such rates and opportunity for response prior to any final order on compensation of professionals.... [I]t being the Court's intention to provide notice and opportunity for comment or hearing as outlined above....

This court has held, *see infra* pages 747–48, that, inasmuch as BI & L failed to request a hearing, the notice just quoted, coupled with the opportunity for response prior to any final order on compensation, was sufficient to meet the notice and hearing requirements of section 330(a). However, with respect to the imposition of sanctions, the bankruptcy court failed to provide BI & L an opportunity for either response or a hearing. The failure to apprise BI & L of sanctions against it until the fee order was entered violated the spirit, if not the express terms, of the court's order of August 17, 1989.[26]

26 There is no contention by any party to this appeal that any suggestion was thereafter made by the bankruptcy court on the record or otherwise regarding the imposition of sanctions upon BI & L. Similarly, there is no indication that any prior notice was given respecting the reduction of lead counsel Miller's fees of $57,596.00 to zero.

b.

[30] It is well-recognized that parties facing the imposition of sanctions under Bankruptcy Rule 9011, under 28 U.S.C. § 1927, and pursuant to the court's inherent power are protected by the due process clause of the Fifth Amendment. *See, e.g.,* ***769** *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 766–767, 100 S.Ct. 2455, 2464, 65 L.Ed.2d 488 (1980); *Braley v. Campbell,* 832

F.2d 1504, 1514 (10th Cir.1987); *In re Endrex Investments, Inc.,* 111 B.R. 939, 943 (D.Colo.1990). In the final fee order in this case, the bankruptcy judge referenced only Bankruptcy Rule 9011 in sanctioning BI & L for what he concluded was improper conduct and did not purport to rely upon 28 U.S.C. § 1927 or the court's inherent authority to impose sanctions, both of which were addressed in *Roadway Express.* The court's authority to impose sanctions under *Roadway Express* has been raised in this appeal by the United States Trustee. In *Roadway Express,* the Supreme Court specifically noted that sanctions "certainly should not be assessed lightly or without fair notice and an opportunity for a hearing on the record." 447 U.S. at 767, 100 S.Ct. at 2464.

In *In re Endrex Investments, Inc.,* the Colorado district court held that a bankruptcy court's imposition of sanctions, *sua sponte* and without notice and opportunity to be heard, upon a debtor and its attorneys under Rule 9011 and the court's inherent power violated their right to due process. 111 B.R. 939. In reaching this decision, the *Endrex* court observed that it was undisputed that neither the creditors of the estate nor the United States Trustee had moved the court for sanctions, and that the imposition of sanctions was *sua sponte.* The court further noted that, although the parties had received notice that the bankruptcy court was prepared to consider the debtor's bad faith filing and maintenance of its Chapter 11 case at the hearing on a motion to dismiss, "the record shows that the court did not mention the issue of sanctions until the *close* of that hearing." 111 B.R. at 944 (emphasis in the original). The court concluded:

> Consequently, the appellants were deprived of any meaningful opportunity to prepare argument against the imposition of sanctions, much less present any evidence to support their argument. The problem was not corrected in the subsequent hearing on the motion for reconsideration, as the court again limited counsel's introduction of evidence to support the appellant's reasonableness in attempting reorganization.

111 B.R. at 944. *In accord, see Jensen v. Federal Land Bank,* 882 F.2d 340 (8th Cir.1989) (Rule 9011); *Tom Gowney Equipment v. Shelley Irrigation Dev.,* 834 F.2d 833, 836 (9th Cir.1987) (Rule 11).

Here, as in *Endrex,* it appears that the bankruptcy court's imposition of sanctions was *sua sponte* and not based upon motion of any party to the bankruptcy case. Although the Bank Committee contends that BI & L was put on notice that their conduct was in issue due to the Bank Committee's fee objections, there is no suggestion made that the Bank Committee or any other party to the bankruptcy proceeding moved the court for sanctions against BI & L.

[31] Further, it is clear from a review of cases such as *Endrex* and *Jensen* that notice pertaining to imposition of sanctions must be sufficiently specific as to provide the party a meaningful opportunity to prepare and present argument and evidence to the contrary. *See Jensen,* 882 F.2d at 341; *Endrex,* 111 B.R. at 944. In the bankruptcy judge's statement in the December, 1988, hearing, no mention was made of the term "sanctions" and no reference was made to Bankruptcy Rule 9011 or any other authority under which he intended to act. The statement was ambiguous at best and is not found to have constituted the fair notice required to satisfy due process. Further, it is conceded that no sanctions hearing was held.

4. *The Propriety of Sanctions*

Notwithstanding the lack of due process in the course of imposing sanctions, BI & L and the Equity Committee have informed the court of their withdrawal of their argument in this respect, while expressly reserving their contention that the bankruptcy court erred as a matter of law in imposing sanctions.

Having previously concluded that the Equity Committee improperly struck off on its own by filing a fruitless action in state court against Heck's officers and directors, ***770** and failed, prior to doing so, to obtain leave of the bankruptcy court, *supra* pp. 763–64, it appears that the imposition of sanctions in this case may have been entirely appropriate. Because the bankruptcy court failed, however, to reference authority other than Rule 9011 in imposing sanctions against BI & L, remand is found to be necessary in order for the bankruptcy judge to analyze and make specific factual findings relative to the standards applicable to the imposition of sanctions under either or both the court's inherent authority and 28 U.S.C. § 1927.

Although the standards relative to the imposition of sanctions under Rule 11 and § 1927 have been recognized as being duplicative to some extent, courts have recognized that the two sources of authority require the application of different standards of proof. *Jones v. Pittsburgh National,* 899 F.2d 1350, 1358 (3rd Cir.1990). In *Jones,* the Third Circuit observed that, unlike Rule 11, sanctions imposed under § 1927 "only covers the excess costs generated by an attorney that resulted from a multiplication of proceedings, 'unreasonably and vexatiously,' " and that § 1927 "requires a finding of counsel's bad faith." *Id.* In *Jones,* as in the present case, remand was found to be necessary inasmuch as the district court did not differentiate between Rule 11 and § 1927 in imposing sanctions. *Id.*

Other courts, like *Jones,* have recognized that the imposition of sanctions under either the court's inherent authority or § 1927 requires a finding of bad faith on the part of counsel. *See, e.g., In re Peoro,* 793 F.2d 1048, 1051 (9th Cir.1986) ("It is clear that the crucial element for a fee award under 28 U.S.C. § 1927 is 'bad faith' "); *Dreiling v. Peugeot Motors of America,* 850 F.2d 1373, 1382 (10th Cir.1988) (fees may be awarded under *Roadway Express* where losing party "has acted in bad faith, vexatiously, wantonly or for oppressive reasons." "[N]egligence, frivolity or improvidence" will not suffice); *Williams v. Giant Eagle Markets, Inc.,* 883 F.2d 1184, 1191 (3rd Cir.1989) (court should exercise authority under § 1927 "only in instances of a serious and studied disregard for the orderly process of justice ... [and] must find willful bad faith on the part of the offending attorney"). *See also Blair v. Shenandoah Women's Center, Inc.,* 757 F.2d 1435, 1437–38 n. 5 (4th Cir.1985) (court may award expenses and fees under *Roadway Express* line of authority to a litigant "whose opponent acts in bad faith in instituting or conducting litigation").

Upon remand, the bankruptcy court is reminded that the factual analysis and findings to be made relative to the propriety of the sanctions under the court's inherent authority or under § 1927 must focus upon the conduct of BI & L relating to the filing of the officers and directors action in state court, without leave of the bankruptcy court, which this court has previously concluded was improper. Conduct on the part of BI & L relative to matters which this court has previously concluded was not unreasonable, unnecessary or inconsistent with the legitimate pursuit and advancement of BI & L's client's interests in the case is not to be revisited except that such conduct may be considered insofar as it constitutes a part of the totality of the circumstances indicating whether the fiduciary action was filed and maintained vexatiously or in bad faith by BI & L.

B. The Withholding of Robert Miller Compensation of $57,596

[32] The bankruptcy court reduced to zero the rate of compensation allowed Robert Miller, lead counsel for the Equity Committee, for the "great majority" of hours billed by Miller for the period from June 1, 1988, through September 30, 1989. In doing so, the total sum of $57,596 in compensation sought by BI & L was denied for Miller's efforts which the bankruptcy court concluded were "inconsistent with the requirements of Bankruptcy Rule 9011," and which "threatened the very possibility of reorganization." *See* Final Fee Order, 112 B.R. at 808. The court reasoned that "beginning in June, 1988, lead counsel of Equity Committee launched a barrage of meritless demands and threats, characterized by the Bank Committee as outrageous, that *771 were intended to coerce other creditors in the case and put in jeopardy the ability of the DIP to provide recovery for anyone. These actions were improper in the representation of equity interests and damaged the DIP by creating substantial administrative expense, delay and confusion." Final Fee Order, 112 B.R. at 808.

The bankruptcy court also observed that Miller had failed to comply with the terms of Administrative Order III, which required supervising attorneys to "strictly adhere to 11 U.S.C. § 330 in determining the allocation of work to be performed by their firms," and to "exercise control over time spent by associates and paralegals on research, revision, and editing ..." *See* Final Fee Order, 112 B.R. at 806. Unfortunately, the bankruptcy court failed either to specify what particular hoursof service it was denying or quantify the extent of the denial for a given ground among the several general reasons which it assigned.

The parties, however, have stipulated that of the $57,596.00 sought, $7,596.00 relates to the officers and directors action and the balance of $50,000.00 relates to other services performed by Miller in the course of his representation of the Equity Committee. Unlike the $7,596.00, which the bankruptcy court properly denied, the $50,000.00 appears to represent services performed for which BI & L is entitled to be paid. The bankruptcy court's displeasure with Miller's having filed the motion in state court for a shareholder meeting and the motion in bankruptcy court for appointment of an operating trustee is not an adequate reason

for the denial of compensation in connection therewith. The suggestion that the 26–day flurry of activity threatened the very possibility of reorganization is not based on a realistic view of that which was taking place. Save for the unauthorized action against the officers and directors, all of that activity was permissible. Indeed, it served very quickly to bring the parties together. There is simply no evidence to support the finding that the very possibility of reorganization was thereby jeopardized. Inasmuch as no sufficient ground has been delineated and quantified as the basis for denying any particular portion of the Miller services other than that pertaining to the officers and directors action, the $50,000.00 must be allowed to BI & L. [27]

27 The parties to this appeal have further stipulated and agreed as follows:

> Berlack, Israels & Liberman is entitled to receive the "final compensation" of $70,989.79 in fees and $29,707.32 in expenses which were approved by the Bankruptcy Court in its February 21, 1990 "Order Awarding Final Compensation to Counsel for Equity Security Holders' Committee, Berlack, Israels & Liberman, Pursuant to Memorandum Opinion Entered February 21, 1989 [sic]," but which has not been paid to Berlack, Israels & Liberman, pursuant to the provision in that Order that no moneys be paid to Berlack, Israels & Liberman if an appeal was taken therefrom ... [together with] interest on the aforementioned withheld fees of $70,989.79 and the aforementioned withheld expenses of $29,707.32, from February 21, 1990, at the interest rate actually earned on the escrow account established pursuant to Article III of the Plan.

V. *Conclusion*

For the reasons fully set forth in section III of this order pertaining to the bankruptcy court's denial of fees to BI & L in the amount of $214,362.45, it is accordingly **ORDERED** that the bankruptcy court's denial of fees to Berlack, Israels & Liberman for services rendered as counsel for the Equity Security Holders' Committee be, and the same hereby is, affirmed to the extent of $114,110.03, and reversed to the extent of $100,252.42 to the end that fees sought by BI & L in conjunction therewith be, and the same hereby are, allowed in such amount of $100,252.42.

For the reasons fully set forth in section IV of this order pertaining to the bankruptcy court's imposition of sanctions upon BI & L in the amount of $91,582.25, it is accordingly ORDERED that the bankruptcy court's imposition of sanctions against Berlack, Israels & Liberman as counsel for the Equity Security Holders' Committee be, and the same hereby is, reversed to the extent of $9,100.00 to the end that fees denied to BI & L in conjunction therewith be, and the same hereby are, allowed in such amount of $9,100.00; and it is further **ORDERED** that this matter be remanded ***772** to the bankruptcy court with respect to the issue of sanctions in the amount of $82,482.25 for further proceedings in accordance with this opinion, including opportunity for the parties to introduce evidence and be heard in connection therewith.

