Court File No. CV-19-615862-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF JTI-MACDONALD CORP.

Applicant

FACTUM OF THE RECEIVER OF JTI-MACDONALD TM CORP. (Comeback Hearing)

Date: April 2, 2019

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in its capacity as receiver of
JTI-Macdonald TM Corp.

PART I - OVERVIEW

1. This Factum is filed by the Receiver[1] in connection with JTI-Macdonald Corp.'s ("**JTI-M**") Comeback Hearing in its proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("**CCAA**"). In particular, this Factum is filed in response to the position taken by certain parties that: (i) royalty payments on account of JTI-M's post-filing use of trademarks owned by JTI-Macdonald TM Corp. ("**TM**") and other post-filing payments required to be made to TM and/or other companies within the JTI group of companies on account of the supply of post-filing goods and services; and (ii) interest payments on secured indebtedness owed by JTI-M to TM, should be suspended. It is the Receiver's position that these payments should continue.

2. The suspension of these payments would be an extraordinary thing for this Court to order. It would prejudice TM by contravening the CCAA and governing case law that is binding on this court and essentially re-ordering well established CCAA priorities. The CCAA specifically provides for the payment of post-filing obligations by a debtor company. There is no free ride. The interest payments owed to TM are in respect of valid and long-standing secured indebtedness. Unlike interest on unsecured indebtedness, interest continues to accrue on secured indebtedness in CCAA proceedings, just as it does in bankruptcy proceedings. Other creditors of JTI-M will not be prejudiced by these payments continuing because of the repayment arrangements that have been put in-place with JT International Holding B.V.

3. Certain parties have also argued that these payments should be suspended in these CCAA proceedings because they were suspended in JTI-M's 2004 CCAA proceedings. This Court is not bound by the 2004 CCAA proceedings, but is instead bound by the CCAA and the governing case law, all of which support the Receiver's position.

PART II - THE FACTS

4. The Affidavit of Robert McMaster sworn April 1, 2019, sets forth a detailed description of the facts relevant to this Factum, which facts are relied upon by the Receiver herein.

[1] The Receiver is PricewaterhouseCoopers Inc., in its capacity as receiver of JTI-Macdonald TM Corp.

PART III - THE ISSUES

5. The issues before this Court, and addressed below, are:

(a) Should this Court suspend the royalty payments and other post-filing payments?

(b) Should this Court suspend the interest payments?

PART IV - LAW AND ARGUMENT

The CCAA requires that royalty payments and other post-filing payments continue

6. Section 11.01 of the CCAA requires that post-filing obligations are required to be paid as they are incurred:

> **Rights of Suppliers**
>
> **11.01** No order made under section 11 or 11.02[2] has the effect of:
>
> (a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or
>
> (b) requiring the further advance of money or credit.
>
> CCAA, s. 11.01, Schedule "B" [emphasis added]

7. In *Sproule v. Nortel Networks Corporation*, the Court of Appeal for Ontario held that "while the [debtor] company is given the opportunity and privilege to carry on during the CCAA restructuring process without paying its existing creditors, it is on a pay-as-you-go basis only." Pre-filing and post-filing obligations are distinguishable: the payment of post-filing obligations the latter being a requirement of carrying on business during CCAA proceedings.

> *Sproule v. Nortel Networks Corporation*, 2009 ONCA 833, at para. 34, Brief of Authorities of the Receiver, Tab 1.

8. The trademarks under which JTI-M sells tobacco products is licensed property that is owned by TM. TM, while it continues to license these trademarks to JTI-M, is entitled to be paid

[2] Section 11 sets out the general power of courts under the CCAA. Section 11.02 provides for the general stay of proceeding under the CCAA.

by JTI-M, notwithstanding the CCAA proceedings. The CCAA also requires that the post-filing payments required to be made to TM and/or other companies within the JTI group of companies on account of the supply of post-filing goods and services also continue so long as JTI-M requires such goods and services during the CCAA proceedings. Certain parties have criticized that these payments are being made to related parties. But JTI-M does not have the option of turning to third parties for the supply of post-filing goods and services that are currently supplied by the JTI group of companies, especially with respect to intellectual property like trademarks.

9. The Quebec Class Action Plaintiffs assert that this Court has the authority to refuse payment to related parties; it does not. The CCAA requires payment for all use of licensed property, like trademarks; there is no exception for payment to related parties. The authority relied on by the Quebec Class Action Plaintiffs expressly found that section 11.01 was inapplicable because there was no supply of goods, services or licensed property. In contrast, in this case the trademarks are clearly licensed property covered by section 11.01. The plain language of the CCAA, and the decision of the Court of Appeal binding on this Court, require payment of these license fees.

> *Re Essar Steel Algoma Inc*, 2016 ONSC 6459, paras. 11, 12, 18, Book of Authority of Quebec Class Action Plaintiffs Tab 20.

