Court File No. CV-13-10362-00CL

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 SILVER STREAMS HOMES INC.; SILVER STREAMS HOMES (PUCCINI) INC., 2148993 ONTARIO INC., 2148990 ONTARIO INC., 2147681 ONTARIO INC. AND 2147650 ONTARIO INC.

BRIEF OF AUTHORITIES OF TARION WARRANTY CORPORATION

(Motion to Approve Settlement Agreement)
(Returnable June 25, 2015)

Date: June 16, 2015

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1991 CarswellOnt 770
Ontario Court of Appeal

Ontario New Home Warranty Program v. Lukenda

1991 CarswellOnt 770, [1991] O.J. No. 320, 25 A.C.W.S. (3d) 978, 2 O.R. (3d) 675, 47 O.A.C. 388

ONTARIO NEW HOME WARRANTY PROGRAM v. LUKENDA

McKinlay, Catzman and Labrosse JJ.A.

Heard: February 18, 1991
Judgment: March 5, 1991
Docket: Doc. CA 171/89

Counsel: *Brian M. Campbell* and *Tanus Rutherford*, for plaintiff.
Joseph A. Bisceglia, for defendant.

Subject: Contracts

Table of Authorities

Statutes considered:

Corporations Act, R.S.O. 1970, c. 89.

Corporations Act, R.S.O. 1980, c. 95 —

s. 4

s. 274

Ontario New Home Warranties Plan Act, R.S.O. 1980, c. 350 —

s. 7(2)

Regulations considered:

Ontario New Home Warranties Plan Act, R.S.O. 1980, c. 350mdash;

O. Reg. 677/84,

"Administration of the Plan,"

s. 1

APPEAL from a decision of Fitzgerald J., reported at (1989), 33 C.L.R. 62, 3 R.P.R. (2d) 238 (Ont. H.C.), dismissing appellant's action to recover pursuant to respondent's guarantee for loss.

***Per curiam*:**

1 The only issue properly before us is whether the appellant, the Ontario New Home Warranty Program (the "Corporation") has the corporate power to require of an applicant, when it applies for registration under the program, that it provide from a third party a guarantee of liabilities to which the ap plicant may become subject pursuant to the provisions of the *Ontario New Home Warranties Plan Act*, R.S.O. 1980, c. 350 (the "Plan Act").

2 The respondent argues that the Corporation has no general corporate power to require third party guarantees as a condition of registration, but can acquire such power only by virtue of a specific or necessarily implied power given by the Plan Act or regulations thereunder. We do not agree.

3 The HUDAC New Home Warranty Program was incorporated by letters patent under the *Corporations Act*, R.S.O. 1970, c. 89. The Corporation's name was changed by supplementary letters patent dated August 3, 1984, to "Ontario New Home Warranty Program". By Ont. Reg. 677/84, s. 1, the Lieutenant Governor in Council designated the Ontario New Home Warranty Program to be the "Corporation" for the purposes of the *Ontario New Home Warranties Plan Act*.

4 Section 4 of the *Corporations Act*, R.S.O. 1980, c. 95, provides that:

> The Lieutenant Governor may in his discretion, by letters patent, issue a charter to any number of persons, not fewer than three, of eighteen or more years of age, who apply therefor, constituting them and any others who become shareholders or members of the corporation thereby created a corporation for any of the objects to which authority of the Legislature extends.

5 Section 274 states:

> A corporation, unless otherwise expressly provided in the Act or instrument creating it, has and shall be deemed to have had from its creation the capacity of a natural person.

6 Such capacity, of course, includes the capacity to require the providing of a guarantee as a term of any contract between the Corporation and any other party. Only if powers within the capacity of a natural person were specifically withdrawn from the Corporation would it be precluded from exercising such powers.

7 The major purpose of the Plan Act is to protect purchasers of new homes by requiring that vendors and builders be screened for financial responsibility, integrity and technical competence. To assure public protection, it provides for warranties, a guarantee bond and compensation in the event of loss by a purchaser resulting from dealings with a registrant. In order to effect the purposes of the Plan Act, a broad and liberal interpretation of its provisions is appropriate.

8 The respondent, Louis B. Lukenda, was president and major shareholder of Harbour View (Sault Ste. Marie) Ltd., at the time it applied for registration under the Plan Act. Harbour View covenanted by a vendor/builder agreement with the Corporation as follows:

> The vendor covenants with the Corporation as follows: The vendor at his own expense shall supply to the Corporation upon request, whether for the purpose of initial registration or renewal, documentation in the form of guarantees, surety bonds, statements of personal net worth, bank statements and other such documentation and records as the Corporation may reasonably require.

9 Such an agreement, in our view, constitutes consent by the applicant, Harbour View, within the terms of s. 7(2) of the Plan Act, which reads:

> A registration is subject to such terms and conditions to give effect to the purposes of this Act *as are consented to by the* applicant or imposed by the Tribunal or prescribed by the regulations.

[Emphasis added.] The Corporation, through its Registrar, required the guarantee, which Harbour View agreed to supply.

10 In summary, the Corporation had the corporate power to require, and did require, that Harbour View provide a third party guarantee, and Harbour View consented to, and did in fact, provide the guarantee.

11 Interlocutory matters raised by the appellant are not properly before this Court.

12 The appeal is allowed. The order of Judge Fitzgerald dated February 7, 1989, dismissing the plaintiff's action [reported at (1989), 33 C.L.R. 62, 3 R.P.R. (2d) 238 (Ont. H.C.)], is set aside with costs here and below.

Appeal allowed.

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TAB 2

HMANALY N§2
Houlden & Morawetz Analysis N§2

Houlden and Morawetz Bankruptcy and Insolvency Analysis

Companies Creditors Arrangement Act
Section 1

L.W. Houlden and Geoffrey B. Morawetz

N§2 — Purpose of the CCAA

N§2 — Purpose of the CCAA

See s. 1

While the *CCAA* does not have an express objective clause, its long title, *An Act to facilitate compromises and arrangements between companies and their creditors* indicates that its objective is to assist insolvent companies in developing and seeking approval of compromises and arrangements with their creditors. The *CCAA* has a broad remedial purpose, giving a debtor company an opportunity to find a way out of financial difficulties short of bankruptcy, foreclosure or the seizure of assets through receivership proceedings. It allows the debtor to devise a plan that will enable it to meet the demands of its creditors through refinancing with new lending, equity financing or the sale of the business as a going concern. This alternative may give the creditors of all classes a larger return and protect the jobs of the company's employees: *Diemaster Tool Inc. v. Skvortsoff (Trustee of)* (1991), 3 C.B.R. (3d) 133, 1991 CarswellOnt 168 (Ont. Gen. Div.). However, the *CCAA* should not be the last gasp of a dying company; if it is to be implemented, it should be implemented at a stage prior to the death throes: *Re Inducon Development Corp.* (1991), 8 C.B.R. (3d) 306, 1991 CarswellOnt 219 (Ont. Gen. Div.).

The decided cases have identified the following purposes of the legislation:

- to permit an insolvent company to avoid or be discharged from bankruptcy by making a composition or arrangement with its creditors: *Browne v. Southern Canada Power Co.* (1941), 23 C.B.R. 131, 71 Que. K.B. 136 (Que. C.A.); *Multidev Immobilia Inc. v. S.A. Just Invest.* (1988), 1988 CarswellQue 38, 70 C.B.R. (N.S.) 91, [1988] R.J.Q. 1928 (Que. S.C.);

- to preserve the insolvent company as a viable operation and to reorganize its affairs to the benefit not only of the debtor but of the creditors: *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 80 C.B.R. (N.S.) 98, 1990 CarswellBC 425 (B.C. S.C.); *Milner Greenhouses, supra*; *Re D.W. McIntosh Ltd.* (1939), 1939 CarswellOnt 87, 21 C.B.R. 206 (Ont. S.C.); *Re Avery Construction Co.* (1942), 1942 CarswellOnt 86, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont. S.C.); *Re Arthur Flint Co.* (1944), 1944 CarswellOnt 59, 25 C.B.R. 156, [1944] O.W.N. 325, [1944] 3 D.L.R. 13 (Ont. S.C.); *Citibank Canada v. Chase Manhattan Bank of Canada* (1991), 5 C.B.R. (3d) 165, 1991 CarswellOnt 182, 2 P.P.S.A.C. (2d) 21 (Ont. Gen. Div.);

- to maintain the *status quo* for a period to provide a structured environment in which an insolvent company can continue to carry on business and retain control over its assets while the company attempts to gain the approval of its creditors for a proposed arrangement that will enable the company to remain in operation for the future benefit of the company and its creditors: *Meridian Dev. Inc. v. Toronto Dominion Bank, supra*; *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 80 C.B.R. (N.S.) 98, 1990 CarswellBC 425 (B.C. S.C.); *Re Canadian Airlines Corp.* (2000), 19 C.B.R. (4th) 1, 2000 CarswellAlta 622 (Alta. Q.B.); *Milner Greenhouses Ltd. v. Saskatchewan* (2004), 2004 CarswellSask 280, [2004] 9 W.W.R. 310, 50 C.B.R. (4th) 214, 2004 SKQB 160 (Sask. Q.B.); *Re Blue Range Resource Corp.* (2000), 192 D.L.R. (4th) 281, 2000 ABCA 239, 20 C.B.R. (4th) 187, 2000 CarswellAlta 1004 (Alta. C.A.).

• to protect the interests of creditors and to permit an orderly administration of the debtor company's affairs: *Meridian Development Inc. v. Toronto Dominion Bank* (1984), 1984 CarswellAlta 259, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, [1984] 5 W.W.R. 215, 53 A.R. 39 (Q.B.);

• to protect an insolvent company from proceedings by creditors that would prevent it from carrying out the terms of a compromise or arrangement: *Feifer v. Frame Manufacturing. Corp.* (1947), 1947 CarswellQue 15, 28 C.B.R. 124, [1947] Que. K.B. 348 (Que. C.A.);

• to permit equal treatment of creditors of the same class: *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 1990 CarswellNS 33, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.);

• to permit a broad balancing of stakeholder interests in the insolvent corporation: *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101, 41 O.A.C. 282, 1990 CarswellOnt 139, 1 O.R. (3d) 289 (Ont. C.A.); *Re Air Canada [Greater Toronto Airport Authority re gates at new terminal (Toronto)]* (2004), 47 C.B.R. (4th) 189, 2004 CarswellOnt 870 (Ont. S.C.J. [Commercial List]).

• in appropriate circumstances to effect a sale, winding-up or liquidation of a debtor company and its assets: *Re Anvil Range Mining Corp.* (2002), 34 C.B.R. (4th) 157, 2002 CarswellOnt 2254 (Ont. C.A.).

The Supreme Court of Canada has held that the *CCAA* offers more flexibility and greater judicial discretion than the rules-based mechanism under the *BIA*, making the former more responsive to complex reorganizations. The exercise of judicial discretion has allowed the *CCAA* to adapt and evolve to meet contemporary business and social needs. As reorganizations become increasingly complex, *CCAA* courts have been called on to innovate. In determining their jurisdiction to sanction measures in a *CCAA* proceeding, courts should first interpret the provisions of the *CCAA* before turning to their inherent or equitable jurisdiction. Noteworthy in this regard is the expansive interpretation the language of the *CCAA* is capable of supporting. The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. The requirements of appropriateness, good faith and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. The question is whether the order will usefully further efforts to avoid the social and economic losses resulting from liquidation of an insolvent company, which extends to both the purpose of the order and the means it employs. The Supreme Court of Canada held that Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected, notably creditors and employees; and that a workout that allowed the company to survive was optimal. It held that courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed. The Supreme Court of Canada has held that reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs: *Re Ted Leroy Trucking Ltd.*, 2010 CarswellBC 3419, 2010 CarswellBC 3420, [2010] 3 S.C.R. 379, 72 C.B.R. (5th) 170, 2010 SCC 60 (S.C.C.). For a full discussion of this case, see N§101 "Claims under the *Excise Tax Act*".

The Alberta Court of Queen's Bench dismissed the *CCAA* application of the debtor. Justice Romaine found that the debtor met the technical requirements for protection under the *CCAA*; however, it was also clear that if the application for an initial order under the *CCAA* did not succeed, a receivership would follow. In considering an initial order, Justice Romaine held that there should be a germ of a reasonable and realistic plan, particularly if there is opposition from the major stakeholders most at risk in the proposed restructuring. Justice Romaine acknowledged that the fundamental purpose of the *CCAA* is to permit a company to carry on business and where possible avoid the social and economic costs of liquidating its assets. Here, the debtor was a company with very few employees; relatively minor unsecured debt; it did not carry on a business that had broader community; and there were no social implications that could require greater flexibility from creditors. The major stakeholders in this case were the secured creditors who opposed the application and the equity holders. Justice Romaine concluded that the restructuring options proposed by the debtor were not realistic or commercially reasonable. This case was not one where the secured creditors had acted precipitously, or where the debtor had not had a more than adequate opportunity to canvass the market for refinancing and restructuring options. The debtor was most likely a liquidating *CCAA*, and given the lack of confidence and the adversarial relationship between the debtor and the secured creditors at risk, a *CCAA* order was not appropriate in the circumstances: *Alberta Treasury Branches v. Tallgrass Energy Corp.*, 2013 CarswellAlta 1496, 2013 ABQB 432 (Alta. Q.B.).