For the reasons fully set forth in section IV of this order pertaining to the bankruptcy court's denial of fees pursuant to Bankruptcy Rule 9011 to BI & L's lead counsel, Robert Miller, in the amount of $57,596.00, it is accordingly **ORDERED** that the bankruptcy court's denial of such fees be, and the same hereby is affirmed to the extent of $7,596.00, and reversed to the extent of $50,000.00 to the end that the fees denied to BI & L in conjunction therewith for work performed by Miller be, and the same hereby are, allowed in the amount of $50,000.00.

JUDGMENT ORDER

For the reasons set forth in the memorandum order this day entered in the above-styled consolidated civil actions, it is **ORDERED, ADJUDGED** and **DECREED** that the bankruptcy court's denial of fees to Berlack, Israels & Liberman for services rendered as counsel for the Equity Security Holders' Committee be, and the same hereby is, affirmed to the extent of $121,706.03; reversed and allowed to Berlack, Israels & Liberman to the extent of $159,352.42; and remanded to the bankruptcy court with respect to the issue of sanctions in the amount of $82,482.25 for further proceedings in accordance with the memorandum order this day entered, including opportunity for the parties to introduce evidence and be heard in connection therewith.

It is further **ORDERED**, in accordance with the stipulation and agreement of the parties on appeal, that Berlack, Israels & Liberman receive fees of $70,989.79 and expenses of $29,707.32 approved by the bankruptcy court in its order of February 21, 1990, together with interest thereon from February 21, 1990, at the interest rate actually earned on the escrow account established pursuant to Article III of the debtor's confirmed plan.

All matters in these consolidated appeals having been resolved, it is further **ORDERED** that these actions be dismissed and stricken from the docket of the court.

End of Document

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TAB 14

CITATION: Re Xinergy Ltd., 2015 ONSC 2692
COURT FILE NO.: CV-15-10936-00CL
DATE: 20150424

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C 36, AS AMENDED AND IN THE MATTER OF CERTAIN PROCEEDINGS TAKEN IN THE UNITED STATES BANKRUPTCY COURT WITH RESPECT TO **XINERGY LTD.** APPLICATION OF XINERGY LTD. UNDER SECTION 46 OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C 36, AS AMENDED	)	*Jane Dietrich and Natalie Levine*, for the Applicant *Aubrey E. Kauffman*, for Whitebox Advisors LLC, Highbridge Capital Management LLC and other DIP Lenders *Sean Sweig*, for Deloitte Restructuring Inc., the proposed Information Officer *James H. Grout*, for Jon Nix, a shareholder of the Applicant **HEARD:** April 23, 2015

NEWBOULD J.

[1] On April 6, 2015, Xinergy Ltd. ("Xinergy"), an Ontario corporation, commenced a voluntary reorganization proceeding in the United States Bankruptcy Court for the Western District of Virginia (the "U.S. Court") under chapter 11 of the United States Bankruptcy Code. On the same date, 25 of Xinergy's U.S. subsidiaries also filed voluntary petitions under chapter 11 of the Bankruptcy Code with the U.S. Court.

[2] On April 6 and 7, 2015 the chapter 11 Debtors filed 17 First Day Motions with the U.S. Court and on April 7 and 8, 2015, the U.S. Court entered the orders requested.

[3] Xinergy has now brought an application before this Court pursuant to Part IV of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended for an order recognizing the U.S. proceedings as foreign main proceedings and for orders recognizing some of the first day orders made by the U.S. Court. At the conclusion of the hearing I granted the orders requested for short reasons to follow. These are my reasons.

Business of the applicant

[4] Xinergy is a publicly traded company on the TSX under the ticker symbol XRG. As at September 30, 2014, the date of Xinergy's most recent public filing, there were approximately 58.3 million voting common shares issued and outstanding, and 7.5 million common non-voting shares issued and outstanding, totalling approximately 65.8 million common shares.

[5] The Chapter 11 Debtors are a U.S.-based producer of metallurgical and thermal coal with mineral reserves, mining operations and coal properties located in the Central Appalachian regions of West Virginia and Virginia. The Chapter 11 Debtors' principal operations include two active mining complexes known as South Fork and Raven Crest located in Greenbrier and Boone Counties, West Virginia. The Chapter 11 Debtors also lease or own the mineral rights to properties located in Fayette, Nicholas and Greenbrier Counties, West Virginia and Wise County, Virginia. Collectively, the Chapter 11 Debtors lease or own mineral rights to approximately 72,000 acres with proven and probable coal reserves of approximately 77 million tons and additional estimated reserves of 40 million tons.

[6] The Chapter 11 Debtors currently produce and ship coal from the South Fork mid-volatile metallurgical mine and the Raven Crest thermal operations. The Chapter 11 Debtors' primary customers for metallurgical coal—used in a chemical process that yields coke for the manufacture of steel—are steel producers, commodities brokers and industrial customers throughout North America, Europe and South America. Electric utilities and industrial companies in the southeastern United States and Europe are the principal customers for the Chapter 11 Debtors' thermal coal.

[7] Recently, U.S. demand for thermal coal has fallen sharply in large part due to (i) increasingly attractive alternative sources of energy, such as natural gas, and (ii) burdensome environmental and governmental regulations impacting end users. Simultaneously, the increasingly stringent regulatory environment in which coal companies operate has driven up the cost of mining and processing coal. Continued weakness in the market for metallurgical and thermal coal, combined with an extremely cold and snowy winter that impacted the mining and shipment of coal, has continued to erode Xinergy's cash position. Prior to approval by the U.S. Court of the post-petition DIP financing, Xinergy lacked the liquidity needed to maintain operations in the near term and to sustain its current capital structure. The confluence of these factors and Xinergy's substantial debt burden has taken Xinergy to the point of unsustainability absent the relief provided by the Chapter 11 proceeding.

[8] Xinergy has issued US$200 million in 9.25% Senior Secured Notes (the "Second Lien Notes"), of which approximately US$195 million (principal amount) is outstanding. As of the April 6, 2015, Xinergy was also obligated under two term loans totalling US$20 million in principal amount (the "First Lien Loans").

Requests for relief

[9] Xinergy seeks recognition of four of the orders granted by the U.S. Court. The U.S. Court orders are:

(a) Order Authorizing Xinergy Ltd. to Act as a Foreign Representative (the "Foreign Representative Order");

(b) Interim Order (I) Authorizing Debtors (a) to Obtain Post-petition Financing and (b) to Utilize Cash Collateral; (II) Granting Adequate Protection to Prepetition Secured Parties; and (III) Scheduling Final Hearing (the " Interim DIP Order");

(c) Interim Trading Order Establishing Notification Procedures and Approving Restrictions on Certain Transfers of Equity Interests in the Debtors' Estates (the "Interim Trading Order"); and

(d) Interim Order (I) Authorizing Debtors to Maintain Existing Bank Accounts and Business Forms and Continue to Use Existing Cash Management System; (II) Granting Administrative Expense Status for Intercompany Claims; and (III) Waiving the Requirements of Section 345(b) of the Bankruptcy Code (the "Interim Cash Management Order")

Recognition of foreign main proceeding

[10] Subsection 46(1) of the CCAA provides that a foreign representative may apply to the Court for recognition of a foreign proceeding in respect of which he or she is a foreign representative.

[11] A "foreign representative" for the purpose of subsection 46(1) of the CCAA is defined by subsection 45(1) of the CCAA, which provides:

> "Foreign Representative" means a person or body, including one appointed on an interim basis, who is authorized, in a foreign proceeding respect of a debtor company, to
>
> (a) monitor the debtor company's business and financial affairs or the purpose of reorganization; or
>
> (b) act as a representative in respect of the foreign proceeding.

[12] In the Chapter 11 proceedings, the Chapter 11 Debtors sought the appointment of Xinergy as the foreign representative of the Chapter 11 Debtors, within the meaning of subsection 45(1) of the CCAA. The Foreign Representative Order was granted by the U.S. Court on April 7, 2015.

[13] Subsection 47(1) of the CCAA provides that the Court shall grant an order recognizing the foreign proceeding if (i) the proceeding is a foreign proceeding; and (ii) the applicant is a foreign representative in respect of that proceeding. There is no question but that the Chapter 11 proceedings are foreign proceedings and should be recognized under the CCAA.

[14] Subsection 47(2) of the CCAA requires that the Court specify whether the foreign proceeding is a "foreign main proceeding" or a "foreign non-main proceeding." I am satisfied that the Chapter 11 proceedings are foreign main proceedings.

[15] Subsection 45(2) of the CCAA provides that in the absence of proof to the contrary, a debtor company's registered office is deemed to be the centre of its main interests, or COMI. The registered office of Xinergy is in Toronto at its counsel's office. In considering whether the registered office presumption has been rebutted a court should consider the following factors in determining COMI (i) the location is readily ascertainable by creditors (ii) the location is one in which the debtor's principal assets and operations are found and (iii) the location is where the management of the debtor takes place. See *Lightsquared LLP, Re* (2012), 92 C.B.R. (5th) 321; *MtGox Co. (Re)* (2014), 20 C.B.R. (6th) 307.

[16] Although Xinergy's registered office is in Ontario, it has no operations in Canada. Additionally, Xinergy has no employees in Canada and no offices in Canada other than its registered office. The Chapter 11 Debtors operate on an integrated basis, with corporate and other major decision-making occurring from the consolidated offices in Knoxville, Tennessee. In particular:

(a) Corporate and other major decision-making occurs from the consolidated offices in Knoxville, Tennessee, although administrative employees frequently work remotely or from the Chapter 11 Debtors' mines in the United States;

(b) All of the senior executives of the Chapter 11 Debtors, including Xinergy, are residents of the United States;

(c) In order to fulfil the Canadian residency requirements of Ontario corporations, Xinergy has two Canadian directors;

(d) The majority of the management of the Chapter 11 Debtors, including Xinergy, is shared;

(e) Employee administration, human resource functions, marketing and communications decisions are made, and related actions taken, on behalf of all of the Chapter 11 Debtors, including Xinergy, in the United States;

(f) The Chapter 11 Debtors, including Xinergy, share a cash management system that is largely funded by the U.S. Subsidiaries, overseen by employees of the United States-based Chapter 11 Debtors and located primarily in the United States;

(g) Other functions shared between the Chapter 11 Debtors, including Xinergy, are managed from the United States including: pricing decisions, business development decisions, accounts payable, accounts receivable and treasury functions;

(h) While Xinergy maintains a bank account with The Toronto Dominion Bank in Ontario, the Chapter 11 Debtors use this account to make Canadian denominated deposits and to pay for Canadian services. When additional funds are required, a transfer is made from the U.S. operating account at Xinergy Corp. Xinergy is dependent on the U.S. subsidiaries for substantially all of its funding requirements; and

(i) Other functions shared between the Chapter 11 Debtors, including Xinergy, are managed from the United States including: pricing decisions, business development decisions, accounts payable, accounts receivable and treasury functions.

[17] As the Chapter 11 proceedings are foreign main proceedings, an order is to go under subsection 48(1) of the CCAA staying all proceedings against Xinergy.

Interim DIP Order

[18] The Interim DIP Facility Order, inter alia:

(a) authorizes Xinergy Corp. to obtain post-petition financing pursuant to the DIP Facility up to an aggregate principal amount of $40 million;

(b) authorizes Xinergy and the other Chapter 11 Debtors to unconditionally guarantee all obligations arising under the DIP Facility;

(c) authorizes the Chapter 11 Debtors to use proceeds of the DIP Facility to pay in full the First Lien Loans (the holders of the First Lien Notes are the DIP lenders) ; and

(d) grants first priority super priority claims in connection with the DIP Facility.

[19] The authorization by the U.S. Court to use the proceeds of the DIP Facility to pay out the First Lien Loans, called a "rollup" provision, is not something that can be ordered in a CCAA proceeding as subsection 11.2(1) of the CCAA provides that DIP security may not secure an obligation that existed prior to an Initial Order. However, the issue is whether our Court should recognize the U.S. Court order authorizing that DIP facility under the principles of comity recognized in section 44 of Part IV of the CCAA.

[20] Such a provision has been recognized in *Hartford Computer Hardware Inc., Re* (2012), 94 C.B.R. (5th) 20 by Morawetz J. (as he then was) under section 49 of the CCAA which permits an order to be made if the Court is satisfied that it is necessary to protect the debtor's property or is in the interests of its creditors.

