2019 01G 2868
IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR
GENERAL DIVISION

IN THE MATTER OF: An Application by BRITISH CONFECTIONERY COMPANY LIMITED and BRITISH BAZAAR COMPANY LIMITED (the "Applicants") for relief under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as am.

SUMMARY OF CURRENT DOCUMENT	
Court File No.	2019 01G
Date of filing of document:	
Name of filing party or person:	Tim Hill, Q.C., (Counsel for the Applicants)
Application to which document being filed relates:	Application for Order pursuant to Section 11.02(2) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as am.
Statement of purpose in filing:	Memorandum of Fact and Law

APPLICANTS' MEMORANDUM OF FACT AND LAW

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Counsel for Bank of Montreal

TO: The Service List appended to the Originating Application (*Inter Partes*)

TO: Supreme Court of NL
P.O. Box 937
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Attention: Court Registry

INTRODUCTION

1. British Confectionery Company Limited ("Confectionary") and British Bazaar Company Limited ("Bazaar") (collectively "the Companies or "the Applicants") apply for an order pursuant to the provisions of section 11.02(2) the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as am. ("*CCAA*"). Specifically, the Companies seek an Order extending the stay of proceedings herein.

2. The Initial Order in this matter was granted by Justice Marshall on May 1, 2019. The stay at present expires on May 27th.

3. In this memorandum the Companies set out the factual matrix giving rise to the present Application, set out the relief being sought, identify the issues to be considered by the Court, and set out the arguments in favour of granting the order applied for.

SUMMARY OF FACTS

4. The Companies are incorporated in Newfoundland and Labrador.

5. Confectionery and Bazaar are the primary operating entities of a group of companies. Confectionery operates a manufacturing facility from leased premises located in St. John's, Newfoundland and Labrador. This facility specializes in the production of specialty paper products; specifically, break-open lottery and promotional products.

6. Bazaar is a company wholly owned by Confectionary. Bazaar owns and administers customer contracts for the purchase of break-open lottery and promotional products. To fulfill these contracts, Bazaar purchases tickets directly from Confectionery. Outside of the purchase and sale of tickets from Confectionery, the economic activity within Bazaar is negligible.

7. A significant portion of the Companies' revenue is generated from two customers: Atlantic Lottery Corporation ("ALC") and British Columbia Lottery Corporation ("BCLC").

8. On October 31, 2018, Confectionary, Bazaar and David Connolly Sr. received a demand for repayment of outstanding amounts owing and a Notice of Intention to Enforce Security from the Bank of Montreal ("BMO").

9. On November 5, 2018, Confectionery and Bazaar filed NOIs pursuant to section 50.4 of the *BIA*.

10. Over the last four years the Companies' sales performance has demonstrated significant variability. The financial performance during that period was impacted by the following factors:

(i) Operational and organizational deficiencies –a number of factors hindered the ability of the Companies to operate efficiently;

(ii) Development costs – the Companies invested in development costs related to new product offerings, production improvements and barcode technology which have not as yet generated an economic return;

(iii) 2016 inventory write off – a review of inventory in 2016 which resulted in a write off of approximately $1.3 million;

(iv) 2017 ALC product recall – during fiscal 2017, seven ALC games distributed into the market were recalled, and an additional six games in production were withheld, all due to reports that the barcodes on certain tickets were not validating properly;

(v) Fire at production facility – in December 2017, a fire at the production facility resulted in the destruction of finished goods inventory and equipment;

(vi) Contract renegotiations with ALC – Effective July 1, 2018, the Companies extended their contract with ALC at a price per ticket approximately 30% lower than the previous contract; and

(vii) Production delays –Production delays experienced in fiscal 2017 have had residual effects that were still impacting the Company during the initial quarters of fiscal 2018.

11. The Companies undertook a number of restructuring initiatives prior to the NOI filings. These included:

(i) reorganizing the Companies' ownership structure;

(ii) partnering with another company so as to increase the Companies' ability to source product and sell to the United States and central Canadian market;

(iii) hiring of a Chief Financial Officer in March 2018 and a new corporate accountant in October 2018; and

(iv) focusing on overhead cost reductions.

12. Since the date of the NOI Filing, the Companies' activities have included, but were not limited to:

(i) working with the Proposal Trustee to complete statutory requirements, including giving notice to creditors and preparing the NOI Cash Flow;

(ii) meeting in person with both key customers, ALC and BCLC;

(iii) holding discussions with potential lenders and equity sources;

(iv) working with the Proposal Trustee to answer questions of creditors and establish payment arrangements regarding post-filing obligations;

(v) working with the Proposal Trustee to organize discussions with the significant secured and unsecured creditors including BMO, Atlantic Canada Opportunities Agency and Business Investment Corporation;

(vi) working with the Proposal Trustee to monitor actual cash flow and reporting on variances to the NOI Cash Flow;

(vii) working with the Proposal Trustee and legal counsel to satisfy information requests made by ALC;

(viii) Having discussions with potential lenders, equity sources and the government of Newfoundland and Labrador;

(ix) Working with the Proposal Trustee to develop a Confidential Information Memorandum ("CIM") in support of the search for alternative financing;

(x) Cooperating with the Proposal Trustee in reviewing the expressions of interest received from potential financing sources and parties interested in purchasing the Companies' assets; and

(xi) Working with the Proposal Trustee to solidify equity investment and financing, or an asset sale, such as to enable a Proposal to be made.

13. On April 9, 2019, the Companies received a binding expression of interest ("BEOI") from a third-party investor ("the Investor"), as was described in a confidential addendum to the 4th Report of the Proposal Trustee in the NOI proceedings (the Report of the Proposed Monitor in this proceeding) (hereafter the "Proposed Monitor's Report). That BEOI was subject to conditions which included due diligence and the participation of the Province of Newfoundland and Labrador, Department of Tourism, Culture, Industry and Innovation ("TCII"), in future lending to the Companies.

14. The Investor has proceeded with its due diligence inquiries, which are substantially complete.

15. As result of the calling of the provincial election TCII was not in a position to make a final determination on future lending to the Companies. TCII has now indicated that the determination of same will be made by June 30, 2019, dependent upon the companies providing further information being sought by TCII this week.

16. The companies seek an extension until the first available court date after June 30, 2019. Should the answer from TCII be negative, the companies intend to ask the court to approve an asset sale process at that next hearing.

17. It is noted that the Investor has expressed an interest in making a stalking horse bid should TCII not approve financing.

NATURE OF THIS APPLICATION

18. In this Application the Companies seek the following relief:

(a) An Order abridging the notice periods pursuant to the *Rules of the Supreme Court, 1986,* Rule 2.01(1);

(b) An Order pursuant to Section 11 of the *CCAA* directing that service on the service list used in the BIA proceedings is sufficient for the purposes of this Application; and

(c) An Order pursuant to Section 11.02(2) of the CCAA extending the stay provided for in the Initial Order.

19. The simple purpose of seeking the extension is to allow the process with the Investor and TCII to reach a conclusion. If that conclusion is not positive, subject to court approval the Companies would proceed to seek an asset sale.

ISSUE ON THE APPLICATION

20. The issue arising on this Application is whether the Companies have met the burden imposed on those seeking an extension to the stay granted under the Initial Order;

ARGUMENT

21. The Court's attention is respectfully drawn to Section 11.02(2) of the *CCAA*, which reads:

11.02(2) Stays, etc. — other than initial application

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

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

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

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

22. The prerequisites for the making of such an order are set out in section 11.02(3):

11.02(3) Burden of proof on application

The court shall not make the order unless

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

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

23. The Court's attention is respectfully drawn to the following extracts from *Re San Francisco Gifts Ltd.*[1], which summarize the approach taken to the issues raised in section 11.02(3) (although it is noted that the sections are renumbered as a result of the 2009 amendments):

Fundamentals

11 The well established remedial purpose of the *CCAA* is to facilitate the making of a compromise or arrangement by an insolvent company with its creditors to the end that the company is able to stay in business. The premise is that this will result in a benefit to the company, its creditors and employees. The Act is to be given a large and liberal interpretation.

[1] 2005 ABQB 91 [Tab 1]

12 The court's jurisdiction under s. 11(6) to extend a stay of proceedings (beyond the initial 30 days of a *CCAA* order) is preconditioned on the applicant satisfying it that:

(a) circumstances exist that make such an order appropriate; and
(b) the applicant has acted, and is acting, in good faith and with due diligence.

13 Whether it is "appropriate" to make the order is not dependant on finding "due diligence" and "good faith." Indeed, refusal on that basis can be the result of an independent or interconnected finding. Stays of proceedings have been refused where the company is hopelessly insolvent; has acted in bad faith; or where the plan of arrangement is unworkable, impractical or essentially doomed to failure.

Meaning of "Good Faith"

14 The term "good faith" is not defined in the *CCAA* and there is a paucity of judicial consideration about its meaning in the context of stay extension applications. The opposing landlords on this application rely on the following definition of "good faith" found in *Black's Law Dictionary* to support the proposition that good faith encompasses general commercial fairness and honesty:

A state of mind consisting of: (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealings in a given trade or business, or (4) absence of intent to defraud or seek unconscionable advantage. [Emphasis added]

15 "Good faith" is defined as "honesty of intention" in the *Concise Oxford Dictionary.*

16 Regardless of which definition is used, honesty is at the core. ...

Supervising Court's Role

28 The court's role during the stay period has been described as a supervisory one, meant to: "...preserve the *status quo* and to move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure." That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling of creditors' meetings and the like. On the contrary, this role requires attention to changing circumstances and vigilance in ensuring that a delicate balance of interests is maintained.

> 29 Although the supervising judge's main concern centres on actions affecting stakeholders in the proceeding, she is also responsible for protecting the institutional integrity of the *CCAA* courts, preserving their public esteem, and doing equity. She cannot turn a blind eye to corporate conduct that could affect the public's confidence in the *CCAA* process but must be alive to concerns of offensive business practices that are of such gravity that the interests of stakeholders in the proceeding must yield to those of the public at large.

24. To summarize, the Court is vested with a great deal of discretion on a motion such as this. Throughout its inquiry the Court will bear in mind the "well established remedial purpose of the *CCAA*", which is "to facilitate the making of a compromise or arrangement by an insolvent company with its creditors to the end that the company is able to stay in business".