<u>Interest on secured indebtedness accrues under the CCAA and should be paid</u>

10. The interest payments in question are accruing and due and owing in respect of valid and long-standing secured indebtedness.

The secured indebtedness has not been invalidated

11. In the approximately twenty-years since the secured indebtedness has been in place, it has not been challenged by any party. There have been no judicial determinations setting it aside or ruling it invalid. Despite the comments made by Justice Riordan about the secured indebtedness—made in a proceeding in which TM was not a party—he acknowledged that "no one has attacked the validity or the legality of the tax planning behind the Interco Contracts, or the transactions themselves." Without any judicial proceeding or determination on the validity of the secured indebtedness, it must be treated as valid.

> *Letourneau c. JTI-MacDonald Corp*, 2015 QCCS 2382, at para. 1099.

12. Justice Mongeon, in his reasons on the Safeguard Motion in the Blais and Letorneau class actions, recognized that without a judicial determination on the secured indebtedness the indebtedness and it secured nature must be taken as valid:

> Whatever the intent or effect of the integrated series of transactions set up to acquire the tobacco operations of the [RJR Group] by [Japan Tobacco] may have been, these integrated transactions are to be considered valid and opposable … unless attacked as being invalid and/or inopposable.
>
> *Conseil Quebecois sur le tabac et la sante c. JTI-Macdonald Corp*, 2013 QCCS 6085, at para. 97, Brief of Authorities of the Receiver, Tab 2.

13. Justice Mongeon also went as far as to say that

> the financial consequences of certain transactions may have the effect of draining the resources of a corporate entity. However, to effectively stop this alleged drainage of resources, the transactions in question must be judicially set aside.
>
> *Conseil Quebecois sur le tabac et la sante c. JTI-Macdonald Corp*, 2013 QCCS 6085, at para. 29, Brief of Authorities of the Receiver, Tab 2.

14. The parties who seek to suspend the payment of interest on the secured indebtedness have had twenty years to seek to set aside the secured indebtedness. They have chosen not to do so. This Comeback Hearing is not the appropriate time to consider the validity of the secured indebtedness.

***Interest is payable on secured debt under the* CCAA**

15. So long as the security and secured indebtedness are valid, interest on that indebtedness should continue to accrue and be paid, as any interest stops rule that applies to unsecured creditors does not apply to secured creditors.

16. In *Nortel Networks Corp., Re*, the Court of Appeal for Ontario found that there is an interest stops rule that applies to unsecured indebtedness in the context of the CCAA. That court did not find that an interest stops rule also applies to secured indebtedness and was careful to refer only to unsecured indebtedness and the impact of the interest stops rule on unsecured creditors in its decision.

> *Nortel Networks Corp., Re,* 2015 ONCA 681, at para. 98, Brief of Authorities of the Receiver, Tab 3.

17. This determination was made on the basis of the *pari passu* principle (i.e., that unsecured creditors should be treated equally and share rateably) and in order to ensure that there is consistent treatment of creditors under the CCAA and the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3, as amended (the "**BIA**").

18. While the *pari passu* principle operates to ensure equal treatment of similarly situated creditors, it does not operate to defeat priorities in insolvency. It would be unfair to diminish the rights of secured creditors by treating them in the same fashion as unsecured creditors, and this would be contrary to the absolute priority rule in insolvencies, whereby creditors (first secured, then unsecured) are entitled to be paid before equity takes.

19. Importantly, interest on unsecured indebtedness stops accruing upon a bankruptcy filing, but interest on secured indebtedness continues to accrue notwithstanding a bankruptcy filing. This is settled law. In *Nortel Networks Corp., Re*, the Court of Appeal sought to avoid the creation of different entitlements for unsecured creditors under the CCAA and the BIA.

> *Nortel Networks Corp., Re,* 2015 ONCA 681, at para. 36, Brief of Authorities of the Receiver, Tab 3.

20. This is consistent with the Supreme Court of Canada's decision in *Century Services Inc. v. Canada (Attorney General)*. The Supreme Court held that

> [w]ith parallel CCAA and BIA restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation.
>
> *Century Services Inc. v. Canada (Attorney General),* 2010 SCC 60, at para. 24, Brief of Authorities of the Receiver, Tab 4.

21. In that same case, the Supreme Court also held that

> [i]f creditors' claims were better protected by liquidation under the BIA , creditors' incentives would lie overwhelmingly with avoiding proceedings under the CCAA and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the CCAA can

only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

> *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, at para. 47, Brief of Authorities of the Receiver, Tab 4.

22. Under the BIA, the claims of secured creditors continue to accrue interest after the date of bankruptcy and a secured creditor is entitled to recover post-bankruptcy interest.

> BIA, ss. 70(1) and 136(1), Schedule "B".
>
> Houlden, Lloyd W. et al, The 2018-2019 Annotated Bankruptcy and Insolvency Act (Toronto: Carswell, 2018), G96(1), Brief of Authorities of the Receiver, Tab 5.