[21] It was obviously seen by the U.S. Court to be in the interests of Xinergy and the other Chapter 11 Debtors to make DIP order that it did. One question to consider is whether there would be any material adverse interest to any Canadian interests in recognizing the "rollup" features of the DIP facility. If there were such material adverse interest, it would put in play a consideration of that adverse interest vis-à-vis the principles of comity that speak to the recognition of an order made in a foreign main proceeding.

[22] In this case, there are four unsecured creditors of Xinergy in Canada being (i) a director owed approximately $1,674, (ii) TMX Equity Transfer Services owed approximately $4,000, (iii) TMX owed $16,492, and (iv) the solicitors for Xinergy (who consent to the rollup DIP facility). The bank account in Canada had approximately $48,415 in it on April 6, 2015. The Canadian unsecured creditors, however, had no economic interest in that bank account as it was secured to the holders of the First Lien Notes. The DIP facility has not changed that. Deloitte, the proposed Information Officer, is of the view that there will be no material prejudice to the Canadian creditors if the Interim Dip Facility order is recognized in these proceedings, and I accept that view.

[23] I am satisfied that the Interim DIP Facility Order should be recognized.

Other orders

[24] The interim trading order made by the U.S. Court ordered on an interim basis certain restrictions on the trading of Xinergy stock. In light of the rules under the Internal Revenue Code in the United States, transfers of the stock may, through no fault of the Chapter 11 Debtors, deprive the Chapter 11 Debtors of important tax benefits. The Interim Trading order was made to protect against this potential harm to debtors in chapter 11 proceedings. It is appropriate to recognize it in this CCAA proceeding.

[25] The relief granted by the U.S. Court in the Interim Cash Management Order will permit Xinergy and the other Chapter 11 Debtors to continue to operate in ordinary course, thereby preserving value for creditors. It is appropriate to recognize it in this CCAA proceeding.

[26] Xinergy has requested an order appointing Deloitte as Information Officer and granting a super-priority charge up to a maximum of $100,000 for its fees and those of its counsel. It is appropriate to make such an order. The DIP lenders consent to the charge. The appointment of Deloitte will help facilitate these proceedings and the dissemination of information concerning the Chapter 11 proceeding. The Information Officer will: (i) act as a resource to the foreign

representative in the performance of its duties; (ii) act as an officer to the Court, reporting to the Court on the proceedings, as required by the Court; and (iii) provide stakeholders of Xinergy with material information on the Chapter 11 proceeding. See *Lear Canada, Re* (2009), 55 C.B.R. (5th) 57 at para. 23 per Pepall J. (as she then was).

[27] For these reasons, I signed the orders as requested at the conclusion of the hearing.

Newbould J.

Released: April 24, 2015

CITATION: Re Xinergy Ltd., 2015 ONSC 2692
COURT FILE NO.: CV-15-10936-00CL
DATE: 20150424

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF CERTAIN PROCEEDINGS TAKEN IN THE UNITED STATES BANKRUPTCY COURT WITH RESPECT TO **XINERGY LTD.**

APPLICATION OF XINERGY LTD. UNDER SECTION 46 OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C 36, AS AMENDED

REASONS FOR JUDGMENT

Newbould J.

Released: April 24, 2015

TAB 15

DUFF & PHELPS

Ninth Report to Court of Duff & Phelps Canada Restructuring Inc. as CCAA Monitor of Unique Broadband Systems, Inc. and UBS Wireless Services Inc.

July 5, 2012

Contents

DUFF&PHELPS

Court File No.: CV-11-9283-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF
UNIQUE BROADBAND SYSTEMS, INC.

NINTH REPORT OF DUFF & PHELPS CANADA RESTRUCTURING INC. AS CCAA MONITOR OF UNIQUE BROADBAND SYSTEMS, INC. AND UBS WIRELESS SERVICES INC.

July 5, 2012

1.0 Introduction

Pursuant to an order ("Initial Order") of the Ontario Superior Court of Justice (Commercial List) ("Court") made on July 5, 2011, Unique Broadband Systems, Inc. ("UBS") and UBS Wireless Services Inc. ("Wireless") (UBS and Wireless are jointly referred to as the "Company") were granted protection under the *Companies' Creditors Arrangement Act* ("CCAA") and RSM Richter Inc. ("Richter") was appointed as the monitor ("Monitor"). Pursuant to a Court order made on December 12, 2011 (the "Substitution Order"), Duff & Phelps Canada Restructuring Inc. ("D&P"), as part of its acquisition of the Toronto restructuring practice of Richter, was substituted in place of Richter as Monitor[1].

Pursuant to an order of the Court made on April 13, 2012, the Company's stay of proceedings expires on July 30, 2012.

[1] On December 9, 2011, the assets used by Richter in its Toronto restructuring practice were acquired by D&P. Pursuant to the Substitution Order, D&P was substituted in place of Richter in certain ongoing mandates, including acting as Monitor in these proceedings. The licensed trustees/restructuring professionals overseeing this mandate prior to December 9, 2011 remain unchanged.

1.1 Purposes of this Report

The purposes of this report ("Report") are to:

a) Provide background information about the Company and these CCAA proceedings;

b) Summarize a settlement between the Company, on the one hand, and DOL Technologies Inc. ("DOL"), Mr. Alex Dolgonos and companies controlled by him (collectively, "DOL Group"), on the other hand, with respect to all known claims that exist between them, subject to Court approval ("Settlement"); and

c) Recommend that this Honourable Court make an order approving the Settlement.

1.2 Currency

Unless otherwise noted, all currency references in this Report are to Canadian dollars.

2.0 Background

Background information concerning the Company is detailed in the affidavit of Robert Ulicki (the "Ulicki Affidavit"), a director of the Company, sworn July 4, 2011 and filed with the Company's CCAA application materials. The Ulicki Affidavit details, *inter alia*, the Company's history, financial position, ownership interest in Look Communications Inc. and litigation.

Additional information concerning the Company and these proceedings is provided in the proposed monitor's report and the Monitor's reports filed in these proceedings. Copies of these reports can be found on the Monitor's website at: www.duffandphelps.com/restructuringcases.

3.0 UBS and DOL Group

The Company commenced these CCAA proceedings in order to implement a process to have determined, on an expedited and cost effective basis, claims made against it principally by two creditor groups – the claims of DOL Group and Jolian Investments Limited and its principal, Mr. Gerald McGoey (together, "Jolian"). The claims arise from the replacement of the Company's board of directors ("Board") in July, 2010 at a special meeting of UBS's shareholders ("Meeting"). Mr. Dolgonos was the Company's Chief Technology Officer prior to the date of the Meeting.

Mr. Dolgonos controls 2064818 Ontario Inc. ("206") and 6138241 Canada Inc., which together are the Company's largest shareholders, owning in excess of 22% of UBS's shares.

The Company's litigation with DOL Group has been at the center of this proceeding since it commenced. The issues between DOL Group and the Company have resulted in UBS incurring significant costs. A summary of the claims between DOL Group and the Company is provided below.

3.1 Claims of DOL Group against UBS

DOL Group filed claims against the Company pursuant to a Court order made August 4, 2011 ("Claims Bar Procedure Order"). The claims include the following:

- Over $8 million for, among other things, a payment under a Technology Development and Strategic Marketing Agreement dated July 12, 2008 between DOL and UBS, unpaid bonuses awarded to DOL prior to the date of the Meeting, amounts owing in respect of the cancellation of a share appreciation rights plan, DOL's legal fees and other costs incurred prior to the date of the Initial Order, plus taxes and interest;

- Indemnification for legal fees and other expenses incurred by DOL and Mr. Dolgonos subsequent to the date of the Initial Order in amounts to be determined; and

- An action pursuant to the oppression remedy provisions of the *Business Corporations Act* (Ontario) against UBS and each of its directors ("Oppression Action") in amounts to be determined.

Copies of DOL Group's claims filed against the Company pursuant to the Claims Bar Procedure Order are provided in Appendix "A", without attachments.

3.2 Claims of UBS against DOL Group

Prior to the commencement of this proceeding, UBS had filed defences and counterclaims with respect to DOL Group's (and Jolian's) claims. UBS denied any amounts were owing to DOL Group and sought, among other things, a declaration that Mr. Dolgonos failed to act honestly and in good faith with a view to the best interests of UBS. UBS sought damages of $8 million in the aggregate as against DOL Group and Jolian.

As part of a Court order made April 13, 2012 ("Claims Determination Process Order"), and in order to advance the Claims Process, the Company limited its claims against DOL Group to:

- Reimbursement of approximately $270,000 in improper or unsupported expenses;

- Damages associated with DOL Group's role in a transaction between the Company and UBS Ltd. in 2003 and events subsequent thereto, in amounts to be determined; and

- The return of advances made by UBS to DOL Group's legal counsel in amounts to be determined.

4.0 Settlement

The Company, with the Monitor's assistance, has been exploring settlement options with DOL Group for several months. A key issue for DOL Group has been the composition of the Board and the election or replacement of the current directors. DOL Group has made clear during this proceeding that it wishes to change the Board composition and has taken steps to attempt to have the Board reconstituted.

The Court was scheduled to hear a motion by the Company on July 6, 2012 ("Hearing Date") seeking to postpone a meeting of shareholders that the Company scheduled for July 11, 2012 ("Shareholder Meeting"), but which the Company advised was subject to a potential postponement. One of the issues that was to be considered at the Shareholder Meeting was the appointment of a new board of directors sought by DOL Group.

Settlement discussions recently accelerated and led to the Settlement, which is summarized below:

a) All litigation claims between DOL Group and UBS, including the Oppression Action, will be dismissed and the parties will deliver mutual releases. Mutual releases will prevent DOL Group from making any indemnification claims against UBS in respect of all matters currently known to DOL Group, but will not prevent UBS from taking proceedings against persons other than DOL Group.

b) UBS will direct the Monitor to admit DOL's claim against UBS for $500,000 pursuant to the Claims Bar Procedure Order, inclusive of all legal and professional expenses payable under any indemnities. This will include all claims by DOL, 206 and Mr. Dolgonos, including Mr. Dolgonos's indemnification claim.

c) The UBS board will be reconstituted through to the conclusion of the CCAA proceedings with Messrs. Vic Wells, Ken Taylor (together, the "Proposed Directors") and one of the current UBS directors as directors. The UBS board may be reconstituted at an annual meeting of UBS shareholders ("AGM") or, to avoid the cost of an AGM, by way of a Court order under the CCAA[2].

[2] UBS intends to seek a Court order in this regard on July 6, 2012 to have the AGM stayed or suspended and to then proceed to reconstitute the Board through a series of sequential Board meetings.

d) DOL Group agrees to support the reconstituted UBS board, including any decision made by the UBS board with respect to how it will resolve/determine the claims made against UBS by Jolian and Mr. McGoey in the CCAA proceedings, through to the conclusion of the CCAA proceedings and to not seek a Court order terminating the CCAA proceedings. UBS will continue defending claims and reorganizing itself in the Court-supervised CCAA proceeding.

e) Mr. Dolgonos will not seek to be a director or officer of UBS, or have any direct or indirect consulting arrangement with the Company, through to the completion of the CCAA proceedings.

f) A Court order would be made that, subject to further Court order, UBS will not be obliged to convene any shareholder meetings until the CCAA proceedings are terminated.

The Settlement is subject to Court approval.

4.1 Recommendation

The Monitor supports the Settlement and respectfully recommends that it be approved by the Court for the following reasons:

a) The Settlement resolves DOL Group's claims (in excess of $8 million) for a claim of $500,000;

b) The Board supports the Settlement;

c) The Company has limited resources. Those resources have been used to fund litigation, and in all likelihood would continue to be depleted, in order to respond to motions brought by or in respect of DOL Group's claims and in having DOL Group's claims determined by the Court;

d) The Settlement resolves one of the two largest claims against the Company and will allow the Company to concentrate its efforts on dealing with Jolian's claims;

e) The Company and the Monitor have met, in person or by phone, with the Proposed Directors. The Proposed Directors have advised that they have no relationship with any party to this proceeding or a conflict of interest in this matter. There is no reason to believe that the Proposed Directors will not act in good faith and in the best interests of the Company. The Proposed Directors are experienced professionals. The Monitor and the Court will continue their supervisory roles;

f) The Proposed Directors will have the benefit of the remaining current director's experience and history of the CCAA proceedings, which should limit any costs and delays associated with a change in the Board composition; and

g) The Proposed Directors have agreed to compensation during the CCAA proceedings at the same rate as the existing directors - $20,000 each per annum.

5.0 Conclusion and Recommendation

Based on the foregoing, the Monitor respectfully recommends that this Honourable Court make an order granting the relief detailed in Section 1.1 (c) of this Report.