25. In reaching a decision on the motion the Court is informed by its appreciation of the honesty of the intentions of the debtor, the effect of an extension on the stakeholders in the business (which may include equity owners, employees and creditors, amongst others), and the integrity of the *CCAA* process.

26. In the case at bar, there is no suggestion that the applicants lack integrity in their operations or approach to the *CCAA* process, or that the process is doomed to failure. This is a patently honest attempt to save the business by ultimately reaching a realistic compromise with the creditors or selling the business as a going concern.

27. In this regard, the Court's attention is drawn to *Re Federal Gypsum Co.*[2], and the comments of Justice MacAdam:

> 34 In view of the preliminary approval of the Plan and the calling of a meeting of creditors to consider and vote on the Plan, it necessarily follows that there should be an extension of the stay to enable the Company to present the Plan to the creditors, to conduct the claims process as previously ordered and to determine whether the creditors have voted in favour or against the Plan. In *Cansugar Inc., Re*, 2004 NBQB 7 (N.B. Q.B.), Justice Glennie, in referencing s.11(6) of the CCAA, noted:

[2] 2007 NSSC 384 [Tab 2]

> In my opinion, the requirements of section 11(6) of the C.C.A.A. have been satisfied in this case. The continuation of the stay is supported by the overriding purpose of the C.C.A.A., which is to allow an insolvent company a reasonable period of time to reorganize and propose a plan of arrangement to its creditors and the Court, and to prevent maneuvers for positioning among creditors in the interim. [emphasis added by counsel]
>
> 35 To similar effect, Topolniski J. in *San Francisco Gifts Ltd., Re*, 2005 ABQB 91 (Alta. Q.B.), at para. 28 observed:
>
> The court's role during the stay period has been described as a supervisory one, meant to: '...preserve the status quo and to move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure.' That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling of creditors' meetings and the like. On the contrary, this role requires attention to changing circumstances and vigilance in ensuring that a delicate balance of interests is maintained. [emphasis added by counsel]
>
> 36 Notwithstanding the objection by the Royal Bank, including the potential prejudice as outlined by counsel in the event there is a deterioration in the value of the assets securing its operating loan, continuation of the stay is to be supported in view of the overriding purpose of the CCAA "...to allow an insolvent company a reasonable period of time to reorganize and propose a plan of arrangement to its creditors and the court...".

28. The extension will, quite simply, "preserve the status quo and move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure."

SUMMARY

29. The orders sought essentially give a little more time to the Companies to either complete a refinancing, or to arrange an asset sale so as to enable the Companies to continue as going concerns.

30. No stakeholder will be prejudiced by the grant of the orders. To the contrary, there is a potential benefit to all if the Companies are allowed to continue under a *CCAA* stay.

31. Based upon all the foregoing, it is respectfully submitted that the orders ought to be granted.

DATED AT the Dartmouth, in the Province of Nova Scotia, this 22nd day of May, 2019.

Tim Hill, Q.C.
Counsel for the Applicants

TAB 1

2005 ABQB 91
Alberta Court of Queen's Bench

San Francisco Gifts Ltd., Re

2005 CarswellAlta 174, 2005 ABQB 91, [2005] A.W.L.D. 1426, [2005] A.J. No. 131, 10 C.B.R. (5th) 275, 137 A.C.W.S. (3d) 242, 378 A.R. 361, 42 Alta. L.R. (4th) 377

In the Matter of the Companies' Creditors Arrangement Act, R.S.A. 1985, c. C-36, As Amended

And In the Matter of a Plan of Compromise or Arrangement of San Francisco Gifts Ltd., San Francisco Retail Gifts Incorporated (Previously Called San Francisco Gifts Incorporated), San Francisco Gift Stores Limited, San Francisco Gifts (Atlantic) Limited, San Francisco Stores Ltd., San Francisco Gifts & Novelties Inc., San Francisco Gifts & Novelty Merchandising Corporation (Previously Called San Francisco Gifts and Novelty Corporation), San Francisco (The Rock) Ltd. (Previously Called San Francisco Newfoundland Ltd.) And San Francisco Retail Gifts & Novelties Limited (Previously Called San Francisco Gifts & Novelties Limited)

Topolniski J.

Heard: January 17, 2005
Judgment: February 9, 2005
Docket: Edmonton 0403-00170

Counsel: Richard T.G. Reeson, Q.C., John Bridgadear, Howard J. Sniderman for Companies
Michael McCabe, Q.C. for Monitor, Browning Crocker Inc.
Jeremy H. Hockin for Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc.; 20 Vic Management Ltd.; Morguard Investments Ltd.; Morguard Real Estate Investments Trust; Millwoods Town Centre, Edmonton; Park Place, Lethbridge; Metro Town, Burnaby, B.C.; Northgate Mall, Edmonton; Brandon Shopping Mall, MB; Herongate Mall, Ottawa; Westmount Shopping Centre, London; Village Mall, St. John's NFLD; Kingsway Garden Mall; Westbrook Mall; Bonnie Doon Shopping Centre; Red Deer Centre; Marlborough Mall; Circile Park Mall; Kildonan Place Mall; Cambridge Centre; Oshawa Centre; Tecumseh Mall; Downtown Chatham Centre; Simcoe Town Centre; Niagara Square; Halifax Shopping Centre; RioCan Property Services; 1113443 Ontario Inc.; Shoppers World, Brampton, ON; Tillicum Mall, Victoria, BC; Confederation Mall, Saskatoon, SK; Parkland Mall, Yorkton, SK; Cambrian Mall, Sault Ste. Marie, ON; Northumberland Mall, Cobourg, ON; Orangeville Mall, Orangeville, ON; Renfrew Mall, Renfrew, ON; Orillia Square Mall, Orillia, ON; Elgin Mall, St. Thomas, ON; Lawrence Square, North York, ON; Trinity Conception Square, Carbonear, NFLD; Charlottetown Mall, Charlottetown PEI; Timiskaming Square
Kent Rowan for Locher Evers International, Neuvo Rags, Quality Press
Tim Shelley (Agent Employee) for Lauer Transportation Services

Subject: Insolvency; Civil Practice and Procedure

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
XIX.2 Initial application
XIX.2.b Grant of stay

XIX.2.b.vii Extension of order

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Effect of arrangement — Stay of proceedings
Debtor operated national chain of novelty goods stores with some 400 employees — Debtor obtained Companies' Creditors Arrangement Act (CCAA) protection on January 7, 2000 — Stay of proceedings under CCAA was extended three times with expectation that entire CCAA process would be completed by February 7th, 2005 — On December 30, 2004, debtor pleaded guilty to nine counts of wilful copyright infringement and paid $150,000 fine — Debtor had sold lamps with counterfeit safety certification labels and was found to have other counterfeit goods in its possession — Debtor brought application for further extension of time — Application granted — Stay was extended to July 19, 2005 — This was not case where debtor's business practices were so offensive as to warrant refusal of extension on public policy grounds — Debtor's conduct was illegal and offensive, but debtor had already been condemned for its illegal conduct in appropriate forum — Denying extension would be additional form of punishment — Of greater concern was effect on unsecured creditors who would be denied right to vote on plan and any chance for small financial recovery — Debtor met prerequisites of acting with due diligence and in good faith in working towards presenting plan of arrangement to its creditors — Delay was primarily attributable to time required for debtor to seek leave to appeal from prior classification decision — Monitor was satisfied that debtor was financially viable despite payment of fine — Potential adverse effect of debtor's misconduct on business relationships was sheer speculation at this point.

Table of Authorities

Cases considered by *Topolniski J.*:

Agro Pacific Industries Ltd., Re (2000), 2000 BCSC 837, 2000 CarswellBC 1143, 76 B.C.L.R. (3d) 364, 5 B.L.R. (3d) 203 (B.C. S.C.) — considered

Associated Investors of Canada Ltd., Re (1987), 56 Alta. L.R. (2d) 259, [1988] 2 W.W.R. 211, 38 B.L.R. 148, 67 C.B.R. (N.S.) 237, (sub nom. *First Investors Corp., Re)* 46 D.L.R. (4th) 669, 1987 CarswellAlta 330 (Alta. Q.B.) — considered

Associated Investors of Canada Ltd., Re (1988), 60 Alta. L.R. (2d) 242, 89 A.R. 344, 71 C.B.R. (N.S.) 71, 1988 CarswellAlta 310 (Alta. C.A.) — considered

Avery Construction Co., Re (1942), [1942] 4 D.L.R. 558, 24 C.B.R. 17, 1942 CarswellOnt 86 (Ont. S.C.) — referred to

Canadian Cottons Ltd., Re (1951), 33 C.B.R. 38, [1952] Que. S.C. 276, 1951 CarswellQue 27 (C.S. Que.) — referred to

Fracmaster Ltd., Re (1999), 1999 CarswellAlta 461, 245 A.R. 102, 11 C.B.R. (4th) 204 (Alta. Q.B.) — 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, 1990 CarswellBC 394 (B.C. C.A.) — referred to

Juniper Lumber Co., Re (2000), 2000 CarswellNB 117 (N.B. Q.B.) — considered

Juniper Lumber Co., Re (2001), 2001 NBCA 30, 2001 CarswellNB 114 (N.B. C.A.) — referred to

Meridian Development Inc. v. Toronto Dominion Bank (1984), [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, 1984 CarswellAlta 259 (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, 1990 CarswellOnt 139 (Ont. C.A.) — referred to

Pacific National Lease Holding Corp., Re (August 17, 1992), Doc. A922870 (B.C. S.C.) — 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, 1992 CarswellBC 524 (B.C. C.A. [In Chambers]) — referred to

Rio Nevada Energy Inc., Re (2000), 2000 CarswellAlta 1584, 283 A.R. 146 (Alta. Q.B.) — considered

Royal Bank v. Fracmaster Ltd. (1999), 1999 CarswellAlta 539, (sub nom. *UTI Energy Corp. v. Fracmaster Ltd.)* 244 A.R. 93, (sub nom. *UTI Energy Corp. v. Fracmaster Ltd.)* 209 W.A.C. 93, 11 C.B.R. (4th) 230 (Alta. C.A.) — referred to

Sairex GmbH v. Prudential Steel Ltd. (1991), 8 C.B.R. (3d) 62, 1991 CarswellOnt 215 (Ont. Gen. Div.) — considered

Skeena Cellulose Inc., Re (2001), 2001 BCSC 1423, 2001 CarswellBC 2226, 29 C.B.R. (4th) 157 (B.C. S.C.) — considered

Statutes considered:

Bankruptcy Code, 11 U.S.C. 1982
Chapter 11 — referred to

Business Corporations Act, R.S.A. 2000, c. B-9
Generally — referred to

Companies Act, 1929 (19 & 20 Geo. 5), c. 23
s. 153 — referred to

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

s. 11(6) — referred to

Copyright Act, R.S.C. 1985, c. C-42
Generally — referred to

s. 42 — referred to

APPLICATION by debtor for further extension of stay of proceedings under *Companies' Creditors Arrangement Act.*

***Topolnlski J.*:**

Introduction

1 The San Francisco group of companies (San Francisco) obtained *Companies' Creditors Arrangement Act*[1] (*CCAA*) protection on January 7, 2000 (Initial Order). Key to that protection was the requisite stay of proceedings that gives a debtor company breathing room to formulate a plan of arrangement. The stay was extended three times thereafter with the expectation that the entire *CCAA* process would be completed by February 7th, 2005. That date was not met. Accordingly, San Francisco now applies to have the stay extended to June 30, 2005.