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TAB 3

1990 CarswellOnt 139
Ontario Court of Appeal

Nova Metal Products Inc. v. Comiskey (Trustee of)

1990 CarswellOnt 139, 1 C.B.R. (3d) 101, 1 O.R. (3d) 289, 23 A.C.W.S. (3d) 1192, 41 O.A.C. 282

ELAN CORPORATION et al. v. COMISKEY (TRUSTEE OF) et al.

Finlayson, Krever and Doherty JJ.A.

Heard: October 30 and 31, 1990
Judgment: November 2, 1990
Docket: Doc. Nos. CA 684/90 and CA 685/90

Counsel: *F.J.C. Newbould*, Q.C., and *G.B. Morawetz*, for appellant The Bank of Nova Scotia.
John Little, for respondents Elan Corporation and Nova Metal Products Inc.
Michael B. Rotsztain, for RoyNat Inc.
Kim Twohig and *Mel Olanow*, for Ontario Development Corp.
K.P. McElcheran, for monitor Ernst & Young.

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered:

Per Finlayson J.A. (Krever J.A. concurring)

Alberta Treasury Branches v. Hat Development Ltd. (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd (1989), 65 Alta. L.R. (2d) 374 (C.A.) — *applied*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 166, 31 B.C.L.R. (2d) 35 (S.C.), aff'd (16 September 1988), Doc. No. Vancouver CA009772, Taggart, Lambert and Locke JJ.A. (B.C. C.A.) — *considered*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (S.C.), aff'd 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.) — *referred to*

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

Sovereign Life Assurance Co. v. Dodd, [1892] 2 Q.B. 573, [1891-4] All E.R. 246 (C.A.) — *applied*

Wellington Building Corp., Re, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626, [1934] O.W.N. 562 (S.C.) — *applied*

Per Doherty J.A. (dissenting in part)

Alberta Treasury Branches v. Hat Development Ltd. (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd (1989), 65 Alta. L.R. (2d) 374 (C.A.) — *considered*

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

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

Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce (1989), 102 A.R. 161 (Q.B.) — *referred to*

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

Metals & Alloys Co., Re (16 February 1990), Houlden J.A. (Ont. C.A.) [unreported] — *considered*

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) — *referred to*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (S.C.), aff'd 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.) — *referred to*

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 47 B.C.L.R. (2d) 193 (S.C.) — *referred to*

Reference re Residential Tenancies Act (Ontario), [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 158 — *referred to*

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

United Maritime Fishermen Co-op., Re (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.), varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.), rev'd (1988), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, 88 N.B.R. (2d) 253, 224 A.P.R. 253 (C.A.) — *considered*

Statutes considered:

Bank Act, R.S.C. 1985, c. B-1 —

s. 178, as am. R.S.C. 1985 (3d Supp.), c. 25, s. 26

Companies' Creditors Arrangement Act, S.C. 1932-33, c. 36 —

s. 3, en. as s. 2A, S.C. 1952-53, c. 3, s. 2

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

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Courts of Justice Act, 1984, S.O. 1984, c. 11 —

s. 144(1)

Interpretation Act, R.S.C. 1985, c. I-21 —

s. 12

Municipal Act, R.S.O. 1980, c. 302 —

s. 369

APPEAL from order of Hoolihan J. dated September 11, 1990, allowing application under *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

FINLAYSON J.A. (KREVER J.A. **concurring) (orally):**

1 This is an appeal by the Bank of Nova Scotia (the "bank") from orders made by Mr. Justice Hoolihan [(11 September 1990), Doc. Nos. Toronto RE 1993/90 and RE 1994/90 (Ont. Gen. Div.)] as hereinafter described. The Bank of Nova Scotia was the lender to two related companies, namely, Elan Corporation ("Elan") and Nova Metal Products Inc. ("Nova"), which commenced proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), for the purposes of having a plan of arrangement put to a meeting of secured creditors of those companies.

2 The orders appealed from are:

(i) An order of September 11, 1990, which directed a meeting of the secured creditors of Elan and Nova to consider the plan of arrangement filed, or other suitable plan. The order further provided that for 3 days until September 14, 1990, the bank be prevented from acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova, and that Elan and Nova could spend the accounts receivable assigned to the bank that would be received.

(ii) An order dated September 14, 1990, extending the terms of the order of September 11, 1990, to remain in effect until the plan of arrangement was presented to the Court no later than October 24, 1990. This order continued the stay against the bank and the power of Elan and Nova to spend the accounts receivable assigned to the bank. Further orders dated September 27, 1990, and October 18, 1990, have extended the stay, and the power of Elan and Nova to spend the accounts receivable that have been assigned to the bank. The date of the meetings of creditors has been extended to November 9, 1990. The application to sanction the plan of arrangement must be heard by November 14, 1990.

(iii) An order dated October 18, 1990, directing that there be two classes of secured creditors for the purposes of voting at the meeting of secured creditors. The first class is to be comprised of the bank, RoyNat Inc. ("RoyNat"), the Ontario Development Corporation ("O.D.C."), the city of Chatham and the village of Glencoe. The second class is to be comprised of persons related to Elan and Nova that acquired debentures to enable the companies to apply under the CCAA.

3 There is very little dispute about the facts in this matter, but the chronology of events is important and I am setting it out in some detail.

4 The bank has been the banker to Elan and Nova. At the time of the application in August 1990, it was owed approximately $1,900,000. With interest and costs, including receivers' fees, it is now owed in excess of $2,300,000. It has a first registered charge on the accounts receivable and inventory of Elan and Nova, and a second registered charge on the land, buildings and equipment. It also has security under s. 178 of the *Bank Act*, R.S.C. 1985, c. B-1, as am. R.S.C. 1985 (3rd Supp.), c. 25, s.

26. The terms of credit between the bank and Elan as set out in a commitment agreement provide that Elan and Nova may not encumber their assets without the consent of the bank.

5 RoyNat is also a secured creditor of Elan and Nova, and it is owed approximately $12 million. It holds a second registered charge on the accounts receivable and inventory of Elan and Nova, and a first registered charge on the land, buildings and equipment. The bank and RoyNat entered into a priority agreement to define with certainty the priority which each holds over the assets of Elan and Nova.

6 The O.D.C. guaranteed payment of $500,000 to RoyNat for that amount lent by RoyNat to Elan. The O.D.C. holds debenture security from Elan and secure the guarantee which it gave to RoyNat. That security ranks third to the bank and RoyNat. The O.D.C. has not been called upon by RoyNat to pay under its guarantee. O.D.C. has not lent any money directly to Elan or Nova.

7 Elan owes approximately $77,000 to the City of Chatham for unpaid municipal taxes. Nova owes approximately $18,000 to the Village of Glencoe for unpaid municipal taxes. Both municipalities have a lien on the real property of the respective companies in priority to every claim except the Crown under s. 369 of the *Municipal Act*, R.S.O. 1980, c. 302.

8 On May 8, 1990, the bank demanded payment of all outstanding loans owing by Elan and Nova to be made by June 1, 1990. Extensions of time were granted and negotiations directed to the settlement of the debt took place thereafter. On August 27, 1990, the bank appointed Coopers & Lybrand Limited as receiver and manager of the assets of Elan and Nova, and as agent under the bank's security to realize upon the security. Elan and Nova refused to allow the receiver and manager to have access to their premises, on the basis that insufficient notice had been provided by the bank before demanding payment.

9 Later on August 27, 1990, the bank brought a motion in an action against Elan and Nova (Court File No. 54033/90) for an order granting possession of the premises of Elan and Nova to Coopers & Lybrand. On the evening of August 27, 1990, at approximately 9 p.m., Mr. Justice Saunders made an order adjourning the motion on certain conditions. The order authorized Coopers & Lybrand access to the premises to monitor Elan's business, and permitted Elan to remain in possession and carry on its business in the ordinary course. The bank was restrained in the order, until the motion could be heard, from selling inventory, land, equipment or buildings or from notifying account debtors to collect receivables, but was not restrained from applying accounts receivable that were collected against outstanding bank loans.

10 On Wednesday, August 29, 1990, Elan and Nova each issued a debenture for $10,000 to a friend of the principals of the companies, Joseph Comiskey, through his brother Michael Comiskey as trustee, pursuant to a trust deed executed the same day. The terms were not commercial and it does not appear that repayment was expected. It is conceded by counsel for Elan that the sole purpose of issuing the debentures was to qualify as a "debtor company" within the meaning of s. 3 of the CCAA. Section 3 reads as follows:

> 3. This Act does not apply in respect of a debtor company unless
>
> (a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and
>
> (b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

11 The debentures conveyed the personal property of Elan and Nova as security to Michael Comiskey as trustee. No consent was obtained from the bank as required by the loan agreements, nor was any consent obtained from the receiver. Cheques for $10,000 each, representing the loans secured in the debentures, were given to Elan and Nova on Wednesday, August 29, 1990, but not deposited until 6 days later on September 4, 1990, after an interim order had been made by Mr. Justice Farley in favour of Elan and Nova staying the bank from taking proceedings.

12 On August 30, 1990 Elan and Nova applied under s. 5 of the CCAA for an order directing a meeting of secured creditors to vote on a plan of arrangement. Section 5 provides:

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.

13 The application was heard by Farley J. on Friday, August 31, 1990, at 8 a.m. Farley J. dismissed the application on the grounds that the CCAA required that there be more than one debenture issued by each company. Later on the same say, August 31, 1990, Elan and Nova each issued two debentures for $500 to the wife of the principal of Elan through her sister as trustee. The debentures provided for payment of interest to commence on August 31, 1992. Cheques for $500 were delivered that day to the companies but not deposited in the bank account until September 4, 1990. These debentures conveyed the personal property in the assets of Elan and Nova to the trustee as security. Once again it is conceded that the debentures were issued for the sole purpose of meeting the requirements of s. 3 of the CCAA. No consent was obtained from the bank as required by the loan terms, nor was any consent obtained from the receiver.

14 On August 31, 1990, following the creation of the trust deeds and the issuance of the debentures, Elan and Nova commenced new applications under the CCAA which were heard late in the day by Farley J. He adjourned the applications to September 10, 1990, on certain terms, including a stay preventing the bank from acting on its security and allowing Elan to spend up to $321,000 from accounts receivable collected by it.

15 The plan of arrangement filed with the application provided that Elan and Nova would carry on business for 3 months, that secured creditors would not be paid and could take no action on their security for 3 months, and that the accounts receivable of Elan and Nova assigned to the bank could be utilized by Elan and Nova for purposes of its day-to-day operations. No compromise of any sort was proposed.

16 On September 11, 1990, Hoolihan J. ordered that a meeting of the secured creditors of Elan and Nova be held no later than October 22, 1990, to consider the plan of arrangement that had been filed, or other suitable plan. He ordered that the plan of arrangement be presented to the secured creditors no later than September 27, 1990. He made further orders effective for 3 days until September 14, 1990, including orders:

(i) that the companies could spend the accounts receivable assigned to the bank that would be collected in accordance with a cash flow forecast filed with the Court providing for $1,387,000 to be spent by September 30, 1990; and

(ii) a stay of proceedings against the bank acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova.

17 On September 14, 1990, Hoolihan J. extended the terms of his order of September 11, 1990, to remain in effect until the plan of arrangement was presented to the Court no later than October 24, 1990 for final approval. This order continued the power of Elan and Nova to spend up to $1,387,000 of the accounts receivable assigned to the bank in accordance with the projected cash flow to September 30, 1990, and to spend a further amount to October 24, 1990, in accordance with a cash flow to be approved by Hoolihan J. prior to October 1, 1990. Further orders dated September 27 and October 18 have extended the power to spend the accounts receivable to November 14, 1990.

18 On September 14, 1990, the bank requested Hoolihan J. to restrict his order so that Elan and Nova could use the accounts receivable assigned to the bank only so long as they continued to operate within the borrowing guidelines contained in the terms of the loan agreements with the bank. These guidelines require a certain ratio to exist between bank loans and the book value of the accounts receivable and inventory assigned to the bank, and are designed in normal circumstances to ensure that there is sufficient value in the security assigned to the bank. Hoolihan J. refused to make the order.

19 On October 18, 1990, Hoolihan J. ordered that the composition of the classes of secured creditors for the purposes of voting at the meeting of secured creditors shall be as follows:

(a) The bank, RoyNat, O.D.C., the City of Chatham and the Village of Glencoe shall comprise one class.

(b) The parties related to the principal of Elan that acquired their debentures to enable the companies to apply under the CCAA shall comprise a second class.

20 On October 18, 1990, at the request of counsel for Elan and Nova, Hoolihan J. further ordered that the date for the meeting of creditors of Elan and Nova be extended to November 9, 1990, in order to allow a new plan of arrangement to be sent to all creditors, including unsecured creditors of those companies. Elan and Nova now plan to offer a plan of compromise or arrangement to the unsecured creditors of Elan and Nova as well as to the secured creditors.