* * *

All of which is respectfully submitted,

Duff + Phelps Canada Restructuring Inc.

DUFF & PHELPS CANADA RESTRUCTURING INC.
IN ITS CAPACITY AS COURT APPOINTED CCAA MONITOR OF
UNIQUE BROADBAND SYSTEMS, INC.
AND UBS WIRELESS SERVICES INC.
AND NOT IN ITS PERSONAL CAPACITY

Appendix "A"

PROOF OF CLAIM

FOR CREDITORS OF UNIQUE BROADBAND SYSTEMS, INC. ("UBS") AND UBS WIRELESS SERVICES INC. ("UBSW" AND, TOGETHER WITH UBS, THE "APPLICANTS")

Please read carefully the enclosed Instruction Letter for completing this Proof of Claim form. Capitalized terms not defined within this Proof of Claim form shall have the meaning ascribed thereto in the Order of the Ontario Superior Court of Justice (Commercial List) dated 4 August 2011, as may be amended from time to time (the "**Claims Order**").

1. **PARTICULARS OF CREDITOR:**

(a) Full Legal Name of Creditor (include trade name, if different):

DOL Technologies Inc.

(the "**Creditor**"). The full legal name should be the name of the Creditor of the Applicant(s), notwithstanding whether an assignment of a Claim, or a portion thereof, has occurred prior to or following 5 July 2011.

(b) Full Mailing Address of the Creditor:

207 Arnold Avenue, Thornhill, ontario
L4J 1C1

The mailing address should be the mailing address of the Creditor and not any assignee.

(c) Other Contact Information of the Creditor: (c/o Alex Dolgonos)

Telephone Number: (416) 567-9647
Email Address: adolgonos@ad2007.com
Facsimile Number: (905) 707-1639
Attention (Contact Person): Alex Dolgonos

(d) Has the claim set out herein been sold, transferred or assigned by the Creditor to another party?

☐ Yes ☒ No

2. PARTICULARS OF ASSIGNEE(S) (IF APPLICABLE)

If the Claim set out herein has been sold, transferred or assigned, complete the required information set out below. If there is more than one assignee, please attach a separate sheet that contains all of the required information set out below for each assignee.

(a) Full Legal Name of Assignee:

_____

_____

(b) Full Mailing Address of the Assignee:

_____

_____

(c) Other Contact Information of the Assignee:

Telephone Number: _____

Email Address: _____

Facsimile Number: _____

Attention (Contact Person): _____

3. PROOF OF CLAIM – CLAIM AGAINST THE APPLICANT(S)

THE UNDERSIGNED HEREBY CERTIFIES AS FOLLOWS:

(a) That I:

☐ am a Creditor of one or more of the Applicants; OR

☒ am

Chief Technology Officer

(state position or title)

of

DOL Technologies Inc.

(name of Creditor)

(b) That I have knowledge of all the circumstances connected with the Claim described and set out below; and

(c) The Applicant(s) was and still is indebted to the Creditor as follows (include all Claims that you assert against the Applicant(s). Claims should be filed in the currency of the transactions, with reference to the contractual rate of interest, if any, and such currency should be indicated as provided below in respect of the following Claim(s):

(complete using original currency and amount)

	Amount of Claim	Currency	Secured	Unsecured
☒ UBS	See Schedule "A" ($8,042,716)	CDN	☐	☒
☐ UBSW			☐	☐

4. **NATURE OF CLAIM – Complete ONLY if you are asserting a Secured Claim**

Applicant: _____

☐ Secured Claim of $ _____

(Original currency and amount)

In respect of this debt, I hold security over the assets of the Applicant(s) valued at

$ _____

(Original currency and amount)

the particulars of which security and value are attached to this Proof of Claim form.

(Give full particulars of the security, including the date on which the security was given, the value which you ascribe to the assets charged by your security, the basis for such valuation and attach a copy of the security documents evidencing the security.)

Schedule "A" to
Proof of Claim of DOL Technologies Inc.

This Schedule "A" and the documents referenced herein and/or attached hereto form part of the Proof of Claim of DOL Technologies Inc. ("**DOL**" or the "**Claimant**") against Unique Broadband Systems, Inc. ("**UBS**" or the "**Company**").

Nature of the Claims

1. DOL is a private Ontario corporation of which 2064818 Ontario Inc. is a shareholder.

2. The Claimant claims against UBS the amount of $8,042,716 (all amounts in Canadian Dollars unless otherwise indicated) plus other amounts as indicated herein, including without limitation, any applicable GST, HST or other taxes ("**Tax**"), or otherwise determined to be payable by UBS to DOL by the Court or the Claims Officer.

3. The $8,042,716 consists of the following claims (all rounded to the nearest dollar), all as described in greater detail herein.

Claim		Amount
I.	Deferred bonus award	$1,256,677 plus Tax
II.	SAR cancellation payouts	$345,586 plus Tax
III.	Indemnification for legal expenses	$245,003 plus interest
IV.	Default and breach by UBS under the Technology Development and Strategic Marketing Agreement entered into between UBS and DOL, dated July 12, 2088 (the "**Technology Agreement**") and/or "termination without Cause"	$6,195,450 plus Tax

Particulars of Claims

I. Deferred Bonus Award

4. On or about August 28, 2009, the Board of Directors of UBS (the "**UBS Board**") granted to DOL a deferred bonus award ("**DBA**") for 2009 of $1,200,000 plus Tax. Attached hereto as Appendix "1" is a memorandum, dated September 8, 2009, from the Chairman and Chief Executive Officer of UBS at the time, Gerald McGoey, to DOL confirming approval of the DBA by the UBS Board and stating that:

> "The DBA will be payable on the earlier of the following conditions:
>
> 1. Adequate cash resources being received by the Company;

2. The termination of the Technology Agreement between DOL and the Company;

3. A change of control of the Company; and

4. At the discretion of the Board of Directors."

5. Based upon the above language, only one of the above conditions needed to be met in order for the DBA to be payable. Despite the fact that at least one of the above conditions had been met prior to July 5, 2011 (the "**CCAA Filing Date**"), UBS failed to make the required DBA payment to DOL and such DBA payment remains outstanding as at the date of this Proof of Claim.

6. In addition to the amount of $1,200,000 plus Tax, pursuant to the terms of the DBA as noted in the DBA memorandum, the DBA accrues compounded monthly interest at the prime rate of interest of Scotia Bank, and such interest is to be paid at the same time as the payment of the DBA. Based upon Scotia Bank's published prime rates from September 1, 2009 to June 30, 2011 (i.e. the 21 full months between the declaration of the DBA on August 28, 2009 and the CCAA Filing Date), the weighted average prime interest rate applicable to the DBA is approximately 2.65% per annum, or 0.22% per month, resulting in the following claim:

Principal amount of DBA Claim	$1,200,000
Interest (21 months compounded at 0.22%/month)	$56,677
Total DBA Claim	$1,256,677 plus Tax

7. Further particulars of the DBA claim are set out in: (i) the Statement of Claim of DOL filed against UBS in Ontario Court File No. CV-10-406609 and attached hereto as Appendix "**2**"; (ii) the Reply and Defense To Counterclaim of DOL and Mr. Alex Dolgonos ("**Dolgonos**") filed in Ontario Court File No. CV-10-406609 and attached hereto as Appendix "**3**" (collectively, the "**DOL/Dolgonos Pleadings**").

II. SAR Cancellation Payout

8. On August 28, 2009 the UBS Board also granted DOL a performance incentive of $330,000 plus Tax, in exchange for the relinquishment by the Claimant of its Share Appreciation Rights Units as at May 31, 2009 ("**SAR Cancellation Payout**"). Attached hereto as Appendix "4" is a copy of a letter agreement ("**SAR Cancellation Agreement**") from the Chairman and Chief Executive Officer of UBS at the time, Gerald McGoey, to DOL evidencing and setting out details of the SAR Cancellation Payout terms.

9. The SAR Cancellation Agreement states that payment of the SAR Cancellation Payout was conditional upon: receiving a full and final release from the Claimant in respect of

the cancellation of SAR Units; Look Communications Inc. ("**Look**") receiving the remaining $50 million consideration for the sale of its spectrum and broadcast licenses to Inukshuk Wireless Partnership; and UBS receiving adequate cash resources. A copy of the required full and final release was executed by the Claimant and is attached at the end of the SAR Cancellation Agreement attached hereto as Appendix "4" hereto. In addition, both of the other conditions to the payment of the SAR Cancellation Payout were met in that Look received the remaining consideration for the sales of its spectrum and broadcast licenses to Inukshuk in or about September 2009 according to the press release dated December 4, 2009 from Look attached hereto as Appendix "5" and UBS had, or would have had if UBS and its new board of directors appointed in July 2010 were acting in good faith in pursuing full payments and dividends which should have been paid by Look to UBS, adequate cash resources to make the $330,000 payment plus Tax.

10. In addition to the amount of $330,000.00 plus Tax, pursuant to the terms of the SAR Cancellation Agreement, the SAR Cancellation Payout accrues compounded monthly interest at the prime rate of interest of Scotia Bank, and such interest is to be paid at the same time as the payment of the SAR Cancellation Payout. As set out, in paragraph 6 above, the interest rate applicable to the SAR Cancellation Payout is 0.22% per month compounded monthly for 21 months (i.e. the full months between the date of the SAR Cancellation Agreement and the CCAA Filing Date) resulting in the following claim:

Principal amount of SAR Cancellation Payout:	$330,000
Interest (21 months compounded at 0.22% per month):	$15,586
Total SAR Cancellation Payout Claim:	$345,586 plus Tax

11. Despite the conditions to the SAR Cancellation Payout having been met prior to the CCAA Filing Date, UBS has failed to pay the SAR Cancellation Payout to DOL and the full amount of the SAR Cancellation Payout remains outstanding as at the date of this Proof of Claim.

III. Indemnification for Legal Expenses

12. Pursuant to Section 3.3.5 of the Technology Agreement, attached hereto as Appendix "6", UBS agreed to reimburse DOL for all reasonable legal expenses incurred in respect of the Technology Agreement, DOL's performance of the services under Technology Agreement and any other matter relating to the Company including the defence against actions commenced by regulatory authorities. UBS also agreed to make all reimbursements to DOL on a monthly basis.

13. In addition to its indemnification obligations under the Technology Agreement, UBS also has an obligation to indemnify DOL pursuant to an Indemnification Agreement dated January 25, 2007 between UBS and AD Enterprises (the "**DOL Indemnification Agreement**"), attached hereto as Appendix "7". AD Enterprises was a proprietorship

owned by Dolgonos. As indicated in the Marrocco Judgment (as defined below), when Dolgonos incorporated DOL, AD Enterprises transferred it business and assets to DOL, including its rights under the DOL Indemnification Agreement. There is also a separate indemnification agreement dated January 25, 2007 between UBS and Dolgonos personally (the "**Dolgonos Indemnification Agreement**"), attached hereto as Appendix "8".

14. DOL brought a motion before the Ontario Superior Court of Justice (Commercial List) (the "**Court**"), heard on or about April 27, 2011, seeking indemnification from UBS of the legal and other expenses incurred by the Claimant. By a Judgment of the Court dated April 27, 2011, the Honourable Mr. Justice Marrocco ordered that UBS has an obligation to indemnify DOL and Dolgonos for their existing and ongoing legal and other expenses, all as more particularly set out in the Judgment of the Court attached hereto as Appendix "9" and the reasons of Mr. Justice Marrocco issued in connection therewith and attached hereto as Appendix "**10**" (together, the "**Marrocco Judgment**").

15. Despite the Marrocco Judgment, UBS has failed, since the time of the appointment of its new Board on July 5, 2010 up to and including the date of this Proof of Claim, to pay any expenses incurred by the Claimant for which the Claimant has demanded indemnification and reimbursement. UBS had adequate resources during this time period to reimburse DOL for its legal and other expenses and DOL understands that UBS has in fact selectively been reimbursing other directors and officers, including payment of a retainer to Lax O'Sullivan Scott Lisus LLP for payment of the legal expenses of the current directors relating to an oppression action filed against them, while failing to reimburse the Claimant.