2 A small group of landlords opposes the motion on the basis of San Francisco's recent guilty plea to *Copyright Act* offenses and the sentencing judge's description of San Francisco's conduct as: "...a despicable fraud on the public. Not only not insignificant but bordering on a massive scale..." The landlords suggest that this precludes any possibility of the company having acted in "good faith" and therefore having met the statutory prerequisite to an extension. Further, they contend that

extending the stay would bring the administration of justice into disrepute.

3 San Francisco acknowledges that its conduct was stupid, offensive and dangerous. That said, it contends that it already has been sanctioned and that it has "paid its debt to society." It argues that subjecting it to another consequence in this proceeding would be akin to double jeopardy. Apart from the obvious consequential harm to the company itself, San Francisco expresses concern that its creditors might be disadvantaged if it is forced into bankruptcy.

4 While there has been some delay in moving this matter forward towards the creditor vote, this delay is primarily attributable to the time it took San Francisco to deal with leave to appeal my classification decision of September 28, 2004. Despite the opposing landlords' mild protestations to the contrary, it is evident that the company has acted with due diligence. The real focus of this application is on the meaning and scope of the term "good faith" as that term is used in s. 11(6) of the *CCAA*, and on whether San Francisco's conduct renders it unworthy of the protective umbrella of the Act in its restructuring efforts. It also raises questions about the role of a supervising court in *CCAA* proceedings.

Background

5 San Francisco operates a national chain of novelty goods stores from its head office in Edmonton, Alberta. It currently has 62 locations and approximately 400 employees.

6 The group of companies is comprised of the operating company, San Francisco Gifts Ltd., and a number of hollow nominee companies. The operating company holds all of the group's assets. It is 100 percent owned by Laurier Investments Corp., which in turn is 100 percent owned by Barry Slawsky (Slawsky), the driving force behind the companies.

7 Apart from typical priority challenges in insolvency matters, this proceeding has been punctuated by a series of challenges to the process and its continuation, led primarily by a group of landlords that includes the opposing landlords.

8 On December 30, 2004, San Francisco pleaded guilty to nine charges under s. 42 of the *Copyright Act*,[2] which creates offences for a variety of conduct constituting wilful copyright infringement. The evidence in that proceeding established that:

> (a) An investigation by the St. John's, Newfoundland, Fire Marshall, arising from a complaint about a faulty lamp sold by San Francisco, led to the discovery that the lamp bore a counterfeit safety certification label commonly called a "UL" label.[3] The R.C.M.P. conducted searches of San Francisco stores across the country, its head office, and a warehouse, which turned up other counterfeit electrical UL labels as well as counterfeit products bearing the symbols of trademark holders of Playboy, Marvel Comics and others.
>
> (b) Counterfeit UL labels were found in the offices of Slawsky and San Francisco's Head of Sales. There was also a fax from "a Chinese location" found in Slawsky's office that threatened that a report to Canadian authorities about the counterfeit safety labels would be made if payment was not forthcoming.
>
> (c) *Copyright Act* charges against Slawsky were withdrawn when San Francisco entered a plea of guilty to the charges;
>
> (d) The sentencing judge accepted counsels' joint submission that a $150,000.00 fine would be appropriate. In passing sentence, he condemned the company's conduct, particularly as it related to the counterfeit labels, expressing grave concern for the safety of unknowing consumers.[4]
>
> (e) San Francisco was co-operative during the R.C.M.P. investigation and the Crown's prosecution of the case.
>
> (f) San Francisco had been convicted of similar offences in 1998.

9 Judge Stevens-Guille's condemnation of San Francisco's conduct was the subject of local and national newspaper coverage.

10 The company paid the $150,000.00 fine from last year's profits.

Analysis

Fundamentals

11 The well established remedial purpose of the *CCAA* is to facilitate the making of a compromise or arrangement by an insolvent company with its creditors to the end that the company is able to stay in business. The premise is that this will result in a benefit to the company, its creditors and employees.[5] The Act is to be given a large and liberal interpretation.[6]

12 The court's jurisdiction under s. 11(6) to extend a stay of proceedings (beyond the initial 30 days of a *CCAA* order) is preconditioned on the applicant satisfying it that:

> (a) circumstances exist that make such an order appropriate; and
>
> (b) the applicant has acted, and is acting, in good faith and with due diligence.

13 Whether it is "appropriate" to make the order is not dependant on finding "due diligence" and "good faith." Indeed, refusal on that basis can be the result of an independent or interconnected finding. Stays of proceedings have been refused where the company is hopelessly insolvent; has acted in bad faith;[7] or where the plan of arrangement is unworkable, impractical or essentially doomed to failure.[8]

Meaning of "Good Faith"

14 The term "good faith" is not defined in the *CCAA* and there is a paucity of judicial consideration about its meaning in the context of stay extension applications. The opposing landlords on this application rely on the following definition of "good faith" found in *Black's Law Dictionary* to support the proposition that good faith encompasses general commercial fairness and honesty:

> A state of mind consisting of: (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealings in a given trade or business, or (4) absence of intent to defraud or seek unconscionable advantage.[9] [Emphasis added]

15 "Good faith" is defined as "honesty of intention" in the *Concise Oxford Dictionary*.[10]

16 Regardless of which definition is used, honesty is at the core. Honesty is what the opposing landlords urge is desperately wanting now and, as evidenced by San Francisco's earlier conviction for *Copyright Act* offences, was wanting in the past.

17 Accepting that the duty of "good faith" requires honesty, the question is whether that duty is owed to the court and the stakeholders directly affected by the process, including investors, creditors and employees, or does the *CCAA* cast a broader net by requiring good faith in terms of the company's dealings with the public at large? As will be seen from the following review of the jurisprudence, it usually means the former.

18 *Rio Nevada Energy Inc., Re*[11] and *Skeena Cellulose Inc., Re*[12] both involved opposed stay extension applications. In *Skeena Cellulose Inc.*, one of the company's two major secured creditors argued that the company's failure to carry out certain layoffs in the time recommended by the monitor showed a lack of good faith and due diligence. Brenner C.J.S.C. found that the delay in carrying out the layoffs was not a matter of bad faith. Given the severe consequences of terminating the stay, he granted the extension.

19 Romaine J. rejected a suggestion of lack of good faith arising from a creditor dispute and allegations of debtor

dishonesty in *Rio Nevada Energy Inc.*, finding that: "Rio Nevada has acted and is acting in good faith *with respect to these proceedings*."[13] [Emphasis added]

20 *Sairex GmbH v. Prudential Steel Ltd.*[14] involved an application by a creditor to proceed against a company under *CCAA* protection. Farley J. declined the application despite his sympathy for the creditor's position and his view that the creditor could make out a fairly strong case. He said: "... I would think that public policy also dictates that a company under *CCAA* protection or about to apply for it should not be allowed to engage in very offensive business practices against another and thumb its nose at the world from the safety of the *CCAA*."[15] In the end, he concluded that the dominant purpose behind the company's actions was not to harm the creditor.

21 Inventory suppliers in *Agro Pacific Industries Ltd., Re*[16] sought to set aside a *CCAA* stay on the ground that the company had not been acting in good faith in entering into contracts. The suppliers' contention that the company knew it was in shaky financial circumstances when it ordered goods and that it did so to pay down the secured creditors was rejected by Thackeray J. He was not satisfied that there was any lack of good faith or collusion between the company and its secured creditors to disadvantage the unsecured creditors.

22 *Juniper Lumber Co., Re*[17] addressed a creditor's allegations of bad faith in the context of an application to set aside the *ex parte* Initial Order. Turnbull J. held that, while fraud may not always preclude *CCAA* relief, it was of such a magnitude in that case as to warrant setting aside the order. He commented that: "basic honesty has to be present" in the course of conduct between a bank and its customer.[18] However, his decision was overturned by the Court of Appeal because the necessary evidentiary foundation was wanting.[19]

23 *Nova Metal Products Inc. v. Comiskey (Trustee of)*,[20] although addressing instant trust deeds, which are no longer of concern under the present *CCAA*, offers a useful discussion of "good faith." Doherty J.A., dissenting in part, commented:

> ...A debtor company should not be allowed to use the Act for any purpose other than to attempt a legitimate reorganization. If the purpose of the application is to advantage one creditor over another, to defeat the legitimate interests of creditors, to delay the inevitable failure of the debtor company, or for some other improper purpose, the court has the means available to it, apart entirely from s. 3 of the Act, to prevent misuse of the Act. In cases where the debtor company acts in bad faith, the court may refuse to order a meeting of creditors, it may deny interim protection, it may vary interim protection initially given when the bad faith is shown, or it may refuse to sanction any plan which emanates from the meeting of the creditors.[21]

24 Doherty J.A. referred to an article by L. Crozier, "*Good Faith and the Companies' Creditors Arrangement Act*,"[22] in which the author contends that the possibility of abuse and manipulation by debtors should be checked by implying a requirement of good faith, as American bankruptcy courts routinely do by invoking good faith to dismiss applications under Chapter 11 of the *Bankruptcy Code* where the debtor's conduct in filing for reorganization is found to constitute bad faith.[23] He also suggests that, as a result of the injunctive nature of the stay, the court's power to take into account the debtor's conduct is inherent in its equitable jurisdiction.