21 There are five issues in this appeal.

(1) Are the debentures issued by Elan and Nova for the purpose of permitting the companies to qualify as applicants under the CCAA debentures within the meaning of s. 3 of the CCAA?

(2) Did the issue of the debentures contravene the provisions of the loan agreements between Elan and Nova and the bank? If so, what are the consequences for CCAA purposes?

(3) Did Elan and Nova have the power to issue the debentures and make application under the CCAA after the bank had appointed a receiver and after the order of Saunders J.?

(4) Did Hoolihan J. have the power under s. 11 of the CCAA to make the interim orders that he made with respect to the accounts receivable?

(5) Was Hoolihan J. correct in ordering that the bank vote on the proposed plan of arrangement in a class with RoyNat and the other secured creditors?

22 It is well established that the CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies, Elan and Nova, are entitled to a broad and liberal interpretation of the jurisdiction of the Court under the CCAA. Having said that, it does not follow that in exercising its discretion to order a meeting of creditors under s. 5 of the CCAA that the Court should not consider the equities in this case as they relate to these companies and to one of its principal secured creditors, the bank.

23 The issues before Hoolihan J. and this Court were argued on a technical basis. Hoolihan J. did not give effect to the argument that the debentures described above were a "sham" and could not be used for the purposes of asserting jurisdiction. Unfortunately, he did not address any of the other arguments presented to him on the threshold issue of the availability of the CCAA. He appears to have acted on the premise that if the CCAA can be made available, it should be utilized.

24 If Hoolihan J. did exercise any discretion overall, it is not reflected in his reasons. I believe, therefore, that we are in a position to look at the uncontested chronology of these proceedings and exercise our own discretion. To me, the significant date is August 27, 1990 when the bank appointed Coopers & Lybrand Limited as receiver and manager of the undertaking, property and assets mortgaged and charged under the demand debenture and of the collateral under the general security agreement, both dated June 20, 1979. On the same date, it appointed the same company as receiver and manager for Nova under a general security agreement dated December 5, 1988. The effect of this appointment is to divest the companies and their boards of directors of their power to deal with the property comprised in the appointment: Raymond Walton, *Kerr on the Law and Practice as to Receivers*, 16th ed. (London: Sweet & Maxwell, 1983), p. 292. Neither Elan nor Nova had the power to create further indebtedness, and thus to interfere with the ability of the receiver to manage the two companies: *Alberta Treasury Branches v. Hat Development Ltd.* (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd (1989), 65 Alta. L.R. (2d) 374 (C.A.).

25 Counsel for the debtor companies submitted that the management powers of the receiver were stripped from the receiver by Saunders J. in his interim order, when he allowed the receiver access to the companies' properties but would not permit it

to realize on the security of the bank until further order. He pointed out that the order also provided that the companies were entitled to remain in possession and "to carry on business in the ordinary course" until further order.

26 I do not agree with counsel's submission covering the effect of the order. It certainly restricted what the receiver could do on an interim basis, but it imposed restrictions on the companies as well. The issue of these disputed debentures in support of an application for relief as insolvent companies under the CCAA does not comply with the order of Saunders J. This is not carrying on business in the ordinary course. The residual power to take all of these initiatives for relief under the CCAA remained with the receiver, and if trust deeds were to be issued, an order of the Court in Action 54033/90 was required permitting their issuance and registration.

27 There is another feature which, in my opinion, affects the exercise of discretion, and that is the probability of the meeting achieving some measure of success. Hoolihan J. considered the calling of the meeting at one hearing, as he was asked to do, and determined the respective classes of creditors at another. This latter classification is necessary because of the provisions of s. 6(a) of the CCAA, which reads as follows:

> 6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company.

28 If both matters had been considered at the same time, as in my view they should have been, and if what I regard as a proper classification of the creditors had taken place, I think it is obvious that the meeting would not be a productive one. It was improper, in my opinion, to create one class of creditors made up of all the secured creditors save the so-called "sham" creditors. There is no true community of interest among them, and the motivation of Elan and Nova in striving to create a single class is clearly designed to avoid the classification of the bank as a separate class.

29 It is apparent that the only secured creditors with a significant interest in the proceeding under the CCAA are the bank and RoyNat. The two municipalities have total claims for arrears of taxes of less than $100,000. They have first priority in the lands of the companies. They are in no jeopardy whatsoever. The O.D.C. has a potential liability in that it can be called upon by RoyNat under its guarantee to a maximum of $500,000, and this will trigger default under its debentures with the companies, but its interests lie with RoyNat.

30 As to RoyNat, it is the largest creditor with a debt of some $12 million. It will dominate any class it is in because, under s. 6 of the CCAA, the majority in a class must represent three-quarters in value of that class. It will always have a veto by reason of the size of its claim, but requires at least one creditor to vote for it to give it a majority in number (I am ignoring the municipalities). It needs the O.D.C.

31 I do not base my opinion solely on commercial self-interest, but also on the differences in legal interest. The bank has first priority on the receivables referred to as the "quick assets", and RoyNat ranks second in priority. RoyNat has first priority on the buildings and realty, the "fixed assets", and the bank has second priority.

32 It is in the commercial interests of the bank, with its smaller claim and more readily realizable assets, to collect and retain the accounts receivable. It is in the commercial interests of RoyNat to preserve the cash flow of the business and sell the enterprise as a going concern. It can only do that by overriding the prior claim of the bank to these receivables. If it can vote with the O.D.C. in the same class as the bank, it can achieve that goal and extinguish the prior claim of the bank to realize on the receivables. This it can do, despite having acknowledged its legal relationship to the bank in the priority agreement signed by the two. I can think of no reason why the legal interest of the bank as the holder of the first security on the receivables should be overridden by RoyNat as holder of the second security.

33 The classic statement on classes of creditors is that of Lord Esher M.R. in *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573, [1891-4] All E.R. 246 (C.A.), at pp. 579-580 [Q.B.]:

> The Act [*Joint Stock Companies Arrangement Act, 1870*] says that the persons to be summoned to the meeting (all of whom, be it said in passing, are creditors) are persons who can be divided into different classes — classes which the Act of Parliament recognises, though it does not define them. This, therefore, must be done: they must be divided into different classes. What is the reason for such a course? It is because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.

34 The *Sovereign Life* case was quoted with approval by Kingstone J. in *Re Wellington Building Corp.*, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626, [1934] O.W.N. 562 (S.C.), at p. 659 [O.R.]. He also quoted another English authority at p. 658:

> In *In re Alabama, New Orleans, Texas and Pacific Junction Ry. Co.*, [1891] 1 Ch. 213, a scheme and arrangement under the Joint Stock Companies Arrangement Act (1870), was submitted to the Court for approval. Lord Justice Bowen, at p. 243, says:
>
>> Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation ... Its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.

35 Kingstone J. set aside a meeting where three classes of creditors were permitted to vote together. He said at p. 660:

> It is clear that Parliament intended to give the three-fourths majority of any class power to bind that class, but I do not think the Statute should be construed so as to permit holders of subsequent mortgages power to vote and thereby destroy the priority rights and security of a first mortgagee.

36 We have been referred to more modern cases, including two decisions of Trainor J. of the British Columbia Supreme Court, both entitled *Re Northland Properties Ltd.* One case is reported in (1988), 73 C.B.R. (N.S.) 166, 31 B.C.L.R. (2d) 35, and the other in the same volume at p. 175 [C.B.R.]. Trainor J. was upheld on appeal on both judgments. The first judgment of the British Columbia Court of Appeal is unreported (16 September, 1988) [Doc. No. Vancouver CA009772, Taggart, Lambert and Locke JJ.A.]. The judgment in the second appeal is reported at 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122.

37 In the first *Northland* case, Trainor J. held that the difference in the terms of parties to and priority of different bonds meant that they should be placed in separate classes. He relied upon *Re Wellington Building Corp.*, supra. In the second *Northland* case, he dealt with 15 mortgagees who were equal in priority but held different parcels of land as security. Trainor J. held that their relative security positions were the same, notwithstanding that the mortgages were for the most part secured by charges against separate properties. The nature of the debt was the same, the nature of the security was the same, the remedies for default were the same, and in all cases they were corporate loans by sophisticated lenders. In specifically accepting the reasoning of Trainor J., the Court of Appeal held that the concern of the various mortgagees as to the quality of their individual securities was "a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both" (p. 203).

38 In *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.), the Court stressed that a class should be made up of persons "'whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest'" (p. 8 [of C.B.R.]).

39 My assessment of these secured creditors is that the bank should be in its own class. This being so, it is obvious that no plan of arrangement can succeed without its approval. There is no useful purpose to be served in putting a plan of arrangement

to a meeting of creditors if it is known in advance that it cannot succeed. This is another cogent reason for the Court declining to exercise its discretion in favour of the debtor companies.

40 For all the reasons given above, the application under the CCAA should have been dismissed. I do not think that I have to give definitive answers to the individual issues numbered (1) and (2). They can be addressed in a later case, where the answers could be dispositive of an application under the CCAA. The answer to (3) is that the combined effect of the receivership and the order of Saunders J. disentitled the companies to issue the debentures and bring the application under the CCAA. It is not necessary to answer issue (4), and the answer to (5) is no.

41 Accordingly, I would allow the appeal, set aside the three orders of Hoolihan J., and, in their place, issue an order dismissing the application under the CCAA. The bank should receive its costs of this appeal, the applications for leave to appeal, and the proceedings before Farley and Hoolihan JJ., to be paid by Elan, Nova and RoyNat.

42 Ernst & Young were appointed monitor in the order of Hoolihan J. dated September 14, 1990, to monitor the operations of Elan and Nova and give effect to and supervise the terms and conditions of the stay of proceedings in accordance with Appendix "C" appended to the order. The monitor should be entitled to be paid for all services performed to date, including whatever is necessary to complete its reports for past work, as called for in Appendix "C".

DOHERTY J.A. **(dissenting in part):**

I Background

43 On November 2, 1990, this Court allowed the appeal brought by the Bank of Nova Scotia (the "bank") and vacated several orders made by Hoolihan J. Finlayson J.A. delivered oral reasons on behalf of the majority. At the same time, I delivered brief oral reasons dissenting in part from the conclusion reached by the majority and undertook to provide further written reasons. These are those reasons.

44 The events relevant to the disposition of this appeal are set out in some detail in the oral reasons of Finlayson J.A. I will not repeat that chronology, but will refer to certain additional background facts before turning to the legal issues.

45 Elan Corporation ("Elan") owns the shares of Nova Metal Products Inc. ("Nova Inc."). Both companies have been actively involved in the manufacture of automobile parts for a number of years. As of March 1990, the companies had total annual sales of about $30 million, and employed some 220 people in plants located in Chatham and Glencoe, Ontario. The operation of these companies no doubt plays a significant role in the economy of these two small communities.

46 In the 4 years prior to 1989, the companies had operated at a profit ranging from $287,000 (1987) to $1,500,000 (1986). In 1989, several factors, including large capital expenditures and a downturn in the market, combined to produce an operational loss of about $1,333,000. It is anticipated that the loss for the year ending June 30, 1990, will be about $2.3 million. As of August 1, 1990, the companies continued in full operation, and those in control anticipated that the financial picture would improve significantly later in 1990, when the companies would be busy filling several contracts which had been obtained earlier in 1990.

47 The bank has provided credit to the companies for several years. In January 1989, the bank extended an operating line of credit to the companies. The line of credit was by way of a demand loan that was secured in the manner described by Finlayson J.A. Beginning in May 1989, and from time to time after that, the companies were in default under the terms of the loan advanced by the bank. On each occasion, the bank and the companies managed to work out some agreement so that the bank continued as lender and the companies continued to operate their plants.

48 Late in 1989, the companies arranged for a $500,000 operating loan from RoyNat Inc. It was hoped that this loan, combined with the operating line of $2.5 million from the bank, would permit the company to weather its fiscal storm. In March 1990, the bank took the position that the companies were in breach of certain requirements under their loan agreements, and warned that if the difficulties were not rectified the bank would not continue as the company's lender. Mr. Patrick Johnson, the president of both companies, attempted to respond to these concerns in a detailed letter to the bank dated March 15, 1990.

The response did not placate the bank. In May 1990, the bank called its loan and made a demand for immediate payment. Mr. Spencer, for the bank, wrote: "We consider your financial condition continues to be critical and we are not prepared to delay further making formal demand." He went on to indicate that, subject to further deterioration in the companies' fiscal position, the bank was prepared to delay acting on its security until June 1, 1990.

49 As of May 1990, Mr. Johnson, to the bank's knowledge, was actively seeking alternative funding to replace the bank. At the same time, he was trying to convince the union which represented the workers employed at both plants to assist in a co-operative effort to keep the plants operational during the hard times. The union had agreed to discuss amendment of the collective bargaining agreement to facilitate the continued operation of the companies.