16. As at the CCAA Filing Date, the Claimant had incurred $245,003 (inclusive of applicable Tax) plus interest of legal fees and expenses for which it is entitled to indemnification and reimbursement from UBS and from which UBS has not reimbursed the Claimant. Attached are copies of legal bills from the Claimant's lawyers Roy Elliott O'Connor LLP (attached hereto as Appendix "**11**"), Bennett Jones LLP (attached hereto as Appendix "**12**") in the aggregate amount of $245,003. Pursuant to the Marrocco Judgement, the Claimant is entitled to and claims payment of this amount plus interest at 3% per annum from the date of the Marrocco Judgment (being April 27, 2011). In addition, the Claimant has continued to incur additional legal and other expenses since the CCAA Filing Date, for which it is entitled to ongoing indemnification and reimbursement as set out above.

IV. Breach by UBS of the Technology Agreement

17. Under the Technology Agreement, DOL agreed to cause Dolgonos to perform the services of Chief Technology Consultant of UBS.

18. Under Section 5.3.1 of the Technology Agreement, in the event of a Good Reason following a Change-of-Control, DOL is entitled to terminate the Technology Agreement. If the Technology Agreement is terminated by DOL on that basis, or in the event of a "termination without Cause" by UBS, DOL is then entitled to 300% of the aggregate of:

(a) DOL's Core Compensation ($475,000.000);

(b) a bonus equal to the greater of:

(i) the bonus paid in the immediately preceding fiscal year;

(ii) the bonus paid in the immediately preceding calendar year;

(iii) the average of the bonuses paid in the two immediately preceding fiscal years;

(iv) or the average of the bonuses paid in the two immediately preceding calendar years; and

(c) amounts due and owing pursuant to Section 3.3 [Benefits] and Section 3.6 [Tax Effective Payments] at the time of termination.

19. Pursuant to the Technology Agreement "Good Reason" means "that the Consultant's business relationship with the company has been substantially altered by the Board."

20. Pursuant to the Technology Agreement, "Change-in-Control" means "that control (control includes a Person or group of Persons acting in concert holding more than 20% of the voting shares of the Company) of the Company has transferred to another Person or Persons acting in concert.

21. At the special meeting of the shareholders of UBS on July 5, 2010, the shareholders voted to remove the incumbent Board of Directors, from the UBS Board and replaced them with a new slate of directors, being Messrs. Robert Ulicki, Grant McCutcheon, and Henry Eaton.

22. As set out in greater detail in the DOL/Dolgonos Pleadings attached as Appendices 2 and 3 hereto, the above actions resulted in a "Good Reason following a Change of Control" and a "termination without Cause" entitling DOL to terminate the Technology Agreement and entitling DOL to payment therefor pursuant to section 5.3.1 thereof.

23. UBS's Management Circular dated May 30, 2010, which was approved by the independent directors (i.e. not including Dolgonos) of the UBS Board, and filed with the regulatory authorities, recognized and noted that the removal of Dolgonos from the UBS Board would result in this a payment of an estimated $7.2 million becoming due and payable to the Claimant:

> *In the event that new Board of Directors terminates the Technology Development and Strategic Marketing Agreement without "Cause", the payment that would be due to DOL is estimated by UBS to be $7.2 Million, taking into account performance incentives aid or awarded only by UBS. See 'Part 3 – Compensation'. Any such payments due to DOL under the Technology Development and Strategic Marketing Agreement are payable to DOL in a lump – sum payment within 5 business days of its termination and, in the case of a*

portion of a contingent restructuring award granted by UBS to DOL in 2009, immediately upon such termination. The portion of the contingent restructuring award is also immediately payable upon a change of control of UBS.

24. As set out in greater detail in the DOL/Dolgonos Pleadings attached as Appendices 2 and 3 hereto, the Claimant is entitled to payment of and claims $6,015,000 plus applicable Tax from UBS pursuant to section 5.3.1 of the Technology Agreement, consisting of the following:

Base Fee per Technology Agreement	$475,000
Performance incentive	$1,530,000
Total termination value (sum of above items)	$2,005,000
Total termination claim ($2,005,000 x 300%) before interest plus Tax	$6,015,000

25. In breach of its contractual duties to the Claimant under the Technology Agreement, UBS had failed by the CCAA Filing Date and continues to fail to pay the Claimant the above amount notwithstanding that such payments are determinable and/or have been determined by the independent directors of UBS, and were thus due immediately or at the latest within 5 business days of the termination of the Technology Agreement pursuant to the terms thereof. Accordingly, the Claimant also claims interest from July 5, 2010 to the CCAA Filing Date at the pre-judgment interest rate of 3% per annum pursuant to section 128 of the *Courts of Justice Act* (Ontario), for a claim of $6,195,450 ($6,015,000 plus $180,450 interest) plus Tax.

Non-Waivers of Post-Filing Claims and Other Rights

26. In addition to any and all amounts claimed above, the Claimant also maintains a claim in relation to all amounts payable by UBS to the Claimant for the period after the CCAA Filing Date ("**Post Filing Claims**"), including but not limited to, any and all amounts for indemnification of legal and other expenses to which the Claimant may be entitled pursuant to the Marrocco Judgment, the Technology Agreement, the DOL Indemnification Agreement, and the Dolgonos Indemnification Agreement, whether in relation to UBS or otherwise, and for any interest payable after the CCAA Filing Date.

27. The Claimant does not waive, and expressly reserves, any and all rights, remedies, arguments, causes of actions and defences it may have in respect of the claims asserted herein or otherwise in relation to UBS or any other person or entity.

28. The Claimant reserves the right to amend or supplement this Proof of Claim and to provide any additional information, documentation or evidence as may be required or desired by the Claimant to establish or support its claims, arguments and defences.

PROOF OF CLAIM

FOR CREDITORS OF UNIQUE BROADBAND SYSTEMS, INC. ("UBS") AND UBS WIRELESS SERVICES INC. ("UBSW" AND, TOGETHER WITH UBS, THE "APPLICANTS")

Please read carefully the enclosed Instruction Letter for completing this Proof of Claim form. Capitalized terms not defined within this Proof of Claim form shall have the meaning ascribed thereto in the Order of the Ontario Superior Court of Justice (Commercial List) dated 4 August 2011, as may be amended from time to time (the "**Claims Order**").

1. **PARTICULARS OF CREDITOR:**

(a) Full Legal Name of Creditor (include trade name, if different):

ALEX DOLGONOS

(the "**Creditor**"). The full legal name should be the name of the Creditor of the Applicant(s), notwithstanding whether an assignment of a Claim, or a portion thereof, has occurred prior to or following 5 July 2011.

(b) Full Mailing Address of the Creditor:

207 Arnold Avenue, Thornhill, Ontario L4J 1C1

The mailing address should be the mailing address of the Creditor and not any assignee.

(c) Other Contact Information of the Creditor:

Telephone Number: (416) 567-9647
Email Address: adolgonos@ad2007.com
Facsimile Number: (905) 707-1639
Attention (Contact Person): Alex Dolgonos

(d) Has the claim set out herein been sold, transferred or assigned by the Creditor to another party?

☐ Yes ☒ No

2. PARTICULARS OF ASSIGNEE(S) (IF APPLICABLE)

If the Claim set out herein has been sold, transferred or assigned, complete the required information set out below. If there is more than one assignee, please attach a separate sheet that contains all of the required information set out below for each assignee.

(a) Full Legal Name of Assignee:

_____

_____

(b) Full Mailing Address of the Assignee:

_____

_____

(c) Other Contact Information of the Assignee:

Telephone Number: _____

Email Address: _____

Facsimile Number: _____

Attention (Contact Person): _____

3. **PROOF OF CLAIM – CLAIM AGAINST THE APPLICANT(S)**

THE UNDERSIGNED HEREBY CERTIFIES AS FOLLOWS:

(a) That I:

☒ am a Creditor of one or more of the Applicants; **OR**

☐ am

_____

(state position or title)

of

_____

(name of Creditor)

(b) That I have knowledge of all the circumstances connected with the Claim described and set out below; and

(c) The Applicant(s) was and still is indebted to the Creditor as follows (include all Claims that you assert against the Applicant(s). Claims should be filed in the currency of the transactions, with reference to the contractual rate of interest, if any, and such currency should be indicated as provided below in respect of the following Claim(s):

(complete using original currency and amount)

	Amount of Claim	Currency	Secured	Unsecured
☒ UBS	To be determined.	CDN	☐	☑
☐ UBSW			☐	☐

4. **NATURE OF CLAIM – Complete ONLY if you are asserting a Secured Claim**

Applicant: _____

☐ Secured Claim of $ _____

(Original currency and amount)

In respect of this debt, I hold security over the assets of the Applicant(s) valued at

$ _____

(Original currency and amount)

the particulars of which security and value are attached to this Proof of Claim form.

(Give full particulars of the security, including the date on which the security was given, the value which you ascribe to the assets charged by your security, the basis for such valuation and attach a copy of the security documents evidencing the security.)

(If you are asserting multiple secured claims, against one or more of the Applicants, please provide full details of your security against each of the Applicants.)

5. PARTICULARS OF CLAIM

Other than as already set out herein, the particulars of the undersigned's total Claim against the Applicant(s) are attached on a separate sheet.

*Provide all particulars of the Claim and supporting documentation that you feel will assist in the determination of your claim. **At a minimum, you are required to provide (if applicable) the invoice date, invoice number, the amount of each outstanding invoice and the related purchase order number.** Further particulars may include the following if applicable: a description of the transaction(s) or agreement(s) giving rise to the Claim; contractual rate of interest (if applicable); name of any guarantor which has guaranteed the Claim; details of all credits, discounts, etc. claimed; and description of the security if any, granted by the affected Applicant(s) to the Creditor and, the estimated value of such security and the basis for such valuation.*

See Schedule "A" and attached Appendices.

6. FILING OF CLAIM

This Proof of Claim form must be received by the Monitor by no later than **5:00 p.m. (Eastern Daylight Time) on 19 September 2011**, to the following address:

RSM Richter Inc.
200 King Street West, Suite 1100
Toronto ON M5H 3T4

Attention: **Lana Bezner**
Telephone: **416-932-6009**
Fax: **416-932-6200**
Email: **lbezner@rsmrichter.com**

THE TIMING FOR THE DEEMED DELIVERY OF CORRESPONDENCE IS SET OUT IN THE CLAIMS ORDER.

DATED this 16th day of September, 2011.

Name of Creditor: Alex Dolgonos.
(Name)

Per: [signature]
Name: Alex Dolgonos
Title:
(please print)

Schedule "A" to
Proof of Claim of Alex Dolgonos

This Schedule "A" and the documents referenced herein and/or attached hereto form part of the Proof of Claim of Alex Dolgonos ("**Dolgonos**" or the "**Claimant**") against Unique Broadband Systems, Inc. ("**UBS**" or the "**Company**").

Nature of the Claims

1. The Claimant claims indemnification and reimbursement against UBS, in an amount to be determined, plus other amounts as may be determined to be payable by UBS to the Claimant by the Court or the Claims Officer.

Particulars of Claims

Entitlement to Indemnification and Reimbursement of Legal Fees and Expenses

2. As indicated in the Proof of Claim (the "**DOL Proof of Claim**") filed by DOL Technologies Inc. ("**DOL**"), there is a indemnification agreement dated January 25, 2007 between UBS and Dolgonos (the "**Dolgonos Indemnification Agreement**"), attached hereto as Appendix "**1**".

3. Also as indicated in the DOL Proof of Claim, a Judgment of the Ontario Superior Court of Justice (Commercial List), dated April 27, 2011, by the Honourable Mr. Justice Marrocco ordered that UBS has an obligation to indemnify each of DOL and Dolgonos for their existing and ongoing legal and other expenses, all as more particularly set out in the Judgment of the Court attached hereto as Appendix "2" and the reasons of Mr. Justice Marrocco issued in connection therewith and attached hereto as Appendix "3" (together, the "**Marrocco Judgment**"). In additional, pursuant to the Marrocco Judgment, if a court decides that Dolgonos was an officer of UBS and that he acted honestly and in good faith with a view to the best interests of UBS, then UBS has an obligation to indemnify Dolgonos pursuant to Article 7 of UBS' bylaws.

4. Dolgonos submits this proof of claim, in an amount to be determined, to preserve all of his rights to indemnification and reimbursement from UBS in accordance with the Dolgonos Indemnification Agreement and the Marrocco Judgment.

Non-Waivers of Post-Filing Claims and Other Rights

5. In addition to any and all claims asserted above, the Claimant also maintains a claim in relation to all amounts payable by UBS to the Claimant for the period after the CCAA Filing Date ("**Post Filing Claims**"), including but not limited to, any and all amounts for indemnification of legal and other expenses to which the Claimant may be entitled pursuant to the Dolgonos Indemnification Agreement and the Marrocco Judgment, whether in relation to UBS or otherwise, and for any interest payable on such amounts.