25 An obligation of good faith in the context of an application to sanction a plan of arrangement was implied in *Associated Investors of Canada Ltd., Re*[24] While *First Investors* was an atypical *CCAA* proceeding, it is worth discussion. Allegations that fraud had been committed on creditors and consumers/investors led to the additional appointment of both a receiver and an inspector under the Alberta *Business Corporations Act*. The inspector had a broad mandate to investigate the company's affairs and business practices that included inquiring into whether the company had intended to defraud anyone.

26 Berger J. (as he then was) noted that the *CCAA* is derived from s. 153 of the English *Companies Act*, 1929 (19 and 20 Geo. 5) c. 23. Having sought assistance from other legislation with wording similar to the *CCAA* and with a genesis in the British statute,[25] he concluded that the court should not sanction an illegal, improper or unfair plan of arrangement.[26] He emphasized that: "If evidence of fraud, negligence, wrongdoing or illegality emerges, the Court may be called upon by interested parties to draw certain conclusions in fact and in law that bear directly upon the Plans of Arrangement."[27] He also determined that, while it might be expedient to approve the plans, the court was bound to proceed with caution, "so as to ensure that wrongful acts, if any, do not receive judicial sanction."[28]

27 In the end, Berger J. adjourned the application pending receipt of a report by the inspector. His decision was reversed

on appeal[29] on the basis that there was nothing in the plans that sanctioned wrongful acts or omissions. The Court of Appeal remitted the matter back for reconsideration on the merits, stating that while the discretion to be exercised must relate to the merits or propriety of the plans, the court could consider whether approving the plans would sanction possible wrongdoing or otherwise hinder later litigation.

Supervising Court's Role

28 The court's role during the stay period has been described as a supervisory one, meant to: "...preserve the *status quo* and to move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure."[30] That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling of creditors' meetings and the like. On the contrary, this role requires attention to changing circumstances and vigilance in ensuring that a delicate balance of interests is maintained.

29 Although the supervising judge's main concern centres on actions affecting stakeholders in the proceeding, she is also responsible for protecting the institutional integrity of the *CCAA* courts, preserving their public esteem, and doing equity.[31] She cannot turn a blind eye to corporate conduct that could affect the public's confidence in the *CCAA* process but must be alive to concerns of offensive business practices that are of such gravity that the interests of stakeholders in the proceeding must yield to those of the public at large.

Conclusions

30 While "good faith" in the context of stay applications is generally focused on the debtor's dealings with stakeholders, concern for the broader public interest mandates that a stay not be granted if the result will be to condone wrongdoing.[32]

31 Although there is a possibility that a debtor company's business practices will be so offensive as to warrant refusal of a stay extension on public policy grounds, this is not such a case. Clearly, San Francisco's sale of knockoff goods was illegal and offensive. Most troubling was its sale to an unwitting public of goods bearing counterfeit safety labels. Allowing the stay to continue in this case is not to minimize the repugnant nature of San Francisco's conduct. However, the company has been condemned for its illegal conduct in the appropriate forum and punishment levied. Denying the stay extension application would be an additional form of punishment. Of greater concern is the effect that it would have on San Francisco's creditors, particularly the unsecured creditors, who would be denied their right to vote on the plan and whatever chance they might have for a small financial recovery, one which they, for the most part, patiently await.

32 San Francisco has met the prerequisites that it has acted and is acting with due diligence and in good faith in working towards presenting a plan of arrangement to its creditors. Appreciating that the *CCAA* is to be given a broad and liberal interpretation to give effect to its remedial purpose, I am satisfied that, in the circumstances, extending the stay of proceedings is appropriate. The stay is extended to July 19, 2005. The revised time frame for next steps in the proceedings is set out on the attached Schedule.

33 Although San Francisco has paid the $150,000.00 fine, the Monitor is satisfied that the company's current cash flow statements indicate that it is financially viable. Whether San Francisco can weather any loss of public confidence arising from its actions and resulting conviction is yet to be seen. Its creditors may look more critically at the plan of arrangement, and its customers and business associates may reconsider the value of their continued relationship with the company. However, that is sheer speculation.

Schedule

Time Frames

1. February 14, 2005 Date Monitor posts Notice to Creditors on website

2. February 14, 2005 Date Monitor publishes the advertisement for one day in Globe & Mail or National Post

3. April 1, 2005 Date for receipt of claims from creditors

4. May 13, 2005 Date by which Monitor must send Notice of Revision or Disallowance.

5. June 13, 2005 Last date for bringing application to challenge a Notice of Revision or Disallowance.

6. June 27, 2005 Date for creditors meeting to vote on the Plan.

7. July 11, 2005 Date for court application to approve Plan (if required).

8. August 18, 2005 Date for Distribution to Prove Unsecured Claims

Stay Extended to July 19, 2005

Application granted.

Footnotes

1 R.S.A. 1985, c. C-36, as am.

2 R.S.C. 1985, c. C-42.

3 Underwriters' Laboratories (UL) operates facilities globally for the testing, certification and quality assessment of products, systems and services. Products are tested to Canadian standards and, if the product complies with those standards, UL issues an identification or listing mark confirming certification (Transcript of the proceedings held December 30, 2004 at pp.4-5)

4 Judge Stevens-Guille said: "Quite frankly, this is and should be described as nothing else than a despicable fraud on the public. Not only not insignificant but bordering on a massive scale company, stores, all of these places that we have been told they had stores...We are talking about electrical appliances that cause fires bought by someone who whether they relied on the UL certificate or not it had a certificate on it and to go to the exercise of getting cheap stuff somewhere and dressing it up with false labels and false safety certificates causes me great pause, such pause that if it were an individual who pled guilty before me today my starting point would be a term of imprisonment in a federal penitentiary, without a doubt." (Transcript of the proceedings held December 30, 2004 at pp. 18/15-18 and 19/2-11).

5 See for example *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.) and *Meridian Development Inc. v. Toronto Dominion Bank* (1984), 52 C.B.R. (N.S.) 109 (Alta. Q.B.).

6 *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101 (Ont. C.A.).

7 *Avery Construction Co., Re*, [1942] 4 D.L.R. 558 (Ont. S.C.), at 559.

8 *Fracmaster Ltd., Re* (1999), 11 C.B.R. (4th) 204 (Alta. Q.B.); aff'd (1999), 11 C.B.R. (4th) 230 (Alta. C.A.).

9 *Black's Law Dictionary*, 7th ed. (St. Paul, Minnesota: West Group, 1999), p.701.

10 *The Concise Oxford Dictionary of Current English*, 6th ed., (Oxford, Eng.: Clarendon Press, 1976), p.373.

11 (2000), 283 A.R. 146 (Alta. Q.B.).

12 2001 BCSC 1423, 29 C.B.R. (4th) 157 (B.C. S.C.).

13 *Rio Nevada Energy Inc.*, at para. 31.

14 (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.).

15 *Sairex GmbH*, at p. 73.

16 2000 BCSC 837, 76 B.C.L.R. (3d) 364 (B.C. S.C.).

17 *Juniper Lumber Co., Re* (N.B. Q.B.).

18 *Juniper Lumber Co., Re*, at para. 13.

19 2001 NBCA 30 (N.B. C.A.).

20 (1990), 1 O.R. (3d) 289 (Ont. C.A.).

21 *Elan Corp.*, at p. 313.

22 (1989), 15 Can. Bus. L.J. 89.

23 Crozier cites *Victory Construction Co. Inc., Re*, 9 B.R. 549 as an example of this. The court in that case found that the debtor company's purpose in filing under c. 11 was to isolate assets from its creditors rather than to reorganize the business. At p. 558, the court commented that good faith was "an implicit prerequisite to the filing or continuation of a proceeding under Chapter 11 of the *Code*."

24 (1987), 46 D.L.R. (4th) 669 (Alta. Q.B.), at 673-674, (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.); See also *Agro Pacific Industries Ltd., Re*, footnote 16, at para. 40 where Thackray J. held that there was an implied duty of good faith on initial applications.

25 *First Investors*, at p. 676.

26 *First Investors*, at p. 677.

27 *First Investors*, at p. 678.

28 *First Investors*, at p. 678.

29 (1988), 89 A.R. 344, 71 C.B.R. (N.S.) 71 (Alta. C.A.).

30 McFarlane J.A. in *Pacific National Lease Holding Corp., Re* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]), at 270, quoting with approval Brenner J. in the court below at (B.C. S.C.) at para. 26.

31 L. J. Crozier, footnote 22 at p. 95, quotes Edith H. Jones, in "The Good Faith Requirement in Bankruptcy," Proceedings of the 61st

Annual Meeting of the National Conference of Bankruptcy Judges, 1987, as statingd that: "... the bankruptcy judge usually at the instance of counsel, upon the filing of appropriate motions, is principally responsible to protect the institutional integrity of the bankruptcy courts, preserve their public esteem, and do equity in specific cases."

32 *Associated Investors of Canada Ltd., Re* (1988), 89 A.R. 344 (Alta. C.A.) at para. 16; *Canadian Cottons Ltd., Re* (1951), 33 C.B.R. 38 (C.S. Que.).

TAB 2

2007 NSSC 384
Nova Scotia Supreme Court

Federal Gypsum Co., Re

2007 CarswellNS 630, 2007 NSSC 384, [2007] N.S.J. No. 559, 163 A.C.W.S. (3d) 687, 261 N.S.R. (2d) 314, 40 C.B.R. (5th) 39, 835 A.P.R. 314

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 the Applicant, Federal Gypsum Company

A.D. MacAdam J.