50 The June 1, 1990 deadline set by the bank passed without incident. Mr. Johnson continued to search for new financing. A potential lender was introduced to Mr. Spencer of the bank on August 13, 1990, and it appeared that the bank, through Mr. Spencer, was favourably impressed with this potential lender. However, on August 27, 1990, the bank decided to take action to protect its position. Coopers & Lybrand was appointed by the bank as receiver-manager under the terms of the security agreements with the companies. The companies denied the receiver access to their plants. The bank then moved before the Honourable Mr. Justice E. Saunders for an order giving the receiver possession of the premises occupied by the companies. On August 27, 1990, after hearing argument from counsel for the bank and the companies, Mr. Justice Saunders refused to install the receivers and made the following interim order:

1. THIS COURT ORDERS that the receiver be allowed access to the property to monitor the operations of the defendants but shall not take steps to realize on the security of The Bank of Nova Scotia until further Order of the Court.

2. THIS COURT ORDERS that the defendants shall be entitled to remain in possession and to carry on business in the ordinary course until further Order of this Court.

3. THIS COURT ORDERS that until further order the Bank of Nova Scotia shall not take steps to notify account debtors of the defendants for the purpose of collecting outstanding accounts receivable. This Order does not restrict The Bank of Nova Scotia from dealing with accounts receivable of the defendants received by it.

4. THIS COURT ORDERS that the motion is otherwise adjourned to a date to be fixed.

51 The notice of motion placed before Saunders J. by the bank referred to "an intended action" by the bank. It does not appear that the bank took any further steps in connection with this "intended action."

52 Having resisted the bank's efforts to assume control of the affairs of the companies on August 27, 1990, and realizing that their operations could cease within a matter of days, the companies turned to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "Act"), in an effort to hold the bank at bay while attempting to reorganize their finances. Finlayson J.A. has described the companies' efforts to qualify under that Act, the two appearances before the Honourable Mr. Justice Farley on August 31, 1990, and the appearances before the Honourable Mr. Justice Hoolihan in September and October 1990, which resulted in the orders challenged on this appeal.

II The Issues

53 The dispute between the bank and the companies when this application came before Hoolihan J. was a straightforward one. The bank had determined that its best interests would be served by the immediate execution of the rights it had under its various agreements with the companies. The bank's best interest was not met by the continued operation of the companies as going concerns. The companies and their other two substantial secured creditors considered that their interests required that the companies continue to operate, at least for a period which would enable the companies to place a plan of reorganization before its creditors.

54 All parties were pursuing what they perceived to be their commercial interests. To the bank, these interests entailed the "death" of the companies as operating entities. To the companies, these interests required "life support" for the companies through the provisions of the Act to permit a "last ditch" effort to save the companies and keep them in operation.

55 The issues raised on this appeal can be summarized as follows:

(i) Did Hoolihan J. err in holding that the companies were entitled to invoke the Act?

(ii) Did Hoolihan J. err in exercising his discretion in directing that a meeting of creditors should be held under the Act?

(iii) Did Hoolihan J. err in directing that the bank and RoyNat Inc. should be placed in the same class of creditors for the purposes of the Act?

(iv) Did Hoolihan J. err in the terms of the interim orders he made pending the meeting of creditors and the submission to the court of a plan of reorganization?

III The Purpose and Scheme of the Act

56 Before turning to these issues, it is necessary to understand the purpose of the Act, and the scheme established by the Act for achieving that purpose. The Act first appeared in the midst of the Great Depression (S.C. 1932-33, c. 36). The Act was intended to provide a means whereby insolvent companies could avoid bankruptcy and continue as ongoing concerns through a reorganization of their financial obligations. The reorganization contemplated required the cooperation of the debtor companies' creditors and shareholders: *Re Avery Construction Co.*, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont. S.C.); Stanley E. Edwards, "Reorganizations under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar Rev. 587, at pp. 592-593; David H. Goldman, "Reorganizations Under the Companies' Creditors Arrangement Act (Canada)" (1985) 55 C.B.R. (N.S.) 36, at pp. 37-39.

57 The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy- or creditor-initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

58 The purpose of the Act was artfully put by Gibbs J.A., speaking for the British Columbia Court of Appeal, in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, an unreported judgment released October 29, 1990 [Doc. No. Vancouver CA12944, Carrothers, Cumming and Gibbs JJ.A., now reported [1991] 2 W.W.R. 136, 51 B.C.L.R. (2d) 84], at pp. 11 and 6 [unreported, pp. 91 and 88 B.C.L.R.]. In referring to the purpose for which the Act was initially proclaimed, he said:

> Almost inevitably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A. ['the Act'], to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

59 In an earlier passage, His Lordship had said:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business.

60 Gibbs J.A. also observed (at p. 13) that the Act was designed to serve a "broad constituency of investors, creditors and employees." Because of that "broad constituency", the Court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest. That interest is generally, but not always, served by permitting an attempt at reorganization: see S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," at p. 593.

61 The Act must be given a wide and liberal construction so as to enable it to effectively serve this remedial purpose: *Interpretation Act*, R.S.C. 1985, c. I-21, s. 12; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, supra, at p. 14 [unreported, p. 92 B.C.L.R.].

62 The Act is available to all insolvent companies, provided the requirements of s. 3 of the Act are met. That section provides:

3. This Act does not apply in respect of a debtor company unless

(a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and

(b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

63 A debtor company, or a creditor of that company, invokes the Act by way of summary application to the Court under s. 4 or s. 5 of the Act. For present purposes, s. 5 is the relevant section:

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.

64 Section 5 does not require that the Court direct a meeting of creditors to consider a proposed plan. The Court's power to do so is discretionary. There will no doubt be cases where no order will be made, even though the debtor company qualifies under s. 3 of the Act.

65 If the Court determines that a meeting should be called, the creditors must be placed into classes for the purpose of that meeting. The significance of this classification process is made apparent by s. 6 of the Act:

6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy Act* or is in the course of being wound up under the *Winding-up Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

66 If the plan of reorganization is approved by the creditors as required by s. 6, it must then be presented to the Court. Once again, the Court must exercise a discretion, and determine whether it will ap prove the plan of reorganization. In exercising that discretion, the Court is concerned not only with whether the appropriate majority has approved the plan at a meeting held in accordance with the Act and the order of the Court, but also with whether the plan is a fair and reasonable one: *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 at 182-185 (S.C.), aff'd 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.).

67 If the Court chooses to exercise its discretion in favour of calling a meeting of creditors for the purpose of considering a plan of reorganization, the Act provides that the rights and remedies available to creditors, the debtor company, and others during the period between the making of the initial order and the consideration of the proposed plan may be suspended or otherwise controlled by the Court.

68 Section 11 gives a court wide powers to make any interim orders:

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

69 Viewed in its totality, the Act gives the Court control over the initial decision to put the reorganization plan before the creditors, the classification of creditors for the purpose of considering the plan, conduct affecting the debtor company pending consideration of that plan, and the ultimate acceptability of any plan agreed upon by the creditors. The Act envisions that the rights and remedies of individual creditors, the debtor company and others may be sacrificed, at least temporarily, in an effort to serve the greater good by arriving at some acceptable reorganization which allows the debtor company to continue in operation: *Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce* (1989), 102 A.R. 161 at p. 165 (Q.B.).

IV Did Hoolihan J. Err in Holding that the Debtor Companies were Entitled to Invoke the Act?

70 The appellant advances three arguments in support of its contention that Elan and Nova Inc. were not entitled to seek relief under the Act. It argues first that the debentures issued by the companies after August 27, 1990, were "shams" and did not fulfil the requirements of s. 3 of the Act. The appellant next contends that the issuing of the debentures by the companies contravened their agreements with the bank, in which they undertook not to further encumber the assets of the companies without the consent of the bank. Lastly, the appellant maintains that once the bank had appointed a receiver-manager over the affairs of the companies on August 27, 1990, the companies had no power to create further indebtedness by way of debentures or to bring an application on behalf of the companies under the Act.

(i) Section 3 and "Instant" Trust Deeds

71 The debentures issued in August 1990, after the bank had moved to install a receiver-manager, were issued solely and expressly for the purpose of meeting the requirements of s. 3 of the Act. Indeed, it took the companies two attempts to meet those requirements. The debentures had no commercial purpose. The transactions did, however, involve true loans in the sense that moneys were advanced and debt was created. Appropriate and valid trust deeds were also issued.

72 In my view, it is inappropriate to refer to these transactions as "shams." They are neither false nor counterfeit, but rather are exactly what they appear to be, transactions made to meet jurisdictional requirements of the Act so as to permit an application for reorganization under the Act. Such transactions are apparently well known to the commercial Bar: B. O'Leary, "A Review of the Companies' Creditors Arrangement Act" (1987) 4 Nat. Insolvency Rev. 38, at p. 39; C. Ham, " 'Instant' Trust Deeds Under the C.C.A.A." (1988) 2 Commercial Insolvency Reporter 25; G.B. Morawetz, "Emerging Trends in the Use of the Companies' Creditors Arrangement Act" (1990) Proceedings, First Annual General Meeting and Conference of the Insolvency Institute of Canada.

73 Mr. Ham writes, at pp. 25 and 30:

> Consequently, some companies have recently sought to bring themselves within the ambit of the C.C.A.A. by creating 'in stant' trust deeds, i.e., trust deeds which are created solely for the purpose of enabling them to take advantage of the C.C.A.A.

74 Applications under the Act involving the use of "instant" trust deeds have been before the Courts on a number of occasions. In no case has any court held that a company cannot gain access to the Act by creating a debt which meets the requirements of s. 3 for the express purpose of qualifying under the Act. In most cases, the use of these "instant" trust deeds has been acknowledged without comment.

75 The decision of Chief Justice Richard in *Re United Maritime Fishermen Co-op.* (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.), varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.), at 55-56 [67 C.B.R.], speaks directly to the use of "instant" trust deeds. The Chief Justice refused to read any words into s. 3 of the Act which would limit the availability of the Act depending on the point at which, or the purpose for which, the debenture or bond and accompanying trust deed were created. He accepted [at p. 56 C.B.R.] the debtor company's argument that the Act:

> does not impose any time restraints on the creation of the conditions as set out in s. 3 of the Act, nor does it contain any prohibition against the creation of the conditions set out in s. 3 for the purpose of obtaining jurisdiction.

76 It should, however, be noted that in *Re United Maritime Fishermen Co-op.*, supra, the debt itself was not created for the purpose of qualifying under the Act. The bond and the trust deed, however, were created for that purpose. The case is therefore factually distinguishable from the case at Bar.

77 The Court of Appeal reversed the ruling of the Chief Justice ((1988), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, 88 N.B.R. (2d) 253, 224 A.P.R. 253) on the basis that the bonds required by s. 3 of the Act had not been issued when the application was made, so that on a precise reading of the words of s. 3 the company did not qualify. The Court did not go on to consider whether, had the bonds been properly issued, the company would have been entitled to invoke the Act. Hoyt J.A., for the majority, did, however, observe without comment that the trust deeds had been created specifically for the purpose of bringing an application under the Act.

78 The judgment of MacKinnon J. in *Re Stephanie's Fashions Ltd.*, unreported, Doc. No. Vancouver A893427, released January 24, 1990 (B.C. S.C.) [now reported 1 C.B.R. (3d) 248], is factually on all fours with the present case. In that case, as in this one, it was acknowledged that the sole purpose for creating the debt was to effect compliance with s. 3 of the Act. After considering the judgment of Chief Justice Richard in *Re United Maritime Fishermen Co-op.*, supra, MacKinnon J. held, at p. 251:

> The reason for creating the trust deed is not for the usual purposes of securing a debt but, when one reads it, on its face, it does that. I find that it is a genuine trust deed and not a fraud, and that the petitioners have complied with s. 3 of the statute.

79 *Re Metals & Alloys Co.* (16 February 1990) is a recent example of a case in this jurisdiction in which "instant" trust deeds were successfully used to bring a company within the Act. The company issued debentures for the purpose of permitting the company to qualify under the Act, so as to provide it with an opportunity to prepare and submit a reorganization plan. The company then applied for an order, seeking, inter alia, a declaration that the debtor company was a corporation within the meaning of the Act. Houlden J.A., hearing the matter at first instance, granted the declaration request in an order dated February 16, 1990. No reasons were given. It does not appear that the company's qualifications were challenged before Houlden J.A.; however, the nature of the debentures issued and the purpose for their issue was fully disclosed in the material before him. The requirements of s. 3 of the Act are jurisdictional in nature, and the consent of the parties cannot vest a court with jurisdiction it does not have. One must conclude that Houlden J.A. was satisfied that "instant" trust deeds suffice for the purposes of s. 3 of the Act.

80 A similar conclusion is implicit in the reasons of the British Columbia Court of Appeal in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*. In that case, a debt of $50, with an accompanying debenture and trust deed, was created specifically to enable the company to make application under the Act. The Court noted that the debt was created solely for that purpose in an effort to forestall an attempt by the bank to liquidate the assets of the debtor company. The Court went on to deal with the merits, and to dismiss an appeal from an order granting a stay pending a reorganization meeting. The Court could not have reached the merits without first concluding that the $50 debt created by the company met the requirements of s. 3 of the Act.