6. The Claimant does not waive, and expressly reserves, any and all rights, arguments, causes of actions and defences it may have in respect of the claims asserted herein or otherwise in relation to UBS or any other person or entity.

7. The Claimant reserves the right to amend or supplement this Proof of Claim and to provide any additional information, documentation or evidence as may be required or desired by the Claimant to establish or support its claims, arguments and defences.

PROOF OF CLAIM

FOR CREDITORS OF UNIQUE BROADBAND SYSTEMS, INC. ("UBS") AND UBS WIRELESS SERVICES INC. ("UBSW" AND, TOGETHER WITH UBS, THE "APPLICANTS")

Please read carefully the enclosed Instruction Letter for completing this Proof of Claim form. Capitalized terms not defined within this Proof of Claim form shall have the meaning ascribed thereto in the Order of the Ontario Superior Court of Justice (Commercial List) dated 4 August 2011, as may be amended from time to time (the "**Claims Order**").

1. **PARTICULARS OF CREDITOR:**

(a) Full Legal Name of Creditor (include trade name, if different):

2064818 Ontario Inc.

(the "**Creditor**"). The full legal name should be the name of the Creditor of the Applicant(s), notwithstanding whether an assignment of a Claim, or a portion thereof, has occurred prior to or following 5 July 2011.

(b) Full Mailing Address of the Creditor:

207 Arnold Avenue, Thornhill, ontario L4J 1G1

The mailing address should be the mailing address of the Creditor and not any assignee.

(c) Other Contact Information of the Creditor: (c/o Alex Dolgonos)

Telephone Number: (416) 567-9647
Email Address: adolgonos@ad2007.com
Facsimile Number: (905) 707-1639
Attention (Contact Person): Alex Dolgonos

(d) Has the claim set out herein been sold, transferred or assigned by the Creditor to another party?

☐ Yes ☒ No

2. **PARTICULARS OF ASSIGNEE(S) (IF APPLICABLE)**

If the Claim set out herein has been sold, transferred or assigned, complete the required information set out below. If there is more than one assignee, please attach a separate sheet that contains all of the required information set out below for each assignee.

(a) Full Legal Name of Assignee:

_____

_____

(b) Full Mailing Address of the Assignee:

_____

_____

(c) Other Contact Information of the Assignee:

Telephone Number: _____

Email Address: _____

Facsimile Number: _____

Attention (Contact Person): _____

3. **PROOF OF CLAIM – CLAIM AGAINST THE APPLICANT(S)**

THE UNDERSIGNED HEREBY CERTIFIES AS FOLLOWS:

(a) That I:

☐ am a Creditor of one or more of the Applicants; **OR**

☒ am

Authorized Signatory

(state position or title)

of

2064818 Ontario Inc.

(name of Creditor)

(b) That I have knowledge of all the circumstances connected with the Claim described and set out below; and

(c) The Applicant(s) was and still is indebted to the Creditor as follows (include all Claims that you assert against the Applicant(s). Claims should be filed in the currency of the transactions, with reference to the contractual rate of interest, if any, and such currency should be indicated as provided below in respect of the following Claim(s):

(complete using original currency and amount)

	Amount of Claim	Currency	Secured	Unsecured
☒ UBS	To be determined	CDN	☐	☒
☐ UBSW			☐	☐

4. **NATURE OF CLAIM – Complete ONLY if you are asserting a Secured Claim**

Applicant: _____

☐ Secured Claim of $ _____

(Original currency and amount)

In respect of this debt, I hold security over the assets of the Applicant(s) valued at

$ _____

(Original currency and amount)

the particulars of which security and value are attached to this Proof of Claim form.

(Give full particulars of the security, including the date on which the security was given, the value which you ascribe to the assets charged by your security, the basis for such valuation and attach a copy of the security documents evidencing the security.)

(If you are asserting multiple secured claims, against one or more of the Applicants, please provide full details of your security against each of the Applicants.)

5. **PARTICULARS OF CLAIM**

Other than as already set out herein, the particulars of the undersigned's total Claim against the Applicant(s) are attached on a separate sheet.

Provide all particulars of the Claim and supporting documentation that you feel will assist in the determination of your claim. ***At a minimum, you are required to provide (if applicable) the invoice date, invoice number, the amount of each outstanding invoice and the related purchase order number.*** *Further particulars may include the following if applicable: a description of the transaction(s) or agreement(s) giving rise to the Claim; contractual rate of interest (if applicable); name of any guarantor which has guaranteed the Claim; details of all credits, discounts, etc. claimed; and description of the security if any, granted by the affected Applicant(s) to the Creditor and, the estimated value of such security and the basis for such valuation.* See Schedule "A" and attached Appendices

6. **FILING OF CLAIM**

This Proof of Claim form must be received by the Monitor by no later than **5:00 p.m. (Eastern Daylight Time) on 19 September 2011**, to the following address:

RSM Richter Inc.
200 King Street West, Suite 1100
Toronto ON M5H 3T4

Attention: **Lana Bezner**
Telephone: **416-932-6009**
Fax: **416-932-6200**
Email: **lbezner@rsmrichter.com**

THE TIMING FOR THE DEEMED DELIVERY OF CORRESPONDENCE IS SET OUT IN THE CLAIMS ORDER.

DATED this 16th day of September, 2011.

Name of Creditor: 2064818 Ontario Inc.
(Name)

Per: [signature]
Name: Alex Dolgonos
Title: Authorized Signatory
(please print)

Schedule "A" to
Proof of Claim of 2064818 Ontario Inc.

This Schedule "A" and the documents referenced herein and/or attached hereto form part of the Proof of Claim of 2064818 Ontario Inc. ("**206**" or the "**Claimant**") against Unique Broadband Systems, Inc. ("**UBS**" or the "**Company**").

Nature of the Claims

1. 206 has issued a Statement of Claim against, among other defendants, UBS, in the Ontario Superior Court of Justice (Commercial List), Court File No. CV-10-9036-00CL (the "**Action**"), a copy of which is attached hereto as Appendix "1".

2. Pursuant to paragraph 17 of the Initial Order of the Ontario Superior Court of Justice (Commercial List) in the proceeding of UBS under the *Companies' Creditors Arrangement Act* (Canada) (the "**CCAA Proceeding**"), all proceedings against the current or future directors of UBS are stayed, except for the Action.

3. The Claimant submits this Proof of Claim to preserve any and all rights and claims that it has as against the defendant UBS under or in connection with the Action.

Non-Waivers of Post-Filing Claims and Other Rights

4. In addition to any and all claims asserted above, the Claimant also maintains a claim in relation to any amounts payable by UBS to the Claimant for the period after the CCAA Filing Date ("**Post Filing Claims**").

5. The Claimant does not waive, and expressly reserves, any and all rights, arguments, causes of actions and defences it may have in respect of the claims asserted herein or otherwise in relation to UBS or any other person or entity.

6. The Claimant reserves the right to amend or supplement this Proof of Claim and to provide any additional information, documentation or evidence as may be required or desired by the Claimant to establish or support its claims, arguments and defences.

7. Nothing herein shall constitute or be deemed to constitute the submission or attornment by the Claimant of the Action, or any part thereof, to the jurisdiction of the Court presiding over the CCAA Proceeding.

TAB 16

Court File No.: CV-11-9283-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF UNIQUE BROADBAND SYSTEMS, INC.

AFFIDAVIT OF ROBERT ULICKI
(sworn 27 June 2012)

I, ROBERT ULICKI, of the City of Toronto in the Province of Ontario **MAKE OATH AND SAY:**

1. I am a director of Unique Broadband Systems, Inc. ("**UBS**") and its wholly-owned subsidiary UBS Wireless Services Inc. ("**UBS Wireless**" and, together with UBS, the "**Applicants**"). I have personal knowledge of the matters herein deposed, save and except where I refer to matters based on information and belief, in which cases I identify the source(s) of that information and believe it to be true. I have also reviewed relevant records, press releases and public filings as necessary, and rely on the information contained in those records, press releases, etc. and believe that information to be true.

2. I am also the portfolio manager and owner of Clareste Wealth Management Inc. ("**CWM**"). CWM manages Clareste LP, which owns approximately 1 per cent of the shares of UBS. In addition to me, the board of directors of UBS and UBS Wireless consists of Henry Eaton and Grant McCutcheon, who were elected to the UBS board at the same time as I was elected. Mr. McCutcheon is also the CEO of UBS. Between them, Mr. Eaton and Mr. McCutcheon hold less than a 1 per cent interest in UBS.

I. Introduction and Summary

3. This Affidavit is filed in support of a Motion brought by UBS seeking to stay or suspend the holding of the 2012 Annual General Meeting of UBS' Shareholders (the "**2012 AGM**") to permit the on-going process to determine two large disputed claims asserted against UBS to be completed, without interruption, in accordance with an on-going claims procedure that has been implemented by the Court. The claims of these creditors are material to the CCAA proceedings and the ability of the Applicants to develop a plan under the CCAA.

4. The 2012 AGM is currently scheduled for 11 July 2012.

5. As described further below, one of the two disputed claims against UBS is asserted by a company that is related to Alex Dolgonos – DOL Technologies Inc. ("**DOL**"). Mr. Dolgonos also controls the single largest shareholder of UBS – 2064818 Ontario Inc. ("**206 Ontario**" and, together with Mr. Dolgonos and DOL, "**Dolgonos**"). 206 Ontario seeks to have the UBS board replaced at the 2012 AGM because Mr. Dolgonos does not agree with the course of action taken by UBS and wishes to put in place a new board selected by him to alter UBS' path in the CCAA proceedings. Based on previous Affidavits filing in these proceedings, I believe that Mr. Dolgonos has, since the CCAA proceedings commenced, been acquiring shares of UBS in the market and would hold enough shares at this point to replace the board at the 2012 AGM, notwithstanding how the other shareholders of UBS might vote.

6. UBS is concerned that: (a) the CCAA proceedings and the determination of the disputed claims, including the claim being asserted by Dolgonos, not be delayed or disrupted; (b) the costs of the CCAA proceedings not be increased; and (c) shareholders have complete information with respect to UBS' financial situation and Dolgonos' disputed claim against UBS before they are called upon to make a decision to change the UBS board and move the company off its current course.

7. As set forth further below, Dolgonos has unsuccessfully attempted to change the UBS board three times in the previous 18 months, including by way of an unsuccessful Motion to remove the majority of the UBS board pursuant to s. 11.5 of the CCAA.

II. Stakeholders on this Motion

8. The Applicants are incorporated pursuant to the *Business Corporation Act*, R.S.O. 1990, c. B.16 ("**OBCA**") and its shares are listed. UBS is a holding company that owns all of the issued and outstanding shares of UBS Wireless. UBS' only realizable assets are its 39 per cent indirect interest in LOOK Communications Inc. ("**LOOK**"). UBS' involvement in LOOK is described further in my Affidavit sworn 7 February 2012.

9. Aside from the Applicants, the major stakeholders in the CCAA proceedings to date have been Mr. Dolgonos, 206 Ontario, DOL, Gerald McGoey and Jolian Investments Limited ("**Jolian**" and, together with Mr. McGoey, "**McGoey**"). As noted above, 206 Ontario and DOL are controlled by Mr. Dolgonos. 206 Ontario is the largest shareholder of UBS and DOL has one of the two largest disputed claims against UBS. DOL filed a proof of claim against UBS for an aggregate amount of more than $8 million, which claim is disputed by UBS. Mr. Dolgonos has also asserted a claim against UBS seeking indemnification for professional fees, which claim is also disputed by UBS.

10. Jolian is a company controlled by Mr. McGoey, the former CEO of UBS. Jolian filed a proof of claim against UBS for in excess of $10 million, which claim is disputed by UBS. Mr. McGoey has also asserted a claim against UBS seeking indemnification for professional fees, which claim is also disputed by UBS.

11. The claims asserted by DOL and Jolian against UBS are based on litigation commenced by DOL and Jolian against UBS asserting that termination payments were triggered as a result of the replacement of the UBS board pursuant to s. 122 of the OBCA at a special meeting of UBS shareholders in July of 2010.

12. The claims being asserted by DOL and Jolian alone exceed the realizable value of UBS' assets.

13. UBS has approximately 15,000 individual shareholders. The majority of these shareholders hold very few shares of UBS. There are, however, a few shareholders that hold larger blocks of shares. Dolgonos, through 206 Ontario, holds the largest block of UBS shares.