Heard: November 29, 2007; December 14, 2007
Judgment: December 14, 2007
Written reasons: January 29, 2008
Docket: S.H. 285667

Counsel: Maurice P. Chaisson, Graham Lindfield for Federal Gypsum Company
Carl Holm, Q.C for BDO Dunwoody Goodman Rosen Inc.
Thomas Boyne, Q.C. for Royal Bank of Canada
Robert Sampson, Robert Risk for Enterprise Cape Breton Corporation, Cape Breton Growth Fund Corporation
Michael Pugsley for Her Majesty in Right of the Province of Nova Scotia (Nova Scotia Economic Development), Nova Scotia Business Incorporated
Michael Ryan, Q.C., Michael Schweiger for Black & McDonald Limited

Subject: Insolvency; Civil Practice and Procedure

Related Abridgment Classifications

Bankruptcy and insolvency
XIX Companies' Creditors Arrangement Act
  XIX.3 Arrangements
    XIX.3.b Approval by court
      XIX.3.b.i "Fair and reasonable"

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"
Debtor had been granted extensions of stay termination date along with approvals to arrange debtor in possession ("DIP") financing — Debtor's proposed claims bar process was subsequently approved — Debtor prepared plan of arrangement under which bank was classified as sole operating lender while other creditors were classified as either term lenders, lease lenders, unsecured creditors, or shareholders — Debtor placed secured lender B Ltd. in unsecured class since B Ltd.'s security had no value as result of postponement and subordination agreement executed in favour of bank and term lenders — Debtor brought application for preliminary approval of plan of arrangement and related relief and for permission to increase DIP financing — Application granted — Plan was to be presented to creditors so they could vote on it, stay termination date was extended, and DIP financing was to be increased — Threshold for preliminary approval of plan was relatively low and no basis was shown for altering proposed plan — Placing of B Ltd. in unsecured class was fair and reasonable since B Ltd.

was essentially unsecured creditor — Placing of bank in separate secured class was also fair and reasonable — Bank would recover full amount of security in any circumstances while all other secured creditors would face substantial shortfalls — Various secured creditors would each have sufficient votes to derail proposed plan and there was no reason to deny bank same veto power — Additional DIP financing was appropriate in light of debtor's need pending presentation of plan to creditors and absence of material deterioration of value of bank's security.

Table of Authorities

Cases considered by *A.D. MacAdam J.*:

Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 10 C.B.R. (3d) 23, 4 B.L.R. (2d) 306, 7 O.R. (3d) 362, 1992 CarswellOnt 159 (Ont. Gen. Div.) — considered

Canadian Airlines Corp., Re (2000), 19 C.B.R. (4th) 12, 2000 CarswellAlta 623 (Alta. Q.B.) — considered

Cansugar Inc., Re (2004), 2004 CarswellNB 9, 2004 NBQB 7 (N.B. Q.B.) — considered

Dylex Ltd., Re (1995), 31 C.B.R. (3d) 106, 1995 CarswellOnt 54 (Ont. Gen. Div. [Commercial List]) — considered

Fairview Industries Ltd., Re (1991), 1991 CarswellNS 35, 11 C.B.R. (3d) 43, (sub nom. *Fairview Industries Ltd., Re (No. 2))* 109 N.S.R. (2d) 12, (sub nom. *Fairview Industries Ltd., Re (No. 2))* 297 A.P.R. 12 (N.S. T.D.) — considered

Fairview Industries Ltd., Re (1991), (sub nom. *Fairview Industries Ltd., Re (No. 3))* 297 A.P.R. 32, 11 C.B.R. (3d) 71, (sub nom. *Fairview Industries Ltd., Re (No. 3))* 109 N.S.R. (2d) 32, 1991 CarswellNS 36 (N.S. T.D.) — considered

Fracmaster Ltd., Re (1999), 245 A.R. 102, 11 C.B.R. (4th) 204, 1999 CarswellAlta 461 (Alta. Q.B.) — considered

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 1990 CarswellBC 394, 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.) — considered

Hunters Trailer & Marine Ltd., Re (2001), 2001 CarswellAlta 964, 94 Alta. L.R. (3d) 389, 27 C.B.R. (4th) 236, [2001] 9 W.W.R. 299, 2001 ABQB 546, 295 A.R. 113 (Alta. Q.B.) — considered

Keddy Motor Inns Ltd., Re (1992), (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 299 A.P.R. 246, 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 110 N.S.R. (2d) 246, 1992 CarswellNS 46 (N.S. C.A.) — considered

Manderley Corp., Re (2005), 2005 CarswellOnt 1082, 10 C.B.R. (5th) 48 (Ont. S.C.J.) — considered

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1990 CarswellOnt 139, 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.) — considered

NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295, 1990 CarswellNS 33 (N.S. T.D.) — considered

Ontario v. Canadian Airlines Corp. (2001), 2001 CarswellAlta 1488, 98 Alta. L.R. (3d) 277, 306 A.R. 124, 2001 ABQB 983, 29 C.B.R. (4th) 236, [2002] 3 W.W.R. 373 (Alta. Q.B.) — considered

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, 1992 CarswellBC 524 (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, 1992 CarswellBC 542 (B.C. C.A.) — considered

San Francisco Gifts Ltd., Re (2005), 2005 ABQB 91, 2005 CarswellAlta 174, 10 C.B.R. (5th) 275, 42 Alta. L.R. (4th) 377, 378 A.R. 361 (Alta. Q.B.) — considered

Simpson's Island Salmon Ltd., Re (2005), 2005 CarswellNB 781, 2006 NBQB 6, 294 N.B.R. (2d) 95, 765 A.P.R. 95, 18 C.B.R. (5th) 182 (N.B. Q.B.) — considered

Stelco Inc., Re (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — considered

Ursel Investments Ltd., Re (1990), 2 C.B.R. (3d) 260, 1990 CarswellSask 34 (Sask. Q.B.) — considered

Ursel Investments Ltd., Re (1992), (sub nom. *Deloitte & Touche Inc. v. Ursel Investments Ltd. (Receiver of))* [1992] 3 W.W.R. 106, (sub nom. *Deloitte & Touche Inc. v. Ursel Investments Ltd. (Receiver of))* 89 D.L.R. (4th) 246, 10 C.B.R. (3d) 61, (sub nom. *Deloitte & Touche Inc. v. Ursel Investments Ltd. (Receiver of))* 97 Sask. R. 170, (sub nom. *Deloitte & Touche Inc. v. Ursel Investments Ltd. (Receiver of))* 12 W.A.C. 170, 1992 CarswellSask 19 (Sask. C.A.) — referred to

Statutes considered:

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

s. 4 — considered

s. 5 — considered

s. 11 — pursuant to

s. 11(6) — referred to

APPLICATION by debtor for preliminary approval of plan of arrangement and related relief and for permission to increase debtor in possession financing.

A.D. MacAdam J.:

1 By Order dated September 18, 2007, the Applicant, Federal Gypsum Company, (herein "the Company" or "the Applicant"), obtained an Order providing for a stay of proceedings pursuant to s.11 of the *Companies Creditors Arrangement Act*, R.S.C 1985, c. C-36, (the "CCAA"). BDO Dunwoody Goodman Rosen Inc. was appointed monitor, (herein "the Monitor"). On September 24, 2007 the Applicant successfully applied for approval of debtor in possession, (herein "DIP") financing, in the amount of $350,000.00. The initial Order provided for a stay of proceedings against the Applicant up to and including October 18, 2007, or such later date as the court may by further order determine, and on October 18, 2007 the stay date was extended to November 29, 2007. On November 5, 2007 the Company made a further application for additional DIP borrowing powers, with approval, from the financing, to retire the creditor holding security on the operating line. DIP financing in the amount of $1,500,000.00 was granted, subject to a restriction on the amount to be advanced. The application to pay out the operating line creditor was denied. On November 22, 2007 a further application was made to establish the Claims Bar process which, with minor changes, was approved.

2 At issue is

1. Preliminary approval of the plan of arrangement (the "Plan") prepared by Federal Gypsum Company (the "Company") for the purposes of presenting the Plan to the Company's creditors;

2. Classification of the creditors for the purpose of voting on the Plan;

3. Calling of a meeting of the Company's creditors pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA");

4. Extension of the Stay Termination Date set out in the initial order made by this Court on September 18, 2007 (the "Initial Order") pursuant to the CCAA and extended by the subsequent Order of this Court to November 29, 2007 at 4:00 p.m.; and

5. Arrangements for additional debtor in possession ("DIP") financing to the Company pursuant to the CCAA.

1. Preliminary Court Approval

3 Counsel for the Company, noting there is nothing in the CCAA requiring the approval of the court for the Company's plan, acknowledges that "...the jurisprudence establishes that such approval is generally necessary prior to calling a meeting of such creditors...". Recognizing the burden is on the Applicant, Counsel suggests the standard to be met is whether the plan is "doomed to failure" as suggested by the British Columbia Court of Appeal in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.) at p.88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.) at para 7; and *Pacific National Lease Holding Corp., Re*, [1992] B.C.J. No. 2309 (B.C. C.A. [In Chambers]) at para.25.

4 In his written submission Counsel references the decision of Austin J. in *Bargain Harold's Discount Ltd. v. Paribas Bank of Canada* (1992), 10 C.B.R. (3d) 23 (Ont. Gen. Div.). Citing Doherty J.A. in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101 (Ont. C.A.), Austin J. at paras. 37, 38 and 39 stated:

37. As to the degree of persuasion required, Doherty J.A. in Elan said at p.316 [O.R.]:

> I agree that the feasibility of the plan is a relevant and significant factor to be considered in determining whether to order a meeting of creditors: Edwards, 'Reorganizations under the Companies' 'Creditors Arrangement Act', supra, at pp. 594-595. I would not, however, impose a heavy burden on the debtor company to establish the likelihood of ultimate success from the outset. As the Act will often be the last refuge for failing companies, it is to be expected that many of the proposed plans of reorganization will involve variables and contingencies which will make the plan's ultimate acceptability to the creditors and the court very uncertain at the time the initial application is made.

38. In *Ultracare Management Inc. v. Zevenberger (Trustee of)* (1990), 3 C.B.R. (3d) 151, (sub nom. *Ultracare Management Inc. v. Gammon*) 1 O.R. (3d) 321 (Gen.Div.), Hoilett J., at p.330 f [O.R.], suggests that the test is whether the plan, or in the present case, any plan, 'has a probable chance of acceptance.'