81 The weight of authority is against the appellant. Counsel for the appellant attempts to counter that authority by reference to the remarks of the Minister of Justice when s. 3 was introduced as an amendment to the Act in the 1952-53 sittings of Parliament (House of Commons Debates, 1-2 Eliz. II (1952-53), vol. II, pp. 1268-1269). The interpretation of words found in a statute, by reference to speeches made in Parliament at the time legislation is introduced, has never found favour in our Courts: *Reference Re Residential Tenancies Act (Ontario)*, [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 138, at 721 [S.C.R.], 561 [D.L.R.]. Nor, with respect to Mr. Newbould's able argument, do I find the words of the Minister of Justice at the time the present s. 3 was introduced to be particularly illuminating. He indicated that the amendment to the Act left companies with complex financial structures free to resort to the Act, but that it excluded companies which had only unsecured mercantile creditors. The Minister does not comment on the intended effect of the amendment on the myriad situations between those two extremes. This case is one such situation. These debtor companies had complex secured debt structures, but those debts were not, prior to the issuing of the debentures in August 1990, in the form contemplated by s. 3 of the Act. Like Richard C.J.Q.B. in *Re United Maritime Fishermen Co-op.*, supra, at pp. 52-53, I am not persuaded that the comments of the Minister of Justice assist in interpreting s. 3 of the Act in this situation.

82 The words of s. 3 are straightforward. They require that the debtor company have, at the time an application is made, an outstanding debenture or bond issued under a trust deed. No more is needed. Attempts to qualify those words are not only contrary to the wide reading the Act deserves, but can raise intractable problems as to what qualifications or modifications should be read into the Act. Where there is a legitimate debt which fits the criteria set out in s. 3, I see no purpose in denying a debtor company resort to the Act because the debt and the accompanying documentation was created for the specific purpose of bringing the application. It must be remembered that qualification under s. 3 entitles the debtor company to nothing more than consideration under the Act. Qualification under s. 3 does not mean that relief under the Act will be granted. The circumstances surrounding the creation of the debt needed to meet the s. 3 requirement may well have a bearing on how a court exercises its discretion at various stages of the application, but they do not alone interdict resort to the Act.

83 In holding that "instant" trust deeds can satisfy the requirements of s. 3 of the Act, I should not be taken as concluding that debentures or bonds which are truly shams, in that they do not reflect a transaction which actually occurred and do not create a real debt owed by the company, will suffice. Clearly, they will not. I do not, however, equate the two. One is a tactical device used to gain the potential advantages of the Act. The other is a fraud.

84 Nor does my conclusion that "instant" trust deeds can bring a debtor company within the Act exclude considerations of the good faith of the debtor company in seeking the protection of the Act. 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: see Lawrence J. Crozier, "Good Faith and the Companies' Creditors Arrangement Act" (1989) 15 Can. Bus. L.J. 89.

(ii) Section 3 and the Prior Agreement with the Bank Limiting Creation of New Debt

85 The appellant also argues that the debentures did not meet the requirements of s. 3 of the Act because they were issued in contravention of a security agreement made between the companies and the bank. Assuming that the debentures were issued in contravention of that agreement, I do not understand how that contravention affects the status of the debentures for the purposes of s. 3 of the Act. The bank may well have an action against the debtor company for issuing the debentures, and it may have remedies against the holders of the debentures if they attempted to collect on their debt or enforce their security. Neither possibility, however, negates the existence of the debentures and the related trust deeds. Section 3 does not contemplate an inquiry into the effectiveness or enforceability of the s. 3 debentures, as against other creditors, as a condition precedent to qualification under the Act. Such inquiries may play a role in a judge's determination as to what orders, if any, should be made under the Act.

(iii) Section 3 and the Appointment of a Receiver-Manager

86 The third argument made by the bank relies on its installation of a receiver-manager in both companies prior to the issue of the debentures. I agree with Finlayson J.A. that the placement of a receiver, either by operation of the terms of an agreement or by court order, effectively removes those formerly in control of the company from that position, and vests that control in the receiver-manager: *Alberta Treasury Branches v. Hat Development Ltd.* (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd without deciding this point (1989), 65 Alta. L.R. (2d) 374 (C.A.). I cannot, however, agree with his interpretation of the order of Saunders J. I read that order as effectively turning the receiver into a monitor with rights of access, but with no authority beyond that. The operation of the business is specifically returned to the companies. The situation created by the order of Saunders J. can usefully be compared to that which existed when the application was made in *Hat Development Ltd.* Forsyth J., at p. 268 C.B.R., states:

> The receiver-manager in this case and indeed in almost all cases is charged by the court with the responsibility of managing the affairs of a corporation. It is true that it is appointed pursuant, in this case, to the existence of secured indebtedness and at the behest of a secured creditor to realize on its security and retire the indebtedness. Nonetheless, this receiver-manager was court-appointed and not by virtue of an instrument. As a court-appointed receiver it owed the obligation and the duty to the court to account from time to time and to come before the court for the purposes of having some of its decisions ratified or for receiving advice and direction. *It is empowered by the court to manage the affairs of the company and it is completely inconsistent with that function to suggest that some residual power lies in the hands of the directors of the company to create further indebtedness of the company and thus interfere, however slightly, with the receiver-manager's ability to manage.*

[Emphasis added.]

87 After the order of Saunders J., the receiver-manager in this case was not obligated to manage the companies. Indeed, it was forbidden from doing so. The creation of the "instant" trust deeds and the application under the Act did not interfere in any way with any power or authority the receiver-manager had after the order of Saunders J. was made.

88 I also find it somewhat artificial to suggest that the presence of a receiver-manager served to vitiate the orders of Hoolihan J. Unlike many applications under s. 5 of the Act, the proceedings before Hoolihan J. were not ex parte and he was fully aware of the existence of the receiver-manager, the order of Saunders J., and the arguments based on the presence of the receiver-manager. Clearly, Hoolihan J. considered it appropriate to proceed with a plan of reorganization despite the presence of the receiver-manager and the order of Saunders J. Indeed, in his initial order he provided that the order of Saunders J. "remains extant." Hoolihan J. did not, as I do not, see that order as an impediment to the application or the granting of relief under the Act. Had he considered that the receiver-manager was in control of the affairs of the company, he could have varied the order of Saunders J. to permit the applications under the Act to be made by the companies: *Hat Development Ltd.*, at pp. 268-269 C.B.R. It is clear to me that he would have done so had he felt it necessary. If the installation of the receiver-manager is to be viewed as a bar to an application under this Act, and if the orders of Hoolihan J. were otherwise appropriate, I would order that the order of Saunders J. should be varied to permit the creation of the debentures and the trust deeds and the bringing of this application by the companies. I take this power to exist by the combined effect of s. 14(2) of the Act and s. 144(1) of the *Courts of Justice Act*, 1984, S.O. 1984, c. 11.

89 In my opinion, the debentures and "instant" trust deeds created in August 1990 sufficed to bring the company within the requirements of s. 3 of the Act, even if in issuing those debentures the companies breached a prior agreement with the bank. I am also satisfied that, given the terms of the order of Saunders J., the existence of a receiver-manager installed by the bank did not preclude the application under s. 3 of the Act.

V Did Hoolihan J. Err in Exercising his Discretion in Favour of Directing that a Creditors' Meeting be Held to Consider the Proposed Plan of Reorganization?

90 As indicated earlier, the Act provides a number of points at which the Court must exercise its discretion. I am concerned with the initial exercise of discretion contemplated by s. 5 of the Act, by which the Court may order a meeting of creditors for purposes of considering a plan of reorganization. Hoolihan J. exercised that discretion in favour of the debtor companies. The factors relevant to the exercise of that discretion are as variable as the fact situations which may give rise to the application. Finlayson J.A. has concentrated on one such factor, the chance that the plan, if put before a properly constituted meeting of the creditors, could gain the required approval. 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: S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," 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.

91 On the facts before Hoolihan J., there were several factors which supported the exercise of his discretion in favour of directing a meeting of the creditors. These included the apparent support of two of the three substantial secured creditors, the companies' continued operation, and the prospect (disputed by the bank) that the companies' fortunes would take a turn for the better in the near future, the companies' ongoing efforts — that eventually met with some success — to find alternate financing, and the number of people depending on the operation of the company for their livelihood. There were also a number of factors pointing in the other direction, the most significant of which was the likelihood that a plan of reorganization acceptable to the bank could not be developed.

92 I see the situation which presented itself to Hoolihan J. as capable of a relatively straightforward risk-benefit analysis. If the s. 5 order had been refused by Hoolihan J., it was virtually certain that the operation of the companies would have ceased immediately. There would have been immediate economic and social damage to those who worked at the plants, and those who depended on those who worked at the plants for their well-being. This kind of damage cannot be ignored, especially when it occurs in small communities like those in which these plants are located. A refusal to grant the application would also have put the investments of the various creditors, with the exception of the bank, at substantial risk. Finally, there would have been obvious financial damage to the owner of the companies. Balanced against these costs inherent in refusing the order would be the benefit to the bank, which would then have been in a position to realize on its security in accordance with its agreements with the companies.

93 The granting of the s. 5 order was not without its costs. It has denied the bank the rights it had bargained for as part of its agreement to lend substantial amounts of money to the companies. Further, according to the bank, the order has put the bank at risk of having its loans become undersecured because of the diminishing value of the accounts receivable and inventory which it holds as security and because of the ever-increasing size of the companies' debt to the bank. These costs must be measured against the potential benefit to all concerned if a successful plan of reorganization could be developed and implemented.

94 As I see it, the key to this analysis rests in the measurement of the risk to the bank inherent in the granting of the s. 5 order. If there was a real risk that the loan made by the bank would become undersecured during the operative period of the s. 5 order, I would be inclined to hold that the bank should not have that risk forced on it by the Court. However, I am unable to see that the bank is in any real jeopardy. The value of the security held by the bank appears to be well in excess of the size of its loan on the initial application. In his affidavit, Mr. Gibbons of Coopers & Lybrand asserted that the companies had overstated their cash flow projections, that the value of the inventory could diminish if customers of the companies looked to alternate sources for their product, and that the value of the accounts receivable could decrease if customers began to claim set-offs against those receivables. On the record before me, these appear to be no more than speculative possibilities. The bank has had access to all of the companies' financial data on an ongoing basis since the order of Hoolihan J. was made almost 2 months ago. Nothing was placed before this Court to suggest that any of the possibilities described above had come to pass.

95 Even allowing for some overestimation by the companies of the value of the security held by the bank, it would appear that the bank holds security valued at approximately $4 million for a loan that was, as of the hearing of this appeal, about $2.3 million. The order of Hoolihan J. was to terminate no later than November 14, 1990. I am not satisfied that the bank ran any

real risk of having the amount of the loan exceed the value of the security by that date. It is also worth noting that the order under appeal provided that any party could apply to terminate the order at any point prior to November 14. This provision provided further protection for the bank in the event that it wished to make the case that its loan was at risk because of the deteriorating value of its security.

96 Even though the chances of a successful reorganization were not good, I am satisfied that the benefits flowing from the making of the s. 5 order exceeded the risk inherent in that order. In my view, Hoolihan J. properly exercised his discretion in directing that a meeting of creditors should be held pursuant to s. 5 of the Act.

VI Did Hoolihan J. Err in Directing that the Bank and RoyNat Inc. Should be Placed in the Same Class for the Purposes of the Act?

97 I agree with Finlayson J.A. that the bank and RoyNat Inc., the two principal creditors, should not have been placed in the same class of secured creditors for the purposes of ss. 5 and 6 of the Act. Their interests are not only different, they are opposed. The classification scheme created by Hoolihan J. effectively denied the bank any control over any plan of reorganization.

98 To accord with the principles found in the cases cited by Finlayson J.A., the secured creditors should have been grouped as follows:

— Class 1 — The City of Chatham and the Village of Glencoe

— Class 2 — The Bank of Nova Scotia

— Class 3 — RoyNat Inc., Ontario Development Corporation, and those holding debentures issued by the company on August 29 and 31, 1990.

VII Did Hoolihan J. Err in Making the Interim Orders He Made?

99 Hoolihan J. made a number of orders designed to control the conduct of all of the parties, pending the creditors' meeting and the placing of a plan of reorganization before the Court. The first order was made on September 11, 1990, and was to expire on or before October 24, 1990. Subsequent orders varied the terms of the initial order somewhat, and extended its effective date until November 14, 1990.

100 These orders imposed the following conditions pending the meeting:

(a) all proceedings with respect to the debtor companies should be stayed, including any action by the bank to realize on its security;

(b) the bank could not reduce its loan by applying incoming receipts to those debts;

(c) the bank was to be the sole banker for the companies;

(d) the companies could carry on business in the normal course, subject to certain very specific restrictions;

(e) a licensed trustee was to be appointed to monitor the business operations of the companies and to report to the creditors on a regular basis; and

(f) any party could apply to terminate the interim orders, and the orders would be terminated automatically if the companies defaulted on any of the obligations imposed on them by the interim orders.

101 The orders placed significant restrictions on the bank for a 2-month period, but balanced those restrictions with provisions limiting the debtor companies' activities, and giving the bank ongoing access to up-to-date financial information concerning the companies. The bank was also at liberty to return to the Court to request any variation in the interim orders which changes in financial circumstances might merit.