III. UBS Board of Directors

14. Prior to 5 July 2010, the UBS board of directors consisted of Gerald McGoey, Louis Mitrovich and Douglas Reeson. Mr. McGoey held the position of Chairman and Chief Executive Officer of UBS. On 5 July 2010, a special meeting of shareholders of UBS (the "**Special Meeting**") that was requisitioned by a group of shareholders of UBS (the "**Shareholder Group**"), including Clareste LP was held. The purpose of the Special Meeting was to remove the directors of UBS pursuant to s. 122 (1) of the OBCA and appoint Mr. Eaton, Mr. McCutcheon and me in their place pursuant to s. 122(3) of the OBCA.

15. At the Special Meeting: (a) the shareholders of UBS voted to remove the sitting UBS board; and (b) Mr. McCutcheon, Mr. Eaton and I were elected as directors to act in their place. We were elected notwithstanding that 206 Ontario, which at the time held 20% of the voting shares of UBS, opposed the removal of Mr. McGoey, Mr. Mitrovich and Mr. Reeson and the election of Mr. Eaton, Mr. McCutcheon and me.

16. UBS held its annual general meeting on 25 February 2011. At that meeting, thirteen (13) shareholders controlling 29 per cent of the voting shares of UBS, including 206 Ontario, nominated an alternate slate of directors. UBS' shareholders did not elect the directors proposed by Dolgonos. Mr. Eaton, Mr. McCutcheon and I were, once again, elected directors of UBS.

17. At the Special Meeting, shareholders provided the current UBS directors with a mandate to:

(a) Review and, if warranted, challenge $2.5 million in "restructuring awards" declared by UBS in favour of the members of the UBS board and Mr. Dolgonos;

(b) minimize UBS' expenses through a review of management compensation and expense claims and, if warranted, seek to recover improper expenses paid to Dolgonos and McGoey;

(c) re-adjust the compensation paid to UBS' directors going forward;

(d) review the agreements between UBS and each of DOL, Jolian and LOOK and take appropriate action;

(e) distribute UBS' assets to shareholders.

18. This mandate is described in the Information Circular attached as **Exhibit "A"**.

19. The foregoing mandate was affirmed by UBS shareholders at the 2011 Annual General Meeting in February of 2011. At that meeting, the shareholders rejected the efforts by Dolgonos to replace the UBS board and re-elected Mr. McCutcheon, Mr. Eaton and me to the UBS board.

20. As described in the Management Discussion and Analysis, copies of which are attached as **Exhibit "B"**, UBS has been consistent that its strategy since July of 2010 has been to, *inter alia*:

(a) maximize the value of its investment in LOOK; and

(b) defend all claims brought against UBS by DOL and Jolian.

21. As set forth below, these CCAA proceedings were commenced as a result of the litigation referenced in paragraph 20(b) and the claims by DOL and Jolian will be determined in the Claims Procedure.

IV. CCAA Proceedings

22. On 5 July 2011, the Court made an Order (the "**Initial Order**") under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**") in respect of the Applicants. A true copy of the Initial Order is attached as **Exhibit "C"**. RSM Richter Inc, now Duff & Phelps Canada, Restructuring Inc. (the "**Monitor**") was appointed by the Initial Order to act as monitor of the Applicants. The Stay Period, as defined in the Initial Order, has been extended a number of times and currently expires on 30 July 2012.

23. The CCAA proceedings were precipitated by Actions commenced against UBS by each of Jolian and DOL after the UBS board was replaced in July of 2010 over the objection of Mr. Dolgonos and Mr. McGoey. There were serious allegations with respect to the conduct of Dolgonos and McGoey at issue in those proceedings and those allegations will, as set forth below, be determined in the CCAA proceedings.

24. As described in my Affidavit sworn 4 July 2011:

> *4. UBS and UBS Wireless are both insolvent and are seeking to commence proceedings under the CCAA to, inter alia:*
>
> (a) *facilitate the determination and compromise or arrangement of creditor claims against UBS to permit the company to propose a plan to realize value from the company's assets, including its shareholdings in LOOK Communications Inc. ("**LOOK**"), and its accumulated tax losses and public listing;*
>
> (b) *avert an imminent liquidity crisis being caused by litigation-related expenses that will prevent UBS from: (i) continuing to carry on business for the benefit of its stakeholders; (ii) defending*

certain proceedings brought against the company; and (iii) prosecuting claims commenced by UBS; and

(c) *provide a process to determine certain claims being asserted against UBS asserted by certain former directors and officers on their merits.*

5. *But for the commencement of proceeding under the CCAA, UBS will not be able to continue and will likely be forced into a liquidating proceeding. This will not be in the best interests of UBS's stakeholders.*

...

53. *The cost of the Litigation [with DOL and Jolian] is, as set forth below, causing a serious strain on UBS's cash flow. The costs of the Litigation are such that UBS believes that it will not be able to fund the Litigation through to a determination on the merits. If UBS is not able to continue to fund the defence of the Litigation (and the prosecution of the counterclaims), the matter will not be determined on its merits and this will result in prejudice to UBS's other stakeholders. The amount being claimed against UBS in the Litigation is more than the total value of UBS's assets and will "swamp" the claims of UBS's other creditors.*

...

80. *UBS ... believes that a CCAA claims process will facilitate the determination of the claims asserted against UBS in the Litigation [with DOL and Jolian] and the Oppression Action in a more cost-effective and expedient manner for the benefit of UBS's stakeholders.*

V. CCAA Claims Procedure

25. There is an on-going process in place to determine the disputed claims being asserted against UBS by Dolgonos and McGoey. Dolgonos' and McGoey's claims are based on the pre-CCAA Actions commenced by Dolgonos and McGoey against UBS as described further in my Affidavit sworn 7 February 2012.

26. On 4 August 2011, the Court made an Order (the "**First Extension and Claims Order**"), *inter alia*, establishing a procedure (the "**Claims Procedure**") for the filing of claims

against UBS. Jolian, through counsel, provided input into the Claims Procedure contained in the First Extension and Claims Order and consented to the making of the First Extension and Claims Order. A copy of the First Extension and Claims Order is attached as **Exhibit "D"**.

27. In accordance with the First Extension and Claims Order:

(a) Dolgonos and McGoey filed claims against UBS;

(b) the claims filed by Dolgonos and McGoey against UBS were, based on the fact that they were disputed by UBS, disallowed by the Monitor;

(c) Dolgonos and McGoey appealed the disallowance of their claims by the Monitor; and

(d) the parties have agreed that Dolgonos' and McGoey's disputed claims against UBS should be determined by a Judge.

28. The disputed claims against UBS being asserted by Dolgonos and McGoey dwarf the claims of UBS' other creditors and are for amounts greater than the realizable value of UBS' assets. Dolgonos' and McGoey's claims total well over $18 million and the determination of the validity of these claims is fundamental to the restructuring of UBS.

29. Pursuant to an Order dated 13 April 2012 (the "**Claims Procedure Timeline Order**") the Court established a timeline for the initial stage of the process by which Dolgonos' and McGoey's disputed claims against UBS will be determined by a Judge. A true copy of the Claims Procedure Timeline Order and the related Endorsement of Mr. Justice Wilton Siegel dated 15 April 2012 are attached as **Exhibit "E"**. In the Endorsement, Mr. Justice Wilton-Siegel that Dolgonos' and McGoey's disputed claims should be determined in the Claims Procedure "as quickly and efficiently as possible".

30. The Claims Procedure Timeline Order required that Dolgonos, McGoey and UBS exchange documents describing their claims and counterclaims, including the legal and

factual basis for the claims, and identify relevant documents. Dolgonos, McGoey and UBS have each delivered these documents. I believe that the issues with respect to the claims being asserted by Dolgonos and McGoey are summarized in the documents delivered by UBS in response to the claims made by Dolgonos and McGoey and true copies of those documents are attached as **Exhibit "F"**.

31. The Claims Procedure Timeline Order further contemplated that, once the parties exchanged documents describing their claims:

(a) DOL and Jolian could bring Motions to bring third party and cross-claims into the Claims Procedure; and

(b) DOL and Jolian would bring Motions seeking leave to enforce an Order made by Mr. Justice Marrocco prior to these CCAA proceedings being commenced requiring that UBS advance professional fees to DOL and Jolian (the "**Marrocco Order**")[1].

32. As contemplated by the Claims Procedure Timeline Order, on 13 June 2012, Mr. Justice Wilton Siegel heard the following Motions:

(a) Motions by DOL and Jolian seeking to add third party claims they wish to bring against the former directors and, in the case of Dolgonos, a former officer of UBS into the Claims Procedure;

(b) Motions by DOL and Jolian seeking to enforce the Marrocco Order; and

(c) Motions by the former directors of UBS seeking advances in respect of professional fees if DOL and Jolian were permitted to advance third party claims in the Claims Procedure[2] (together, the "**Interim Motions**").

[1] The Motion to lift the stay imposed by the Initial Order was brought pursuant to an Order made by Justice Simmons of the Ontario Court of Appeal, a copy of which is attached as **Exhibit "G"**.

[2] A Motion by the former CFO of UBS seeking similar relief was adjourned to be dealt with at a later date.

33. Mr. Justice Wilton-Siegel has not yet released his decision on the Interim Motions. The outcome of the Interim Motions will determine the balance of the schedule for the Claims Procedure. Once Mr. Justice Wilton-Siegel releases his decision on the Interim Motions, UBS will apply to the Court to have a schedule put in place to have Dolgonos' and McGoey's claims determined on their merits.

34. I believe that Dolgonos has sought to delay the Claims Procedure for as long as possible in the hopes that the 2012 AGM will result in a change of the UBS board and a change in direction for UBS.

VI. Previous Attempts to Change UBS Board

35. If the 2012 AGM is not stayed, Dolgonos will be able to proceed with his 4th direct attempt to change the UBS board in the past 18 months.

A. Oppression Action

36. Pursuant to a Statement of Claim issued on 22 December 2010, 206 Ontario commenced an action against UBS, Mr. McCutcheon, Mr. Eaton and me (the "**Oppression Action**") seeking, *inter alia*, to remove us from the UBS board. The Initial Order did not, initially, stay proceedings against the directors in the Oppression Action and 206 Ontario indicated that it intended to pursue the Oppression Action notwithstanding the CCAA proceedings.

37. On 20 December 2011, UBS brought a motion (the "**Director Stay Motion**") seeking, *inter alia*, to have the stay imposed by the Initial Order expanded to include the Oppression Action against the directors. Dolgonos opposed the Director Stay Motion and indicated that he wished to proceed with the Oppression Action as against the directors outside of the CCAA proceedings. On 25 January 2012, the Court granted the Directors Stay Motion. A copy of the Endorsement is attached as **Exhibit "H"**.

B. 2011 Annual General Meeting

38. As noted above, Dolgonos unsuccessfully attempted to replace the UBS board at UBS' 2011 Annual General Meeting held in February of 2011.

C. Director Removal Motion

39. On 20 December 2011, 206 Ontario brought a motion (the "**Director Removal Motion**") in the CCAA proceedings seeking an Order pursuant to s. 11.5 of the CCAA removing and replacing two of the directors of UBS with partners in a law firm that acted as counsel to DOL.

40. The Director Removal was heard at the same time as the Director Stay Motion and on 25 January 2012, Mr. Justice Wilton-Siegel dismissed the Director Removal Motion.

41. The Director Removal Motion was specifically intended to replace the majority of the UBS board with a view to having a new group of directors review and re-visit the decisions of the current UBS board with respect to, *inter alia*, Dolgonos' disputed claims against UBS. When cross-examined in connection with the Director Removal Motion, one of the proposed directors put forward by Dolgonos indicated that it was his understanding that Mr. Dolgonos' objective in replacing directors was to re-consider the actions of the UBS board based on Mr. Dolgonos' concern with decisions taken by the UBS board:

> *Q. And did [Mr. Dolgonos] ever explain to you any objectives he had in replacing the board with you and Mr. Pasternack?*
>
> *A. I believe it was just to have a fresh set of eyes on the situation. That the existing board had taken the decisions that were now in dispute [by Mr. Dolgonos] and human nature is such that you tend to defend what you have done; whereas a fresh group of people might come and look at the situation and see something differently.*

VII. Dolgonos Partial Bid

42. The prospect of a partial take-over bid by Mr. Dolgonos, and the impact a change in control of UBS would have on the interest of UBS' stakeholders, was an issue that was raised when UBS sought protection under the CCAA.