39 These two standards are in conflict, Ultracare requiring the probability of success, and Elan requiring something less. Having regard to the nature of the legislation, I prefer the test enunciated by Doherty J.A. in Elan. In *First TreasuryFinancial Inc. v. Cango Petroleums Inc.* (1991), 3 C.B.R. (3d) 232 (Ont. Gen. Div.) at p.238, I expressed the view that the statute required 'a reasonable chance' that a plan would be accepted. [emphasis added by counsel]

5 Also referenced by counsel is *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43 (N.S. T.D.), where, at para. 80, Glube, C.J.T.D., (as she then was), observed:

> 80 I have no hesitation in accepting the line of cases which are concerned with the concept of requiring a reasonable probability of success in the meetings to be held to deal with any proposal. (See *Diemaster Tool*, supra, and *First Treasury FinancialInc. v. Cango Petroleums Inc.* (1991), 3 C.B.R. (3d) 232, 78 D.L.R. (4th) 585 (Ont. Gen. Div.)). In my opinion, it would seem to be totally impractical and extremely costly to continue to prepare a plan when there is no hope that it will be approved. [emphasis added by counsel]

6 In his submission, counsel notes the reference to an article by Stanley E. Edwards by Osborn J. in *Ursel Investments Ltd., Re* (1990), 2 C.B.R. (3d) 260 (Sask. Q.B.), at para.47, (reversed on other grounds at (1992), 10 C.B.R. (3d) 61 (Sask. C.A.)).

47 Stanley E. Edwards in his article 'Reorganizations Under the Companies' 'Creditors Arrangement Act' which appeared in (1947) 25 the Can. Bar Rev., 587 outlined the main problems which counsel and the courts will face in applying the Act. This article suggests that the Court before it orders a meeting of the creditors under ss. 4 and 5 of the Act must first be satisfied that:

(a) The companies should be kept going despite insolvency.

(b) The public has an interest in the continuation of the enterprise, particularly if the companies supply commodities or services that are necessary or desirable to large numbers of consumers, or if they employ large numbers of workers who would be thrown out of employment by its liquidation.

(c) The plan of reorganization is so framed that it is likely to accomplish its purpose.

(d) The plan should embrace all parties, if possible, but particularly secured creditors.

(e) The reorganization plan should be fair and equitable as between the parties.

7 Counsel says the Company has been in "significant discussions" with the term lenders, Cape Breton Growth Corporation, (herein "CBGC"), and Enterprise Cape Breton Corporation, (herein "ECBC"), (herein collectively referred to as the "Federal Crown Corporations"); Nova Scotia Business Inc., (herein "NSBI") and Nova Scotia — Office of Economic Development, (herein "NSOED"), (herein collectively referred to as the "Nova Scotia Crown Corporations"), each of whom hold or purport to hold, first secured charges on some of the fixed assets of the Company, as do the Federal Crown Corporations. Counsel anticipated, that in view of the plan proposing to retire the operating line provided by Royal Bank of Canada (herein "Royal Bank"), their acceptance of the plan.

8 In fact, the Royal Bank by its counsel in both written and oral submissions indicated its objection to the proposed extension of the stay termination date and the request for additional DIP financing. Counsel for the Royal Bank noted that in the affidavit of Rhyne Simpson, Jr., Director and President of the Applicant, that the Federal Crown Corporations and the Nova Scotia Crown Corporations did not appear to be on side with the proposed plan, and as the Royal Bank had repeatedly taken the position it did not support the process and would object to the plan of arrangement accordingly, "...it would seem clear that the proposed plan of compromise will not be approved." Counsel also suggests the court should consider whether, even if adopted by the creditors, the Plan has a reasonable probability of success. In this respect counsel suggests that to continue the process for another two months would involve "...significant expense and risk to the secured lenders, when it appears that the Company would not be able to successfully implement the plan even if accepted by the creditors." The Plan, in the submission of counsel, is deficient in that notwithstanding the proposal to repay the Royal Bank on the implementation date, the Company did not have the resources to do so. Counsel, referencing the report of the Monitor, and taking into account the extent of the DIP financing and the amount of the outstanding operating loan of the Royal Bank, says the Company would not have sufficient funds in place, on approval of the Plan, to retire the Royal Bank operating loan.

9 Through the course of the Application, counsel for the Federal Crown Corporations and the Nova Scotia Crown Corporations indicated they had no objection to either the extension of the stay termination date or the request for additional DIP financing. In doing so, counsel made it clear that they were not agreeing with the Plan as filed but rather were prepared to provide the Company with an opportunity to continue dialogue and discussions with the creditors concerning the nature and content of the final plan that would be submitted to a vote of the creditors.

10 In respect to the Royal Bank's concern the company would not have the necessary resources to retire its operating loan, even if the plan was approved by the creditors, counsel indicated the Company is in negotiations both with the DIP financing lender and other potential lenders to arrange financing to take effect upon approval of the plan, and presumably would, as a result, have the necessary resources to retire the Royal Bank operating loan.

11 A further concern raised by counsel for the Royal Bank related to the allocation of responsibility for administrative and operating expenses during the stay, as between the various secured creditors. In the earlier applications, it had been stipulated that the share of such expenses would be borne by the secured creditors in proportion to their respective indebtedness.

Counsel for the Royal Bank suggested the possibility that some of the other secured creditors could enter into agreements whereby only one or two would recover on their assets and therefore a limitation of responsibility to share any expenses to the amount recovered could adversely affect the share of such expenses borne by the Royal Bank. Counsel for the Monitor advised that although there were agreements between various secured lenders involving a sharing of recovery, there was no agreement suggesting that any of the secured creditors had foregone their entitlement to repayment of their share of any realization on assets on which they held security. Therefore the concern, as acknowledged by counsel for the Royal Bank, was ameliorated.

12 In view of the relatively low threshold on the Company in seeking Court approval to have a plan of arrangement submitted to the creditors for a vote, I am satisfied the plan should proceed and the creditors should determine whether they do, or do not accept the plan as finally filed.

2. Classification of Creditors

13 The proposed Classification of Creditors, as set out in s. 3.3 of the Plan, is as follows:

> (a) Operating Lender — This category will consist of Royal Bank of Canada for the amounts owing under its operating line of credit as of the Filing Date;
>
> (b) Term Lenders — This category will consist of Enterprise Cape Breton Corporation, Cape Breton Growth Fund Corporation, Her Majesty in Right of the Province of Nova Scotia (Nova Scotia Economic Development) and Nova Scotia Business Incorporated (collectively, the 'Term Lenders');
>
> (c) Lease Lenders — This category will consist of Royal Bank of Canada for its leases on rolling stock, Ford Credit Canada Limited, National Leasing Limited, First Union Rail Corporation and Nova Scotia Business Incorporated for its lease on the premises located in Port Hawkesbury, Nova Scotia in which the Business operates (collectively, the 'Lease Lenders');
>
> (d) Unsecured Creditors;
>
> (e) Shareholders of the Company — This category will consist of Federal Gypsum Inc. and Blue Thunder Construction Ltd. (collectively, the 'Shareholders')

14 Counsel for Black and MacDonald Limited, (herein "BML") who purport to hold a subordinate secured charge on assets of the Company, objected to the classification of BML as an unsecured creditor. Counsel for the Federal Crown Corporations and for the Nova Scotia Crown Corporations also indicated a potential concern with the proposed classification and, in particular, the classification of the Royal Bank as a separate secured class. Counsel were invited to submit further written submissions as to their concerns.

15 In his written submission, counsel for the Company references *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.), and the observations of Blair, J.A., at paras.23-25:

> 23 In *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), Paperny J. nonetheless extracted a number of principles to be considered by the courts in dealing with the commonality of interest test. At para. 31 she said:
>
> > In summary, the cases establish the following principles applicable to assessing commonality of interest:
> >
> > 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
> >
> > 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.

> 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.C.A., namely to facilitate reorganizations if possible.
>
> 4. In placing a broad and purposive interpretation on the C.C.C.A., the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
>
> 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
>
> 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.
>
> . . . . .
>
> 25 In the passage from his reasons cited above (paragraphs 13 and 14) the supervising judge in this case applied those principles. In our view he was correct in law in doing so.

16 In his written submission, counsel also references *NsC Diesel Power Inc., Re* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.) and the comments of Davison, J., at paras. 27-29.

> 27 In my view the court should avoid putting in the same class parties with a potential conflict of interest. I see that such a conflict could arise as between subcontractors and those with direct contracts with the owner. They have different contractual rights. A subcontractor may vote for a reduced amount of claim knowing he could still claim the deficiency from the general contractor, and this is cited as only an example of the possibility of conflict.
>
> 28 The test that was suggested by Bowen L.J. in *Sovereign Life Assur. Co. v. Dodd*, [1892] 2 Q.B. 573 (C.A.), dealing with the English legislation, is to place in one class persons 'whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.'
>
> 29 With those principles in mind, I would direct the subcontractors with liens to comprise a separate class.