102 These orders were made under the wide authority granted to the court by s. 11 of the Act. L.W. Houlden and C.H. Morawetz, in *Bankruptcy Law of Canada*, 3d ed. (Toronto: Carswell, 1989), at pp. 2-102 to 2-103, describe the purpose of the section:

> The legislation is intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and it creditors. This aim is facilitated by s. 11 of the Act, which enables the court to restrain further proceedings in any action, suit or proceeding against the company upon such terms as the court sees fit.

103 A similar sentiment appears in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*. Gibbs J.A., in discussing the scope of s. 11, said at p. 7 [unreported, pp. 88-89 B.C.L.R.]:

> When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success, there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

104 Similar views of the scope of the power to make interim orders covering the period when reorganization is being attempted are found in *Meridian Developments Inc. v. Toronto-Dominion Bank; Meridian Developments Inc. v. Nu-West Ltd.*, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 11 D.L.R. (4th) 576, 53 A.R. 39 (Q.B.) at 114-118 [C.B.R.]; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) at 12-15 [C.B.R.]; *Quintette Coal Ltd. v. Nippon Steel Corp.*, an unreported judgment of Thackray J., released June 18, 1990 [since reported (1990), 47 B.C.L.R. (2d) 193 (S.C.)], at pp. 5-9 [pp. 196-198 B.C.L.R.]; and B. O'Leary, "A Review of the Companies' Creditors Arrangement Act," at p. 41.

105 The interim orders made by Hoolihan J. are all within the wide authority created by s. 11 of the Act. The orders were crafted to give the company the opportunity to continue in operation, pending its attempt to reorganize, while at the same time providing safeguards to the creditors, including the bank, during that same period. I find no error in the interim relief granted by Hoolihan J.

VIII Conclusion

106 In the result, I would allow the appeal in part, vacate the order of Hoolihan J. of October 18, 1990, insofar as it purports to settle the class of creditors for the purpose of the Act, and I would substitute an order establishing the three classes referred to in Part VI of these reasons. I would not disturb any of the other orders made by Hoolihan J.

Appeal allowed.

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TAB 4

2014 ONSC 4488
Ontario Superior Court of Justice

Choo-Yick v. Tarion Warranty Corp.

2014 CarswellOnt 14874, 2014 ONSC 4488, 246 A.C.W.S. (3d) 480

Richard Choo-Yick and Kenisha Choo-Yick (Plaintiffs) and Tarion Warranty Corporation and Mike Hanas (Defendants)

H.A. Rady J.

Heard: July 25, 2014
Judgment: July 29, 2014
Docket: 270/13

Counsel: Richard Choo-Yick, Kenisha Choo-Yick, for themselves
Montgomery Shillington, for Defendants

Subject: Civil Practice and Procedure; Contracts; Insolvency

Table of Authorities

Cases considered by *H.A. Rady J.*:

Baradaran v. Tarion Warranty Corp. (2014), 2014 CarswellOnt 1794, 2014 ONCA 123 (Ont. C.A.) — considered

McIntyre v. Grigg (2006), 83 O.R. (3d) 161, 274 D.L.R. (4th) 28, 2006 CarswellOnt 6815, 43 C.C.L.T. (3d) 209, 39 M.V.R. (5th) 39, 217 O.A.C. 217 (Ont. C.A.) — referred to

Montreal Trust Co. of Canada v. ScotiaMcLeod Inc. (1995), 129 D.L.R. (4th) 711, 9 C.C.L.S. 97, 23 B.L.R. (2d) 165, 87 O.A.C. 129, 1995 CarswellOnt 1203, (sub nom. *ScotiaMcLeod Inc. v. Peoples Jewellers Ltd.)* 26 O.R. (3d) 481 (Ont. C.A.) — considered

Montreal Trust Co. of Canada v. ScotiaMcLeod Inc. (1996), 137 D.L.R. (4th) vi (note), 1996 CarswellOnt 6010, 1996 CarswellOnt 6011, 95 O.A.C. 399 (note), 205 N.R. 314 (note), [1996] 3 S.C.R. viii (note) (S.C.C.) — referred to

Piedra v. Copper Mesa Mining Corp. (2011), 332 D.L.R. (4th) 118, 280 O.A.C. 1, 2011 ONCA 191, 2011 CarswellOnt 1495 (Ont. C.A.) — considered

Statutes considered:

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

Ontario New Home Warranties Plan Act, R.S.O. 1990, c. O.31
Generally — referred to

Rules considered:

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

R. 21 — pursuant to

R. 21.01(1)(b) — considered

R. 21.01(2)(b) — considered

R. 21.01(3)(d) — considered

MOTION by new home warranty corporation and its employee to strike certain claims against them in action by purchasers of new home.

***H.A. Rady J.*:**

Introduction

1 The defendants move pursuant to Rule 21 for an order staying or dismissing the plaintiffs' claim against Mike Hanas; striking the claim for punitive damages; and striking the claim for "twenty year open claim on our family's health due to mould issue". The defendants submit that no cause of action lies against Mr. Hanas who is a Tarion employee; there is no basis for the claim for punitive damages; and the claim for an "open claim" is not available in law.

2 The plaintiffs filed no factum or book of authorities but rather delivered an affidavit setting out a detailed chronology of their dealings with their house builder and Tarion.

Preliminary Matter

3 The motion is primarily grounded in Rule 21.01(1)(b) and (3)(d). Rule 21.01(2)(b) provides that no evidence is admissible on a motion pursuant to Rule 21.01(1)(b). There is no residual discretion to admit evidence and therefore, the affidavit is not properly before the court on this motion.

Facts

4 The following facts are taken from the statements of claim and defence, the relevant legislation and the decision of the Licence Appeal Tribunal.

5 Tarion is the corporation designated by the Lieutenant Governor in Council pursuant the *Ontario New Home Warranties Plan Act* to administer the Ontario New Home Warranties Plan.

6 The Act serves a two-fold purpose: consumer protection and the regulation of the new home building industry. In order to protect consumers, the Act imposes limited mandatory warranties on new home builders in Ontario and provides for the payment of compensation to those purchasers whose builders have failed to honour them. The Act provides for the administration of a mandatory licensing scheme for all new home builders in Ontario.

7 The Act also sets out an administrative procedure to be followed after a warranty claim is made to the builder and Tarion. Timelines are imposed on builders to complete the warranted repairs. If the builder and homeowner do not agree on whether a defect amounts to a warranted item, Tarion may be contacted to conciliate the dispute and conduct an inspection. If an agreement cannot be reached, Tarion is to make a warranty assessment whether the claim is covered under the warranty.

8 If the builder is unwilling or unable to honour its warranty, after the prescribed time, Tarion provides the homeowner with compensation. Tarion has the right to arrange for the performance of repairs instead of paying compensation.

9 If a homeowner disagrees with Tarion's warranty findings, there is an automatic right of appeal to the Licence Appeal Tribunal, which conducts a hearing *de novo*. There is an automatic right of appeal of a decision made by the Tribunal to the Divisional Court.

10 The builder's warranty to a homeowner, as prescribed by the Act is subject to specific exclusions namely secondary damage caused by defects, such as property damage and personal injury; and damage caused by dampness or condensation due to an owner's failure to maintain adequate ventilation.

11 The Act and its regulations set out certain limits to Tarion's liability to provide compensation. The total maximum amount payable to homeowners is $300,000. The maximum amount payable for damage caused by environmentally harmful substances or hazards, deleterious substances, mould or any other fungal or bacterial contamination is $15,000 per home. As a result, the plaintiffs' claim is subject to the $15,000 limit on damages caused by mould contamination.

12 Mr. Hanas is an employee of Tarion. Mr. Hanas was a manager of claims at the time the plaintiffs made their warranty claim. Mr. Hanas, however, transferred to a different Tarion department before Tarion issued its Decision Letter. Tarion's field claims representatives inspected the plaintiffs' home. They reported to Mr. Hanas until he transferred to a different department. Thereafter, the field claims representatives reported to a new manager of claims.

13 On March 4, 2008, the plaintiffs entered into an agreement to purchase a new home located at 1920 Purcell Drive, London from Cameron Properties Inc. On July 24, 2008, the plaintiffs took possession. On July 15, 2010, the plaintiffs delivered a second-year warranty claim form to Tarion, complaining of mould growth in the basement among other things.

14 At the plaintiffs' request, on September 23, 2010, Tarion conducted an emergency inspection. No evidence of a window leak was found at the time. The plaintiffs advised that they were hiring a consultant to remove the basement drywall and prepare a report. Tarion's inspection report noted that the owner could request a conciliation inspection between November 24 and December 23, 2010.

15 Tarion was given a report by the builder's consultant, which concluded that any mould was caused by dampness or condensation due to failure by the owner to maintain adequate ventilation. Tarion also received a report by the plaintiffs' consultant that concluded the mould was the result of a leaking basement window. Tarion subsequently retained a consultant to evaluate the home.

16 On January 27, 2011, the builder was deemed bankrupt pursuant to the *Bankruptcy and Insolvency Act.*

17 On February 3, 2011, the consultant retained by Tarion released its report. The consultant determined that a leak in a window might be contributing to mould, but it was not a major contributor.

18 On February 8, 2011, Tarion's field claims representative reassessed the warranty claim in light of Tarion's consultant's report and found the claim to be warranted. Because the builder was unable to undertake the required remedial work, Tarion retained contractors to carry out the work recommended in its consultant's report.

19 The required work was completed and on March 1, 2011, Tarion was given a Statement of Condition from an expert indicating that the home was fit for habitation. The defendants have pleaded that the cost of the work at that point had already exceeded the $15,000 maximum prescribed by the Act and its regulations.

20 The plaintiffs were not satisfied with the remedial work. They initially declined Tarion's request that they define the items that they wished to dispute, so that a Decision Letter could be issued. On October 30, 2012, Tarion issued a Decision Letter. On November 14, 2012, the plaintiffs filed a Notice of Appeal of Tarion's Decision Letter at the Licence Appeal Tribunal.

21 On January 11, 2013, the Tribunal made a prehearing order that Tarion arrange to have the home tested for mould by an independent qualified entity, as soon as possible, in order to determine if the mould remediation performed to date had eliminated the mould issue in the home.

22 On January 15, 2013, the testing referred to in the Tribunal prehearing order took place at the home. The testing was completed by Pure Balance Environmental Inc. and the results were released in a report dated January 29, 2013. The report concluded that, although there was no visible mould growth, there were significantly elevated spore trap samples in the basement of the home. The report recommended that certain cleaning and remedial work be done to remedy the problem.

23 Tarion offered to retain a contractor to undertake the cleaning and remedial work recommended in the Pure Balance Environmental Inc. report. Ultimately, on March 28, 201, Tarion issued a Supplementary Decision Letter, which indicated that, based on the findings of the Pure Balance Environmental Inc., Tarion was prepared to:

a. conduct destructive testing on the two exterior walls of the basement bedroom to determine whether there was any active mould growth behind the walls causing the spores in the air. If active mould growth was found behind the walls, it would be remediated. The room would be reinstated to its original condition; and

b. after the destructive testing was conducted, it would undertake the recommendations outlined in the Pure Balance Environmental Inc. report. These recommendations would be performed, even if no active mould growth was found as a result of the destructive testing.

24 The plaintiffs' appeal to the Tribunal was heard by Tribunal Member Keith Penner over three days, commencing on April 10, 2013. The Tribunal considered the appropriateness of Tarion's Decision Letter and Supplementary Decision Letter. It heard evidence from the plaintiffs and from representatives of Tarion, including Mr. Hanas.

25 The plaintiffs' appeal to the Tribunal involved essentially the same issues raised by the plaintiffs' statement of claim.

26 On April 29, 2013, the Tribunal's written reasons were released. The Tribunal reaffirmed Tarion's position in its Decision Letter and Supplementary Decision Letter. Tarion was directed to proceed as proposed in the Supplementary Decision Letter.

Analysis

27 The test on a Rule 21.01(1)(b) motion is whether it is plain and obvious that the claim discloses no reasonable cause of action. The facts as pleaded are assumed to be true and the pleading must be read generously in order to overcome any drafting defects. For the reasons that follow, I have concluded that it is plain and obvious that there is no claim against Mr. Hanas, for punitive damages or for an "open file".

28 First, it is clear that at all material times Mr. Hanas was acting in his capacity as a Tarion employee. Findings of liability against employees in their personal capacities are rare in the absence of findings of fraud, deceit or dishonesty none of which are pleaded by the plaintiffs. In *Montreal Trust Co. of Canada v. ScotiaMcLeod Inc.* (1995), 26 O.R. (3d) 481 (Ont. C.A.), at 9 , leave to appeal refused, [1996] S.C.C.A. No. 40 (S.C.C.), the court made the following comments:

The decided cases in which employees and officers of companies have been found personally liable for actions ostensibly carried out under a corporate name are fact-specific. In the absence of findings of fraud, deceit, dishonesty or want of authority on the part of the employees or officers, they are also rare... In every case, however, the facts giving rise to personal liability were specifically pleaded. Absent allegations which fit within the categories described above, officers or employees of limited companies are protected from personal liability unless it can be shown that their actions are themselves tortious or which exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own."