43. On 3 June 2011, UBS received a letter from Dolgonos' counsel, Wildeboer Dellelce LLP ("**Wildeboer**"), indicating that Mr. Dolgonos, or a corporation or corporations controlled by him, intended to make a partial take-over bid for the shares of UBS. In my affidavit sworn 4 July 2011 in support of the Application by the Applicants under the CCAA, I advised that:

> *On 3 June 2011, UBS received a letter from Wildeboer Dellelce LLP indicating that Mr. Dolgonos, or a corporation or corporations controlled by him, intended to make a partial take-over bid for the shares of UBS. ...*
>
> *If this partial take-over bid is made, it may result in a change of control of UBS. This could result in Mr. Dolgonos, or a company or companies controlled by him, determining whether UBS continues to defend the [DOL and Jolian Claims] and the Oppression Action.*

44. Subsequent to the CCAA proceedings commencing, Dolgonos took no steps to proceed with the partial take-over bid threatened on 3 June 2011 until 18 January 2012, when Wildeboer sent a letter, through counsel, to UBS advising that Mr. Dolgonos intended to bring a partial take-over bid on or after 27 January 2012.

45. On 1 February 2012, Mr. Dolgonos launched the Dolgonos Partial Bid by delivering the Bid Circular, a copy of which is attached as **Exhibit "I"**, and related documents to all of UBS's shareholders. 206 Ontario is offering to acquire up to 10 million UBS shares – this represents 10% of UBS's voting shares – for $0.08 per share.

46. In the press release dated 1 February 2012 issued in connection with the Dolgonos Partial Bid, Mr. Dolgonos expresses his concern that UBS "is on the wrong course" and at page 24 of the Bid Circular delivered by Dolgonos, shareholders are told that the ultimate purpose of the Dolgonos Partial Bid is to replace the UBS board.

47. On 2 March 2012, UBS brought a Motion seeking to suspend the Dolgonos Partial Bid. Pursuant to an Endorsement dated 6 March 2012, a true copy of which is attached as **Exhibit "J"**, Mr. Justice Wilton-Siegel found that the Dolgonos Partial Bid was not stayed by the Initial Order and refused to suspend the Dolgonos Partial Bid on the basis, *inter alia*, that the prejudice to stakeholders identified by UBS – a change in the UBS board and a change in direction by UBS – could be addressed by the Court at a later date.

48. The Dolgonos Partial Bid was to close on 9 March 2012. Dolgonos has, however, extended twice already and the Dolgonos Partial Bid now expires on 17 August 2012. I do not believe that Dolgonos wishes to close the Dolgonos Partial Bid and spend up to $800,000 – a significant premium – to acquire further shares of UBS until he has replaced the UBS board with his selected directors, if ever.

VIII. Dolgonos March Requisition

49. On 8 March 2012, 206 Ontario and another company controlled by Mr. Dolgonos, 6138241 Canada Inc. ("**613 Canada**"), delivered a Requisition requesting that UBS call a special meeting of shareholders for the purpose of removing and replacing the current UBS board with Kenneth D. Taylor, Azim S. Fancy, Daniel Marks and Victor Wells (the "**Dolgonos March Requisition**"). True copies of the Dolgonos March Requisition and the related Press Release are attached as **Exhibit "K"**.

50. In the Press Release in respect of the Dolgonos March Requisition, Dolgonos indicates that: (a) the election of the proposed slate of directors "would represent the Company's foremost opportunity to preserve value in UBS and establish an organization that can

build on the Company's assets"; (b) the proposed directors "are highly qualified and motivated to see UBS emerge from the CCAA process with the court's approval and preserve and enhance the Company's value"; and (c) UBS' shareholders are being given two very different visions for the future of UBS.

51. I am concerned with Dolgonos' motivation in seeking to replace the entire UBS board in the middle of the CCAA proceedings and the Claims Procedure without any apparent thought being given to how the change in the board will impact the CCAA proceedings or the Claims Procedure. It is clear that Mr. Dolgonos intends to have influence over the UBS board going forward. In February of 2012 Mr. Dolgonos wrote to UBS' shareholders:

> *As the founder of UBS, I am committed to the Company, but UBS is on the wrong course. It needs new leadership. ... I am committed to working with a new board so that UBS can look to the future with renewed optimism.*

52. In his 6 March 2012 Endorsement denying UBS' request that the Dolgonos Partial Bid be suspended, Mr. Justice Wilton Siegel found:

> *....I think that a motion addressing the directors' response to a shareholder requisition is a more appropriate proceeding in which to address the impact of the proposed change in the board of directors. At that time,* ***the actual proposal of Dolgonos will be available for consideration, including any features directed toward addressing the legitimate concern of the UBS Directors that his principal objective is to have a new board of directors re-examine the merits of defending the DOL action.*** *In addition, the schedule for determination of the DOL action and the Jolian action, as well as the identities of the proposed directors, will be known.....With this information, the court can make a more informed, and possibly a more nuanced, determination regarding the merits of any request for a special meeting of shareholders as well as the timing of any such meeting.* (emphasis added)

53. In connection with the Dolgonos March Requisition, Dolgonos has not provided any information whatsoever to address what Mr. Justice Wilton-Siegel described as UBS' legitimate concerns with respect to changing the UBS board while the CCAA proceedings are pending and the Claims Procedure is on-going.

54. I note that in connection with the Dolgonos Partial Bid, UBS wrote to Mr. Dolgonos on 3 February 2012 to inquire as to how the issues later identified by Mr. Justice Wilton-Siegel would be addressed by Dolgonos. A copy of UBS's letter is attached as **Exhibit "L"**. Mr. Dolgonos has not provided a substantive response to this letter.

55. UBS is prepared to meet with Mr. Dolgonos at any time to discuss the course being taken by UBS, but Mr. Dolgonos has not approached UBS with any concerns or suggestions. In fact, Dolgonos has not, at any point, opposed the CCAA proceedings and Dolgonos, in fact, consented to the Claims Procedure.

56. I am not aware of Dolgonos raising any issues with the Monitor with respect to the course being taken by UBS in the CCAA proceedings or providing any suggestions as to how any issues he might have with the course being taken by UBS might be addressed while ensuring that Dolgonos' and McGoey's disputed claims are determined.

IX. Scheduling of 2012 AGM and Special Meeting

57. On 28 March 2012, UBS agreed to hold the special meeting requisitioned by Dolgonos on 11 July 2012, at the same time as the 2012 AGM. The letter to Dolgonos' counsel and a copy of the Press Release announcing the 2012 AGM are attached as **Exhibit "M"**.

58. As set forth in the 28 March 2012 letter to Dolgonos' counsel, my Affidavit sworn 3 April 2012 and UBS' letter to shareholders in connection with the 2012 AGM, UBS agreed to hold the 2012 AGM on 11 July 2012 on the assumption that Dolgonos' and McGoey's disputed claims against UBS could be determined by July of 2012 and that, if

the disputed claims were not determined, UBS might adjourn the 2012 AGM until the claims were determined in the Claims Procedure.

59. On 8 May 2012, Wildeboer complained to the Ontario Securities Commission and the TSX with respect to UBS' response to Dolgonos' meeting requisition. Copies of that correspondence, as well as UBS' response and a Press Release issued by UBS to address Dolgonos' issues, are attached as **Exhibit "N"**.

60. On 25 April 2012, Dolgonos scheduled a 0930 appointment before Mr. Justice Wilton-Siegel for the purpose of scheduling a Motion by Dolgonos to challenge UBS' response to the Dolgonos March Requisition and, in particular, the position taken by UBS that it might seek to delay the 2012 AGM – Dolgonos wanted a firm date established for the 2012 AGM. A true copy of the e-mail exchange with respect to that 0930 appointment is attached as **Exhibit "O"**. Dolgonos' proposed Motion was not scheduled.

61. Rather than unilaterally adjourning the 2012 AGM and risking (further) litigation with Dolgonos, UBS has elected to seek an Order from the Court staying or suspending the obligation to convene the 2012 AGM until such time as the Dolgonos and McGoey disputed claims are determined.

62. I understand that the Monitor supports UBS' position that the 2012 AGM ought to be adjourned until such time as the Dolgonos' and McGoey's disputed claims against UBS are determined in accordance with the Claims Procedure.

63. A transition to a new board at this stage in the CCAA proceedings, and the Claims Procedure, will cause disruption and will result in increased costs and delays.

64. I do not know what, if any, information or understanding the directors being proposed by Dolgonos have with respect to UBS, the CCAA proceedings or the claims being asserted by Dolgonos and McGoey. None of the directors being proposed by Dolgonos have been in contact with UBS to obtain an understanding of the company, the CCAA proceedings or the Claims Procedure. I am concerned that the appointment of a completely new board

will result in delays and increased costs as the new directors familiarize themselves with the issues involved in the CCAA and the Claims Procedure. The current directors have a great deal of knowledge with respect to the matters in issue.

65. I am also concerned that the replacement of the board will result in a change in UBS' counsel resulting in increased costs as new counsel becomes familiar with the CCAA proceedings, the Claims Procedure and the extensive litigation related to these matters.

66. Finally, I am concerned that no information has been provided as to the fees that will be paid to the Dolgonos' slate of directors if they are elected or what measures will need to be put in place in order to protect Dolgonos' directors. As matters currently stand, Mr. McCutcheon, Mr. Eaton and I are paid directors' fees of $20,000 each per year and we have not requested a charge against UBS's assets in the CCAA proceedings.

67. I believe that until the Dolgonos' and McGoey's disputed claims are determined, there will not be sufficient information on which shareholders can make an informed decision about the future course of UBS. To ask that shareholders make a decision with respect to UBS' future without knowing whether Dolgonos' or McGoey's disputed claims are valid is unreasonable, given the significant impact the validity of Dolgonos' and McGoey's disputed claims has on the value of UBS' shares and the financial position of the company. The dispute with respect to Dolgonos' and McGoey's disputed claims also give rise to serious issues with respect to Mr. Dolgonos' conduct that may have an impact on how shareholders vote. Only once Dolgonos' and McGoey's disputed claims are determined will the remainder of UBS shareholders be in a position to properly assess the request by Mr. Dolgonos that his proposed slate of directors lead the future course of UBS in place of the current board.

68. UBS' shareholders are being presented with two different visions for the company. I differ with Mr. Dolgonos, however, as to whether, if the 2012 AGM goes forward on 11 July 2012 and the board is replaced with Dolgonos' slate of directors, UBS' shareholder will have exercised a choice as between these two visions. Since February of 2011, Mr. Dolgonos has acquired additional shares of UBS and the results of the 2012 AGM will

likley not reflect a change in the views of shareholders, but a change in Mr. Dolgonos' shareholdings such that he can impose his will on the other UBS shareholders -- shareholders that have already rejected his vision for UBS twice before.

69. There is no prejudice to Dolgonos in waiting until the Claims Procedure is completed and Dolgonos' and McGoey's disputed claims are determined on their merits as part of the on-going Claims Procedure.

X. Position of Other UBS Shareholders

70. In connection with the 2012 AGM, UBS delivered the Notice of Meeting and Management Information Circular, and the letter to UBS shareholders attached as **Exhibit "P"**. The letter advises shareholders that UBS might seek to adjourn the 2012 AGM.

71. As previously noted, UBS has approximately 15,000 shareholders, most of whom hold a relatively small number of shares. There are, however, a few shareholders aside from 206 Ontario who hold larger blocks of shares. I have received correspondence from 11 UBS shareholders who, together with Clarest LP, hold a 19 per cent interest in UBS. These shareholders have advised me that they support the efforts of the current board and wish to ensure that they have more information on the validity and quantum of Dolgonos' and McGoey's disputed claims before making a decision on a change in direction for UBS. Correspondence from those shareholders is attached as **Exhibit "Q"**.

SWORN before me at the City of Toronto in the Province of Ontario, this 27th day of June 2012

Commissioner for Taking Affidavits or Notary

ROBERT ULICKI

TOR_LAW\7942197\1

TAB 17

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

Proposed Wording

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

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

Rationale

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

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

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

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

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

Present Law

None.

Senate Recommendation

The reform follows Senate recommendation #35.

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

AND IN THE MATTER OF CERTAIN PROCEEDINGS TAKEN IN THE UNITED STATES BANKRUPTCY COURT WITH RESPECT TO XINERGY LTD.

APPLICATION OF XINERGY LTD. UNDER SECTION 46 OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

Court File No.: CV-15-10936-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced at Toronto

BOOK OF AUTHORITIES OF THE MOVING PARTY
(returnable on May 28, 2015)

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