23. At law there is not an interest stops rule for secured debt in CCAA proceedings. It would be a perverse result to stop the payment of interest to secured creditors in the CCAA and thereby create an incentive for those creditors to seek recourse only to the BIA where their entitlements are superior. This would thwart the purposes highlighted by the Supreme Court by undermining reorganizations under the CCAA.

24. The Initial Order and the repayment arrangements that were put in-place with JT International Holding B.V. were carefully calibrated to address any prejudice to JTI-M's creditors that could result from the continued accrual and payment of interest to TM, while at the same time preventing undue prejudice to TM. The order sought by the Québec Class Action Plaintiffs seeks to upset this balance and create a new interest stops rule.

PART V - ORDER REQUESTED

25. For the reasons set forth herein, the Receiver respectfully requests that: (i) royalty payments on account of JTI-M's post-filing use of trademarks owned by TM and other post-filing payments required to be made to TM and/or other companies within the JTI group of companies on account of the supply of post-filing goods and services; and (ii) interest payments on secured indebtedness owed by JTI-M to TM, should be continued.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 2nd day of April, 2019.

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in its capacity as receiver of
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SCHEDULE "A"
LIST OF AUTHORITIES

1. *Sproule v. Nortel Networks Corporation*, 2009 ONCA 833
2. *Re Essar Steel Algoma Inc*, 2016 ONSC 6459
3. *Letourneau c. JTI-MacDonald Corp*, 2015 QCCS 2382
4. *Conseil Quebecois sur le tabac et la sante c. JTI-Macdonald Corp*, 2013 QCCS 6085
5. *Nortel Networks Corp., Re*, 2015 ONCA 681
6. *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60

SCHEDULE "B"
RELEVANT STATUTES

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

Section 11.01

Rights of suppliers

11.01 No order made under section 11 or 11.02 has the effect of

(a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or

(b) requiring the further advance of money or credit.

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

Section 70(1)

Precedence of bankruptcy orders and assignments

70 (1) Every bankruptcy order and every assignment made under this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, legal hypothecs of judgment creditors, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or the creditor's representative, and except the rights of a secured creditor.

Section 136(1)

Priority of Claims

136 (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:

(a) in the case of a deceased bankrupt, the reasonable funeral and testamentary expenses incurred by the legal representative or, in the Province of Quebec, the successors or heirs of the deceased bankrupt;

(b) the costs of administration, in the following order,

(i) the expenses and fees of any person acting under a direction made under paragraph 14.03(1)(a),

(ii) the expenses and fees of the trustee, and

(iii) legal costs;

(c) the levy payable under section 147;

(d) the amount of any wages, salaries, commissions, compensation or disbursements referred to in sections 81.3 and 81.4 that was not paid;

(d.01) the amount equal to the difference a secured creditor would have received but for the operation of sections 81.3 and 81.4 and the amount actually received by the secured creditor;

(d.02) the amount equal to the difference a secured creditor would have received but for the operation of sections 81.5 and 81.6 and the amount actually received by the secured creditor;

(d.1) claims in respect of debts or liabilities referred to in paragraph 178(1)(b) or (c), if provable by virtue of subsection 121(4), for periodic amounts accrued in the year before the date of the bankruptcy that are payable, plus any lump sum amount that is payable;

(e) municipal taxes assessed or levied against the bankrupt, within the two years immediately preceding the bankruptcy, that do not constitute a secured claim against the real property or immovables of the bankrupt, but not exceeding the value of the interest or, in the Province of Quebec, the value of the right of the bankrupt in the property in respect of which the taxes were imposed as declared by the trustee;

(f) the lessor for arrears of rent for a period of three months immediately preceding the bankruptcy and accelerated rent for a period not exceeding three months following the bankruptcy if entitled to accelerated rent under the lease, but the total amount so payable shall not exceed the realization from the property on the premises under lease, and any payment made on account of accelerated rent shall be credited against the amount payable by the trustee for occupation rent;

(g) the fees and costs referred to in subsection 70(2) but only to the extent of the realization from the property exigible thereunder;

(h) in the case of a bankrupt who became bankrupt before the prescribed date, all indebtedness of the bankrupt under any Act respecting workers' compensation, under any Act respecting unemployment insurance or under any provision of the *Income Tax Act* creating an obligation to pay to Her Majesty amounts that have been deducted or withheld, rateably;

(i) claims resulting from injuries to employees of the bankrupt in respect of which the provisions of any Act respecting workers' compensation do not apply, but only to the

extent of moneys received from persons guaranteeing the bankrupt against damages resulting from those injuries; and

(j) in the case of a bankrupt who became bankrupt before the prescribed date, claims of the Crown not mentioned in paragraphs (a) to (i), in right of Canada or any province, rateably notwithstanding any statutory preference to the contrary.

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Proceedings commenced in Toronto

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