29 In *Piedra v. Copper Mesa Mining Corp.*, 2011 ONCA 191 (Ont. C.A.), the court explained that claims against individuals in their personal capacities "must withstand a high degree of scrutiny" and that courts must be "scrupulous in weeding out claims that are improperly pleaded or where the evidence does not justify an allegation of a personal tort". See also *Baradaran v. Tarion Warranty Corp.*, 2014 ONCA 123 (Ont. C.A.), the facts of which bear a similarity to this case. In *Baradaran*, the Court of Appeal upheld a motions judge's decision to strike a claim made against a Tarion employee.

30 I see no basis on which the claim for punitive damages can be sustained. The statement of claim reveals no allegations of conduct that would justify such an award. The pleading does not articulate or particularize any high-handed, callous, malicious or vindictive conduct or a breach of any duty of good faith. The claim as pleaded is simply an expression of the plaintiffs' dissatisfaction with the defendants' conclusions and the remedy Tarion considered was appropriate. The plaintiffs' appeal was dismissed and as far as I am aware, no appeal of the Tribunal's decision was taken.

31 While negligent conduct can attract punitive damages, such cases are rare and exceptional and when the conduct in question was deliberate, intentional and extreme: *McIntyre v. Grigg* [2006 CarswellOnt 6815 (Ont. C.A.)], 2006 CanLII 37326. That is not this case.

32 Finally, the request for an "open claim" cannot succeed in the face of the Act which expressly excludes liability for secondary damages, including personal injury.

33 As a result, the claim against Mr. Hanas is struck as are the claims for punitive damages and for an "open claim" without leave to amend.

34 I will receive brief written submissions on costs from the defendants by August 15, 2014 and the plaintiffs by September 12, 2014.

Motion granted.

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TAB 5

CREDITOR - DEBTOR LAW IN CANADA

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by

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and Chapter 20 by E. R. Edinger, B.A., LL.B. (U.B.C.),
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> The statute of Elizabeth, while making void transfers, the object of which is to defeat or delay creditors, does not make void but expressly protects them in the interest of transferees who have given valuable consideration therefor, and it has been decided over and over again that knowledge on the part of such a transferee of the motive or design of the transferor is not conclusive of bad faith or will not preclude him from obtaining the benefit of his security. So long as there is an existing debt and the transfer to him is made for the purpose of securing that debt and he does not either directly or indirectly make himself an instrument for the purpose of subsequently benefiting the transferor, he is protected and the transaction cannot be held void.[19]

What is unclear from this quotation is what further evidence is necessary to satisfy the statute. Other cases talk about the purchaser being privy or party to the fraudulent intent[20] or concurring in it,[21] but these terms do not tell us much. Perhaps the best analysis of the law after *Mulcahy v. Archibald* is contained in a report of the New Brunswick Consumer Protection Project on unsecured creditors' remedies:

> In setting aside the transaction made by the debtor, the issue is the intent of the transaction. Under the existing jurisprudence, if the third party gives valuable consideration, there must be a concurrence of intent to attack the transaction. Mere knowledge of the debtor's improper intent does not create a concurrence of intent.[22]

Speaking of the common idea that the transferee must be privy to the fraud, the report comments:

> Privity would undoubtedly exist if the third party shared the actual intent to defeat creditors or to give an unjust preference. If the third party's own intent is to gain a good bargain for himself, some form of collusion or assistance with the deliberate object of helping the debtor to carry out his improper intent would probably be necessary.[23]

---

19 *Mulcahy v. Archibald*, *supra*, note 17, p. 529. To the same effect, see *Manitoba Brewing and Malting Co. v. McDonald* (1909), 11 W.L.R. 313 (Sask. K.B.); *Banque d'Hochelaga v. Potvin*, [1924] 1 W.W.R. 488 (Alta. C.A.); *Ferguson v. Laskewka*, *supra*, note 14; *Bank of Montreal v. Vandine* (1952), 33 M.P.R. 368 (N.B.C.A.); *Woodmann Interiors Ltd. v. Zeh* (1989), 75 C.B.R. (N.S.) 100 (Alta. Q.B.).

20 *Meeker Cedar Products Ltd. v. Edge* (1968), 12 C.B.R. (N.S.) 49, affirmed without written reasons 12 C.B.R. (N.S.) 60 (S.C.C.); *Lange v. Lange* (1981), 14 Man. R. (2d) 153 (Q.B.); *Stathakis v. Sara* (1983), 48 C.B.R. (N.S.) 286 (Ont. S.C.); *Re Associated Fisheries of Canada Ltd.* (1987), *supra*, note 1; *Gresham v. Gresham* (1993), 18 C.B.R. (3d) 201 (B.C.C.A.).

21 *Re Johnson; Golden v. Gillam* (1881), 20 Ch. D. 389, affirmed (*sub nom. Golden v. Gillam*) 51 L.J. Ch. 503 (C.A.); *Monteith v. Hayden* (1987), 205 A.P.R. 273 (N.B.C.A.). Compare *Royal Bank v. Victor* (1986), 7 B.C.L.R. (2d) 151 (S.C.), in which Meredith J. uses the idea of "collusion" between the transferors and transferee.

22 Dore and Kerr, *Third Report of the Consumer Protection Project: Legal Remedies of the Unsecured Creditor after Judgment* (N.B. 1976), p. 115 (unpublished). See also Ontario Law Reform Commission, *Report on the Enforcement of Judgment Debts and Related Matters* (1983), vol. 4, pp. 143-47, 163, 219.

23 Dore and Kerr, *supra*, note 22, p. 116. The writers try to reconcile the Canadian cases with s. 6 of the statute by arguing (p. 115) that the section "would seem to refer, not to the transaction between the debtor and the third party, but to some subsequent transaction by the third party". This seems a strained reading of the section. The better view is that the Canadian cases have

If the New Brunswick writers are correct in their interpretation of *Mulcahy v. Archibald*, our law is now substantially different from the English case law and from what appears to have been the intent of s. 6 of the statute. The case reflects a tenderness for the purchaser which may be justified by the need for freedom and security of commerce but which makes an attack on a transfer for value very difficult indeed.

(d) The Proof of Intent

We noted earlier that the crucial problem in any fraudulent conveyance action is to prove the fraudulent intent of the debtor and, in the case of transfers for value, the concurrence of the transferee. We discussed the presumptions developed by the courts to aid them in finding fraud in certain types of voluntary transactions (Kerr's class (1)). Even where fraud must be proved as a fact, the courts as early as *Twyne's Case*[24] developed evidentiary rules which would enable them to find fraud unless the supporters of the transaction could explain away the suspicious circumstances. These rules have come down to us today as the so-called badges of fraud.

While the legal or persuasive burden to prove the case remains on the plaintiff throughout the trial, the plaintiff may raise an inference of fraud sufficient to shift the evidentiary burden to the defendant if the plaintiff can establish that the transaction has characteristics which are typically associated with fraudulent intent.[25] No doubt proof of one or several badges of fraud will not compel a finding for the plaintiff, but it does raise a *prima facie* case which it would be prudent for the defendant to attempt to rebut.[26]

Lists of the badges of fraud vary from writer to writer, and no comprehensive catalogue is likely to be agreed upon. The judges in *Twyne's Case* listed six "signs and marks of fraud" present in the facts before them:[27]

effectively rewritten the section in the interest of protecting transfers for value. The history of judicial interpretation of the Statute of Elizabeth is characterized by extensive lawmaking under the guise of interpretation.

24 (1601), 76 E.R. 809.

25 The distinction between legal and evidentiary burdens is based on Thayer, as interpreted in Tapper, *Cross on Evidence* (7th ed. 1990), pp. 110-12. There is the occasional case which supports the rule as set out in the text, *e.g.*, *Koop v. Smith* (1915), 25 D.L.R. 355 at 358-59 (S.C.C.) *per* Duff J.; *Commerce Capital Mortgage Corp. v. Jemmett* (1981), 37 C.B.R. (N.S.) 59 (Ont. H.C.); *Goertz v. Goertz (Trustee of)* (1992), 16 C.B.R. (3d) 42 (Sask. C.A.). However, there are other cases which talk of the burden shifting without making it clear what is meant by that obscure image. *Cf.* Davies J. in *Koop v. Smith*, *supra*, p. 356. It is submitted that the better view is as expressed in the text. It should be noted that a fraudulent intent deemed to exist by another statute, such as the Bulk Sales Act, may provide the basis for a finding of intent under the Statute of Elizabeth or its provincial equivalent: see *Wiebe v. Holmes*, [1971] 4 W.W.R. 588 (Man. Q.B.), and cases cited therein; Dore and Kerr, *supra*, note 22, pp. 119-20.

26 In Schiff's terms, proof of some badges of fraud raises a justifiable inference of fraud but not a compelled determination of fraud unless the defendant leads evidence: see Schiff, *Evidence in the Litigation Process* (4th ed. 1993), pp. 1651-53.

27 *Supra*, note 24, pp. 812-14.

(1) The gift was general "without exception of his apparel, or any thing of necessity".
(2) The donor continued in possession and used the goods as his or her own, including selling them.
(3) The transaction was secret.
(4) The transfer was made pending the writ.
(5) The transfer amounted to a trust of the goods "and fraud is always apparelled and clad with a trust, and a trust is the cover of fraud".
(6) The deed contained the self-serving and unusual provision "that the gift was made honestly, truly, and bona fide".

Later judges and writers[28] have added other fact situations which raise one's suspicions of fraud:

(7) The deed gives the grantor a general power to revoke the conveyance.
(8) The deed contains false statements as to the consideration.
(9) The consideration is grossly inadequate.
(10) There is unusual haste to make the transfer.
(11) Some benefit is retained under the settlement by the settlor.[29]
(12) Cash is taken in payment instead of a cheque.
(13) A close relationship exists between the parties to the conveyance.

One can think of other candidates for the list.

The judges are very careful to avoid the impression that the badges of fraud doctrine can be used mechanically. The plaintiff is still required to prove fraud

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28 See, *e.g.*, *Ferguson v. Lastewka*, *supra*, note 14; *Bank of Montreal v. Vandine, supra*, note 19; *Re Dougmore Realty Holdings Ltd.; Fisher v. Wilgorn Invt. Ltd.* (1966), 59 D.L.R. (2d) 432, reversed on other grounds 65 D.L.R. (2d) 419 (Ont. C.A.); *Meeker Cedar Products Ltd. v. Edge, supra*, note 20; *Bank of Nova Scotia v. Zgurski* (1970), 72 W.W.R. 464 (Alta. T.D.); *Solomon v. Solomon, supra*, note 17; *Holdenreid v. Holdenreid* (1978), 29 C.B.R. (N.S.) 138 (Ont. H.C.); *Westinghouse Canada Ltd. v. Caldwell* (1979), 31 C.B.R. (N.S.) 276 (B.C.S.C.); *Bank of Nova Scotia v. MacDonald* (1982), 39 N.B.R. (2d) 71 (Q.B.); *India Films Overseas Limited v. Keefer Investments Inc.* (1984), 55 C.B.R. (N.S.) 154 (B.C.S.C.); *Sochan v. Sochan* (1984), 31 Sask. R. 13 (U.F.C.); *Bank of Montreal v. Horan* (1986), 54 O.R. (2d) 757 (Ont. H.C.); *Re Associated Fisheries of Canada Ltd., supra*, note 1; *Monteith v. Hayden, supra*, note 21; *Nuove Ceramiche Ricchetti S.p.A. v. Mastrogiovanni* (1988), 76 C.B.R. (N.S.) 310 (Ont. H.C.); *633746 Ontario Inc. (Trustee of) v. Salvati* (1990), 79 C.B.R. (N.S.) 72 (Ont. H.C.); *Mannal v. Busch* (1990), 251 A.P.R. 385 (N.S.T.D.); *Chow v. Pearson* (1992), 12 C.B.R. (3d) 226 (B.C.S.C.); *Canadian Imperial Bank of Commerce v. Graat* (1992), 5 B.L.R. (2d) 271 (Ont. Gen. Div.); *Dondee Stock Farms Ltd. (Trustee of) v. Giesbrecht* (1993), 24 C.B.R. (3d) 20 (Sask. Q.B.); Hals., *supra*, note 1, para. 366; Kerr, *supra*, note 15, pp. 350-78; Parker, *supra*, note 6, cc. 5-7.

29 But see *Sun Sudan Oil Co. v. Methanex Corp.* (1992), 5 Alta. L.R. (3d) 292, 318 (Q.B.) where Hunt J. concludes that the Statute of Elizabeth "only comes into play when the assignor reserves some benefit to himself". Taken literally, this would promote a badge of fraud into an absolute requirement, although the judge is able to find some support in dicta by Jessel M.R., quoted in *Mulcahy v. Archibald, supra*, note 17, p. 529.

on all the facts of the case, and a court might still dismiss a fraudulent conveyance action because the plaintiff's evidence is explained away by the surrounding circumstances taken as a whole.[30] Some of the above items are obviously more important than others. Still the plaintiff who can identify a number of suspicious circumstances in the transaction is obviously in a better position to escape a non-suit and to force the defendant to give evidence, thus exposing that defendant to cross-examination.

Perhaps the most common type of fraudulent conveyance, and one which is bound to attract suspicion, is the sale or gift of property to a close relative. The existence of this close relationship between the parties is itself a badge of fraud,[31] but the courts have gone further and have developed a secondary evidentiary rule applicable to these kinds of conveyances.