17 Counsel then references from the further comments of Justice Blair in *Stelco Inc., supra*, at paras. 30 and 35-36:

> 30 We agree with the line of authorities summarized in *Canadian Airlines Corp., Re* and applied by the supervising judge in this case which stipulate that the classification of creditors is determined by their legal rights in relation to the debtor company, as opposed to their rights as creditors in relation to each other. To the extent that other authorities at the trial level in other jurisdictions may suggest to the contrary — see, for example *NsC Diesel Power Inc., Re, supra* — we prefer the Alberta [ie. *Canadian Airlines Corp., Re* (*supra*)] approach.
>
> . . . . .
>
> 35 Finally, to hold the classification and voting process hostage to the vagaries of a potentially infinite variety of disputes as between already disgruntled creditors who have been caught in the maelstrom of a CCAA restructuring, runs the risk of hobbling that process unduly. It could lead to the very type of fragmentation and multiplicity of discrete classes or sub-classes of classes that judges and legal writers have warned might well defeat the purpose of the Act: ...
>
> 36 In the end, it is important to remember that classification of creditors, like most other things pertaining to the CCAA, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny J. noted in *Canadian Airlines Corp., Re*, 'the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans.'
>
> [emphasis added by counsel]

18 Counsel for the Company suggested the concerns raised by Davison, J. in *NsC Diesel, supra*, were not present here and that the proposed classification system was based on a "commonality of interest" and was appropriate. Any minor deficiencies, counsel suggests are "...clearly outweighed by the purposive benefits of the classes as presented in the Plan", referencing the comments of Justice Blair at para. 6 in *Stelco Inc., supra.*

3. The Black and MacDonald Limited Classification

19 BML claims as secured creditor of the company, and objects to the classification placing it in the unsecured class. Counsel for BML asserts his client holds a security agreement "... charging all of the companies right, title, and interest in and to all equipment and proceeds thereof", excluding only the leased equipment. Counsel acknowledges BML executed a postponement and subordination agreement in favour of both the term lenders and the operating lender such that it holds a subordinate security on the assets charged in favour of both the term lender and the operating lender. After noting the six principles outlined by Paperny, J. in *Canadian Airlines Corp., Re* [2000 CarswellAlta 623 (Alta. Q.B.)], *supra*, counsel references para 22:

> ... the commonality test cannot be considered without also considering the underlying purpose of the C.C.A.A. which is to facilitate reorganizations of insolvent companies. To that end, the court should not approve a classification scheme which would make a reorganization difficult, if not impossible, to achieve. At the same time, while the C.C.A.A. grants the court the authority to alter the legal rights of parties other than the debtor company without their consent, the court will not permit a confiscation of rights or an injustice to occur. (emphasis added)

20 Paul G. Goodman, President of the Monitor, in an Affidavit filed in this application, deposes:

> ... it is the Monitor's opinion that, subject to the currently intervening charge of the DIP lender and the Administrative Charge, as at the date of the Initial Order and as at December 7:
>
> (a) the assets on which RBC holds security are sufficient to provide for a 100% payout of its Operating Loan;
>
> (b) the assets on which NSBI, OED, CBGF & ECBC hold security, if realized on, would leave each of these creditors with a significant deficiency;
>
> (c) as B & M's security interest is subordinated to those of RBC, NSBI, OED, CBGF & ECBC there would be no assets remaining to be realized on by B & M under its security and in the result its security has no value.

21 The flexibility afforded the Court, in respect to CCAA applications, is to ensure that Plans of Arrangement and Compromise are fair and reasonable as well as designed to faciliate debtor reorganization. Justice Romaine, in *Ontario v. Canadian Airlines Corp.*, 2001 ABQB 983 (Alta. Q.B.), at paras. 36-38 stated:

> [36] The aim of minimizing prejudice to creditors embodied in the CCAA is a reflection of the cardinal principle of insolvency law: that relative entitlements created before insolvency are preserved: *R. v. Goode, Principles of Corporate Insolvency Law*, 2nd ed. (London: Sweet & Maxwell, 1997) at 54. While the CCAA may qualify this principle, it does so only when it is consistent with the purpose of facilitating debtor reorganization and ongoing survival, and in the spirit of what is fair and reasonable.
>
> [37] Paperny J. (as she then was) also discussed the purpose of the CCAA in *Re Canadian Airlines Corp.* (2000), 265 A.R. 201 (Q.B.), aff'd [2000] A. J. No. 1028 (C.A.), online: QL (AJ) (C.A.), leave refused [2001] S.C.C.A. No. 60. At para. 95, she stated that the purpose of the CCAA is to facilitate the reorganization of debtor companies for the benefit of a broad range of constituents.
>
> [38] Paperny J. also noted in para. 95 that, in dealing with applications under the CCAA, the court has a wide discretion to ensure the objectives of the CCAA are met. At para. 94, she identified guidance for the exercise of the discretion in *Olympia &York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen.Div.) at p. 9 as follows:

> Fairness' and 'reasonableness' are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise in equity — and 'reasonableness' is what lends objectivity to the process.

22 Counsel for BML suggests the Court should give weight to its status as a secured creditor. In fact, however, on the evidence presented to date, it would appear that BML's claim has no value, other than as an unsecured claim against the Company. In the opinion of the Monitor, there would be no assets available to BML, in the event of a liquidation of the Company's assets and therefore its security has "no value". I am satisfied that in classifying BML as an unsecured creditor, there is no "confiscation of rights or ... injustice". This security, having no apparent value, they are therefore unsecured and their classification as an unsecured creditor is both fair and reasonable in the circumstances.

4. The Royal Bank Classification

23 The term lenders, being the Nova Scotia Crown Corporations and the Federal Crown Corporations, object to the classification of the operating lender, being the Royal Bank, in a separate class. Counsel for the Federal Crown Corporations references *Stelco Inc., Re, supra*, and the observations of Blair, J. A., at paras 21-22:

> 21 Everyone agrees that the classification of creditors for CCAA voting purposes is to be determined generally on the basis of a 'commonality of interest' (or a 'common interest') between creditors of the same class. Most analyses of this approach start with a reference to *Sovereign Life Assurance Co. v. Dodd* (1892), [1891-94] All E.R. Rep. 246 (Eng. C.A.), which dealt with the classification of creditors for voting purposes in a winding-up proceeding. Two passages from the judgments in that decision are frequently cited:
>
> At pp. 249-350 Lord Esher said:
>
> > The Act provides that the persons to be summoned to the meeting, all of whom, is to be observed, are creditors, are persons who can be divided into different classes, classes which the Act [FN3] recognizes, though it does not define. The creditors, therefore, must be divided into different classes. What is the reason for prescribing such a course? It is because the creditors composing the different classes have different interests, and, therefore, it a different state of facts exists with respect to different creditors, which may affect their minds and judgments differently, they must be separated into different classes.
>
> At. p. 251, Bowen L.J. stated:
>
> > The word 'class' used in the statute is vague, and to find out what it means we must look at the general scope of the section, which enables the court to order a meeting of a class of creditors to be summoned. It seems to me that we must give such a meeting to the term 'class' as will prevent the section being so worked as to produce confiscation and injustice, and that we must confine its meaning to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.
>
> 22 These views have been applied in the CCAA context. But what comprises those 'not so dissimilar' rights and what are the components of that 'common interest' have been the subject of debate and evolution over time. It is clear that classification is a fact-driven exercise, dependent upon the circumstances of each particular case. Moreover, given the nature of the CCAA process and the underlying flexibility of that process — a flexibility which is its genius — there can be no fixed rules that must apply in all cases.

24 Counsel for the Federal Crown Corporations, as well as for the Nova Scotia Crown Corporations, suggest that carving out a separate class for Royal Bank, from the remaining secured creditors, runs contrary to the principles outlined by Justice

Paperny in *Canadian Airlines Corp., Re, supra.* Although not disputing the appropriateness of the creation of a class of creditors of "lease lenders", "unsecured creditors", and "shareholders", Counsel suggest the classification of two classes of secured creditors would create fragmentation that is unnecessary and contrary to the "commonality of interest" principle. Secured creditors are, in the submission of counsel, secured creditors and there is no reasonable, logical, rational and practical reason not to have all the secured debt within the same class.

25 Counsel for the Federal Crown Corporations refers to *Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.), and the decision of Justice Freeman, where at paras. 21-22, he notes an article by Ronald N. Robertson, Q.C., in a publication entitled "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association — Ontario Continuing Legal Education, April 5, 1983. The author comments to the effect that the CCAA authorizes the Court to alter the legal rights of parties, other than the debtor company, without their consent, and secondly that the purpose of the Act is to facilitate reorganizations and this is a factor to be considered at every stage of the process, including in the classification of creditors. As such, to accept "identity of interest" in classification of creditors would result in a "multiplicity of discreet classes" making reorganizations difficult, if not impossible.

26 Counsel's submission also refers to *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 71, 1991 CarswellNS 36 (N.S. T.D.), where Glube, C.J.T.D., (as she then was), at paras. 32-33, commented as follows:

> I have no difficulty in rationalizing the decisions in *Norcen* and *Elan*. In my opinion, whether the security is on 'quick' assets or 'fixed' assets, the companies listed under Fairview secured creditors and Shelburne secured creditors, except for Central Capital, all have a first charge. There does not have to be a commonality of interest of the debts involved, provided the legal interests are the same. In addition, it does not automatically follow that those who have different commercial interests, that is, those who hold security on 'quick' assets, are necessarily in conflict with those who hold security on hard or fixed assets. Just saying there is a conflict is insufficient to warrant putting them into separate classes.
>
> In the present case, all the secured creditors of Fairview and all the secured creditors of Shelburne, except Central Capital, have a first charge of some sort, even though the security of each differs. They have a common legal interest, excluding Central Capital. I find that there is a commonality or community of interest of the secured creditors of Fairview and the secured creditors of Shelburne. Based on this position, I find that the Fairview secured creditors shall continue as one group.

27 The submission by counsel for the Federal Crown Corporations continues:

> Like the situation in Fairview, both RBC and the Term Lenders each have a first charge of some sort, even though the type of asset differs. There is clearly a common legal interest in the debtor Company amongst each of the secured creditors. The distinction between security on 'quick' assets such as accounts receivable and inventory as opposed to security on hard or fixed assets as has been put forward by RBC (herein referred to as Royal), throughout is clearly not determinative.

28 Counsel also references the additional comments of Chief Justice Glube, at para. 19:

> I suggest that all counsel are reading too much into the two decisions *Norcen Energy Resources Ltd. V. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20, 64 AltaL.R. (2d) 139,[1989] 2 W.W.R. 566 (Q.B.) and *Nova Metal Products Inc. v.Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey*) 41 O.A.C. 282, 1 O.R. (3d) 289 [hereinafter *Elan*]. In my opinion the two cases do not set up two 'lines' of cases reaching different conclusions. I suggest that each was decided on their particular facts. The court should be wary about setting up rigid guidelines which 'must' be followed. The *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the 'C.C.A.A.') is intended to be a fairly summary procedure and should not be stretched out over months and years with protracted litigation. Quite definitely, each case must be decided on its own unique set of circumstances.

29 One of the circumstances considered in the Company's proposal to separately classify the term lenders and the

operating lender is the opinion of the Monitor that upon liquidation the operating lender would recover the full amount of its operating loan, while there would be a substantial shortfall in respect to the term lenders. This opinion reflects the reported levels of receivables and inventory outlined in the various Monitor's reports, as compared with the indebtedness to the operating lender, and suggests that on a liquidation the operating lender would be successful in retiring its outstanding indebtedness. Also, the appraisal of the fixed assets, on the basis of an orderly liquidation, would appear to suggest a substantial shortfall in realization by the term lenders. Clearly, in respect to the relationship to the Company by the operating lender and the term lenders, the prospects for recovery on an orderly liquidation, being considerably different, would not be consistent with the "commonality" principle, at least, as it may relate to the prospects for recovery. There is also a very real difference in the nature of the assets on which they are secured, in that in the one instance the security is on fixed real assets and in the other on receivable and inventory. The latter are subject to ongoing fluctuations as the Company continues in operation.

5. Conclusion on Classification

30 There is nothing in the submission of Counsel, nor in the circumstances to warrant altering the classification proposed by the Company. BML's security has, apparently, little or no value. Each of the Federal Crown Corporations and the Nova Scotia Crown Corporations appear to have sufficient votes to derail the proposed Plan. There is no reason to deny the Royal Bank, who would then not have such a veto over the Plan, inclusion in the fixed asset lenders security classification. The Company has not suggested they be in the same class, and no reason has been advanced to warrant departing from the Company's proposed classification.

3. The Creditors' Meeting

31 Sections 4 and 5 of the CCAA provide:

> 4. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.
>
> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

32 Counsel for the Company references the observation of Paperny J. in *Fracmaster Ltd., Re* (1999), 11 C.B.R. (4th) 204 (Alta. Q.B.), at para.24:

> 24 I also note the principle that even where a plan is proposed, the court need not order a meeting of the creditors or class of creditors. That is because ss.4 and 5 of the CCAA, which provide for such meetings, are permissive, not mandatory. As Houlden and Morawetz state at 10A-11: 'If the court believes that the proposed plan or arrangement is not in the best interests of creditors, it may refuse to make the order...[I]f the plan lacks economic reality, the court will also refuse to make the order.'

33 In the circumstances and having regard to my earlier comments, I am satisfied there should be a meeting of creditors to consider and vote on the Plan.

4. Extension of Stay of Proceedings

34 In view of the preliminary approval of the Plan and the calling of a meeting of creditors to consider and vote on the Plan, it necessarily follows that there should be an extension of the stay to enable the Company to present the Plan to the

creditors, to conduct the claims process as previously ordered and to determine whether the creditors have voted in favour or against the Plan. In *Cansugar Inc., Re*, 2004 NBQB 7 (N.B. Q.B.), Justice Glennie, in referencing s.11(6) of the CCAA, noted:

> In my opinion, the requirements of section 11(6) of the C.C.A.A. have been satisfied in this case. The continuation of the stay is supported by the overriding purpose of the C.C.A.A., which is to allow an insolvent company a reasonable period of time to reorganize and propose a plan of arrangement to its creditors and the Court, and to prevent maneuvers for positioning among creditors in the interim. [emphasis added by counsel]

35 To similar effect, Topolniski J. in *San Francisco Gifts Ltd., Re*, 2005 ABQB 91 (Alta. Q.B.), at para. 28 observed:

> The court's role during the stay period has been described as a supervisory one, meant to: '...preserve the status quo and to move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure.' That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling of creditors' meetings and the like. On the contrary, this role requires attention to changing circumstances and vigilance in ensuring that a delicate balance of interests is maintained. [emphasis added by counsel]

36 Notwithstanding the objection by the Royal Bank, including the potential prejudice as outlined by counsel in the event there is a deterioration in the value of the assets securing its operating loan, continuation of the stay is to be supported in view of the overriding purpose of the CCAA "...to allow an insolvent company a reasonable period of time to reorganize and propose a plan of arrangement to its creditors and the court...".

5. Additional DIP Financing

37 According to counsel, providing the court approves presentation of the Plan to the creditors and the extension is granted, the Company will require additional DIP financing. In referencing the cash flow projections and the anticipated need for additional financing, counsel notes that the proposed increase is somewhat smaller than the earlier cash flow projections had anticipated. The reason, counsel suggests, is "...due in part to a slower than anticipated growth in sales which has reduced the Company's cash requirements." Counsel continues:

> It is clear from the cash flow reports prepared by the Company, however, that there is indeed a growth in sales which will require additional financing.

38 Although approval has already been made for initial DIP financing, with its "super-priority" security in favour of the DIP lender and later for additional DIP financing, each application must be considered on its own merits and in the circumstances then existing. In respect to this Application, counsel again references the observations of C. Campbell J. In *Manderley Corp., Re* (2005), 10 C.B.R. (5th) 48 (Ont. S.C.J.), at para.18:

> 18 The operative legal principles are set out in the following quotations from Houlden and Morawetz' Bankruptcy & Insolvency Analysis (Carswell, 2004), section N16 — Stay of Proceedings — CCAA — at page 18:
>
> > Although the C.C.A.A. makes no provision for DIP financing, it seems to be well established that, under its inherent powers, the court may give a priority for such financing and for professional fees incurred in connection with the working out of a C.C.A.A. plan.

Also referenced is *Hunters Trailer & Marine Ltd., Re* (2001), 295 A.R. 113 (Alta. Q.B.), and the comment by Wachowich J., at para. 32:

> 32 Having reviewed the jurisprudence on this issue, I am satisfied that the Court has the inherent or equitable jurisdiction to grant a super-priority for DIP financing and administrative charges, including the fees and disbursements of the professional advisors who guide a debtor company through the CCAA process.

Counsel notes the three issues outlined by Glennie J. in *Simpson's Island Salmon Ltd., Re* [2005 CarswellNB 781 (N.B. Q.B.)], *supra*, at paras.16-17 and 19:

> 16 In order for DIP financing with super-priority status to be authorized pursuant to the CCAA, there must be cogent evidence that the benefit of such financing clearly outweighs the potential prejudice to secured creditors whose security is being eroded. See *United Used Auto & Truck Parts Ltd., Re*, [1999] B.C.J. No. 2754 (B.C.S.C. [In Chambers]), affirmed [2000] B.C.J. No. 409 (B.C.C.A.)
>
> 17 DIP financing ought to be restricted to what is reasonably necessary to meet the debtor's urgent needs while a plan of arrangement or compromises is being developed.
>
> 19 A Court should not authorize DIP financing pursuant to the CCAA unless there is a reasonable prospect that the debtor will be able to make an arrangement with its creditors and rehabilitate itself.

39 Counsel recognizes the court is engaged in a "balancing act that is the hallmark of DIP financing" as declared by C. Campbell J. in *Manderley*, *supra*, at para.27. At para.18, in *Simpson's Island Salmon Ltd.*, *supra*, Justice Glennie observed:

> Failure to grant an increase in the Administrative Charge would result in the Applicants no longer being able to continue their attempts at restructuring.

40 Counsel suggests a similar result would occur if the proposed additional DIP was not approved and that so long as a reasonable chance of rehabilitation remains,

> ...a company under CCAA protection should be afforded what measures are available to aid that rehabilitation, despite the concomitant prejudice to its creditors. A successful restructuring continues to be in the best interest of both the Company and its creditors.

In counsel's submission, the "small additional prejudice to creditors" in allowing the additional DIP financing is "far outweighed by the potential benefits to all of the Company's stakeholders of allowing the Company the opportunity to present the Plan." Counsel's written submission concludes by referencing *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]) and the comment by Farley, J., to the effect that "...the mere fact that a significant secured creditor objects to such financing in no way precludes the Court's ability to allow DIP financing." The submission continues by noting the observation of Wachowich J. in *Hunters*, *supra*, at para. 32:

> ...If super-priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively would be denied a debtor company in many cases.

41 In his objection, counsel for the Royal Bank reiterates the bank's concern that DIP financing will erode its security. Counsel speculates that the increase in DIP financing means the margin of its debt to the current assets secured by its security would be reduced and indeed, applying a 50 per cent margin rate, would be eliminated. In his written submission, counsel observed:

> Although there is no evidence before the Court as to the estimated diminution in value of current assets in the event of liquidation, there is such evidence regarding the fixed assets. The appraisal provided by Universal Worldwide LLC estimates the value of the fixed assets on 'orderly liquidation' at $2,850,000US but only $950,000 on 'quick/forced sale', a drop of 2/3 in the later case. A drop in value of 50% in the case of the current assets would see the Bank get nothing in the event that the additional DIP financing sought were granted and that a liquidation ensued. This is without consideration of any impact from the Administration Charge.

42 It is clear the value of the security held by the Royal Bank is at risk by the continuation of the stay and the granting of additional DIP financing to enable the Company to present its Plan to its creditors for their consideration. However, the latest report of the Monitor does not reflect a substantial erosion in the value of the assets secured by the Royal Bank. Exhibit 3 to the Monitor's Report of November 26, 2007 shows accounts receivable of $778,383.00, while on November 23 the amount

was $958,232.00. With respect to inventory, the raw materials at September 21 are reported at $944,393.00 and finished goods at $561,220.00, for a total of $1,505,613.00. The totals for November 23 were raw materials at $723,465.00 and finished goods at $438,165.00, for a total of $1,161,630.00. Although there has been a decline, it would not appear to be substantial and no evidence was submitted to suggest any greater concern about a potential deterioration during the period encompassed by the request to extend the stay. Although the additional DIP, together with the additional administrative charges, will impact on any recovery on realization of assets in general, there is, notwithstanding the speculation of counsel for the Royal Bank, no evidence the bank's security will be rendered valueless in the event of an eventual liquidation, particularly in view of the allocation of approximately 95 per cent of the burden of the DIP and administrative charges to the assets secured to the Federal Crown Corporations and the Nova Scotia Crown Corporations. In the initial report by the Monitor, the preliminary calculation of secured creditor percentages was 5.53 per cent for the Royal Bank, (taking into account both its operating loan and lease loan), with the remainder to the other secured creditors, including creditors holding leases. Although counsel for the Nova Scotia Crown Corporations suggested he would be submitting a revised figure for their loans, he further indicated it would not materially affect the percentages as outlined in the Monitor's Report. As such, the responsibility of the Royal Bank for the expenses of the restructuring are slightly over five per cent, and absent evidence of a material deterioration in the value of the assets secured under its security, as well as the value of the assets held by the other secured creditors, and in view of the need for the additional DIP financing to permit the Company to meet with and present to its creditors the Plan, I am satisfied to approve the additional financing and to grant the necessary priority contemplated by it.

Application granted.

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