The leading Canadian case is *Koop v. Smith*[32] in which it was sought to set aside a bill of sale executed in favour of the defendant by her brother at a time when the latter was financially embarrassed. Counsel for the plaintiff urged the Supreme Court to accept and apply a rule developed in the Ontario courts to the effect that where the transaction in question occurs between close relatives, the evidence of the relatives as to *bona fide* should be corroborated.

The Supreme Court held that the bill of sale should be declared to be void but their comments on the Ontario corroboration rule do not go quite as far as plaintiff's counsel appears to have argued. Davies J. commented as follows:

> I think the rule laid down by the Courts of Ontario with regard to assignments made between near relations and impeached by the creditors of the assignor as fraudulent is a salutory one, namely, that where it is accessible some corroborative evidence of the *bona fides* of the transaction should be given.[33]

Duff J. considered the proposed rule at greater length. He began by noting that the trial judge appeared to have held that a suspicious transaction between close relatives can only be supported by corroborative evidence. He submitted this proposition to a long but useful analysis:

30 See cases and texts cited *supra*, note 28. See also *Havel v. Galemar Hldg. Ltd.* (1981), 36 O.R. (2d) 348 (H.C.); *Re Ross* (1983), 56 N.S.R. (2d) 264 (T.D.); *Bank of Nova Scotia v. Bass* (1983), 47 C.B.R. (N.S.) 203 (Man. Q.B.); *Austin Marshall Limited v. Bennie* (1985), 56 C.B.R. (N.S.) 71 (Ont. H.C.); *Holbrook v. Cedpar Properties Inc.* (1986), 62 C.B.R. (N.S.) 18 (Ont. H.C.); *Cas's Mechanical Services Inc. v. Topping* (1989), 77 C.B.R. (N.S.) 145 (Sask. Q.B.); *Smeds v. Olney* (1990), 3 C.B.R. (3d) 85 (B.C.S.C.); *Davis v. Thachuk* (1991), 5 C.B.R. (3d) 256 (B.C.S.C.).

31 There are numerous cases. See, *e.g.*, *Re Fancy* (1984), 51 C.B.R. (N.S.) 29 (Ont. H.C.); *Re Whetstone* (1984), 52 C.B.R. (N.S.) 280 (Ont. H.C.); *Carew v. Power* (1984), 50 C.B.R. (N.S.) 275 (Nfld. D.C.); *Courtesy Chevrolet Oldsmobile Ltd. v. Dhaliwal* (1987), 67 C.B.R. (N.S.) 72 (Ont. H.C.).

32 *Supra*, note 25. See also *Re Whetstone*, *supra*, note 31; *Northland Bank v. Smetaniuk* (1986), 62 C.B.R. (N.S.) 113 (B.C.S.C.).

33 *Supra*, note 25, p. 356.

> I do not think the proposition put thus absolutely is part of the English law or of the law of British Columbia; but I think it is a maxim of prudence based upon experience that in such cases a tribunal of fact may properly act upon that when suspicion touching the reality or the *bona fides* of a transaction between near relatives arises from the circumstances in which the transaction took place then the fact of relationship itself is sufficient to put the burden of explanation upon the parties interested and that, in such a case, the testimony of the parties must be scrutinized with care and suspicion; and it is very seldom that such evidence can safely be acted upon as in itself sufficient. . .
>
> I may add that I think it doubtful whether the Ontario decisions when properly read really do lay it down as a rule of law that the fact of relationship is sufficient in itself to shift the burden of establishing the burden of proof in the strict sense. It may be that the proper construction of these cases is that the burden of giving evidence and not the burden of the issue is shifted. (As to this distinction see the admirable chapter IX, in Professor Thayer's 'Law of Evidence'.) In my own view as indicated above, even this would be putting the matter just a little too high; I think the true rule is that suspicious circumstances coupled with relationship make a case of *res ipsa loquitur* which the tribunal of fact may and will generally treat as a sufficient *prima facie* case, but that it is not strictly in law bound to do so; and that the question of the necessity of corroboration is strictly a question of fact.[34]

The other three judgments given in the case add little to the point under discussion.[35]

The passages quoted above have been much referred to in subsequent cases, but the courts' interpretations have not been consistent. A few judges apparently read *Koop v. Smith* as requiring corroboration in all cases of suspicious transactions between close relatives.[36] Most cases and authorities have taken what is submitted to be the better view that in such a situation the uncorroborated evidence will usually not be sufficient but that "the necessity of corroborative evidence under such circumstances is not, however, a hard and fast rule, but a maxim of prudence".[37]

---

34 *Supra*, note 25, pp. 358-59. See also *Goertz v. Goertz (Trustee of)*, *supra*, note 25.

35 Anglin and Brodeur JJ. say that the question of fraudulent intent is for the trial judge to decide and his conclusions should not be distributed on appeal. Idington J. agrees but adds, p. 357:

> These cases of alleged fraudulent assignment must generally depend largely upon the view of the facts taken by the trial Judge. It is quite competent for him, if impressed with the veracity of the assignor, to accept and act upon his unsupported statement. The transaction and established surrounding circumstances might be such as to justify his doing so. Or, on the other hand, they might be such as to render his doing so questionable.

See also *E.E. McCoy Co. v. Wiseman* (1987), 200 A.P.R. 1 (N.S.A.D.).

36 *Killops (Killips) v. Porter* (1916), 9 W.W.R. 949 (Alta. T.D.); and *Petryshyn v. Kochan*, [1940] 2 W.W.R. 353 (Sask. K.B.).

37 13 C.E.D. (Ont. 3rd) *Fraudulent and Voidable Conveyances*, para. 128. See also *Union Bank v. Murdock*, [1917] 3 W.W.R. 820 (Man. C.A.); *Imperial Bank v. Esakin*, [1924] 2 W.W.R. 33 (Sask. C.A.); *Re Can. Imperial Bank of Commerce and Ash* (1964), 47 D.L.R. (2d) 620 (B.C.S.C.); *Re Dougmore Realty Holdings Ltd.*, *supra*, note 28; *Bank of Nova Scotia v. Zgurski*, *supra*, note 28; *Toronto-Dom. Bank v. Michael*, *supra*, note 17; *Gallop v. Hamlin* (1973), 39 D.L.R. (3d) 524 (Ont. C.A.); *Traders Group Ltd. v. Mason* (1973) 43 D.L.R. (3d) 76 (N.S.T.D.):

discussed earlier must be evident to the creditor or to someone standing in the creditor's shoes.

The requirement that the plaintiff prove that the creditor knew of the debtor's insolvency and shared in the intent to prefer was established early in Canadian law, although there were dissenters, particularly in the Manitoba courts.[38] These concurrent intent rules have created obvious problems in challenging fraudulent preferences because the task of establishing the creditor's knowledge and involvement will usually be much more difficult than finding the necessary intent in the debtor alone. A similar problem bedevilled the law of bankruptcy until 1976 when the Supreme Court of Canada held in *Hudson v. Benallack*[39] that, in order to set a transaction aside under s. 73 of the Bankruptcy Act,[40] one need only be concerned with the intent of the debtor. While the Supreme Court is careful to distinguish their previous decisions on fraudulent preference statutes, Dickson J. does describe one of them, *Benallack v. Bank of B.N.A.*,[41] as "unsatisfactory".[42] Bearing in mind the similar history and objectives of fraudulent preference provisions in the Bankruptcy Act and in provincial statutes, it is difficult to see why the reasoning in the later *Benallack* case should not apply to the provincial statutes as well, and this conclusion has already been adopted in one New Brunswick case.[43]

(f) Transactions Attacked Within 60 Days

The purpose of provisions like Ontario s. 4 (3)-(4), as noted earlier, was to lighten the burden of the plaintiff challenging transactions entered into within 60 days of an action or of an assignment by the debtor. The Ontario legislation has not been particularly successful in achieving this end compared to the differently drafted statutes in western Canada.

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38 *Schwartz v. Winkler* (1901), 13 Man. R. 493; *cf. Gunn v. Vinegratsky* (1911), 17 W.L.R. 54 (Man. C.A.); *Robinson v. McCauley* (1913), 4 W.W.R. 930, affirmed 5 W.W.R. 789 (Man. C.A.); *Weidman Bros. v. Simovitch*, [1945] 3 W.W.R. 203 (Man. K.B.); Jewers, "Fraudulent Conveyance and Preference Legislation in Canada" (1956), 28 Man. Bar News 1 at 8-11.

39 [1976] 2 S.C.R. 168.

40 R.S.C. 1970, c. B-3. See now Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 95.

41 *Supra*, note 35.

42 "The case [*Benallack v. Bank of B.N.A.*, *supra*, note 35] is unsatisfactory, if I may, with respect, say so, in that none of the 'long line of decisions' upon which Idington J. relies is identified and no reasons are given for concluding that the intent to which the Ordinance refers must be entertained by the creditor as well as the debtor." (*Supra*, note 39, p. 180).
The criticism is not completely fair. Idington J. no doubt felt it unnecessary to cite previous cases and make policy arguments in light of the then recent decisions on the question in *Gibbons v. McDonald*, *supra*, note 27 and *Johnson v. Hope*, *supra*, note 20, not to speak of the discussion by Parker, whose book was published in 1903. The judgment of the Yukon Territorial Court appealed from is not reported but a substantial portion is reproduced in *Northern Commercial Co. v. Powell*, *supra*, note 35. It appears to have been a more thorough treatment of the issue and, as the Supreme Court affirmed it, they may have felt that extensive reasons were unnecessary.

43 *Federal Business Development Bank v. Van Klaveren* (1979), 51 A.P.R. 79 at 84-85 (N.B.Q.B.). But see *Canadian Commercial Bank v. Prudential Steel Ltd.*, *supra*, note 35.

The Ontario Act originally provided that a transaction occurring within the 60-day period was "presumed" to have been made with the relevant intent and to be an unjust preference. The courts had considerable difficulty in deciding whether the presumption so worded was rebuttable or not.[44] When the sections were amended in 1891 to read "presumed prima facie", the courts, after some initial uncertainty, held that the defence of pressure was gone absolutely but that, as to intent, the presumption was rebuttable. The onus of rebutting the presumption by establishing no fraudulent intent is on those supporting the transaction.[45] The plaintiff must still prove the insolvency of the debtor as a fact before the plaintiff can rely on the presumption sections.[46]

In western Canada, the sections were drafted more widely with the result that it appears clear that the doctrine of pressure is gone absolutely and the presumption of fraudulent intent is irrebuttable.[47] One assumes that, as in Ontario, insolvency must still be proven as a fact.

(g) Excluded Transactions

Most Canadian fraudulent preference statutes contain lists of transactions which are excluded from the operation of the legislation. The reader is referred to the specialist books and essays on reviewable transactions for further assistance. The conveyance of property which is not exigible or attachable at the instance of judgment creditors also cannot be attacked under fraudulent preference or conveyance legislation.[48]

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44 See cases cited in *Lawson v. McGeoch* (1893), 20 O.A.R. 464.

45 *Lawson v. McGeoch, supra*, note 44; *Webster v. Crickmore* (1898), 25 O.A.R. 97; *Dana v. McLean* (1901), 2 O.L.R. 466 (C.A.); *Keenan v. Richardson* (1902), 1 O.W.R. 333 (C.A.); *Brown v. Beamish* (1905), 5 O.W.R. 722; *Crawford v. Magee* (1905), 6 O.W.R. 44; *Craig v. McKay* (1906), 12 O.L.R. 121 (C.A.); *Clifton v. Towers* (1917), 39 O.L.R. 292 (C.A.); and *Pellatt v. McLean* (1929), 63 O.L.R. 522. In *Shediac Boot & Shoe Co. v. Buchanan* (1903), 35 N.S.R. 511 (C.A.), it was held that where the words "*prima facie*" are not included in the statute, the presumption is irrebuttable as to intent. The same results may follow today under the New Brunswick and Nova Scotia statues which omit the words "*prima facie*". *Quaere* as to the Prince Edward Island legislation.

46 *Caulfeld, Burns and Gibson Ltd. v. Kitchen*, [1956] O.W.N. 697.

47 *Empire Sash & Door Co. v. Maranda, supra*, note 11, pp. 87-88; *Hazell v. Cullen* (1914), 20 B.C.R. 603; *Smith v. Sugarman* (1909), 2 Alta. L.R. 442, reversed 3 Alta. L.R. 108, which was reversed 47 S.C.R. 392; *Robinson v. McCauley, supra*, note 38; *Trusts & Guarantee Co. v. R.J. Whitlaw Co.* (1914), 6 W.W.R. 42 (Alta. T.D.); *McLean v. Hodge* (1919), 50 D.L.R. 123 (Sask. C.A.); *cf. Codville v. Fraser* (1902), 14 Man. R. 12 (C.A.); *Weidman Bros. v. Simovitch, supra*, note 38.

48 13 C.E.D. (Ont. 3rd) *Fraudulent and Voidable Conveyances*, para. 106; and see Chapter 13, section 2(i).

19

CONFLICTS OF LAW*

1. Introduction

While the other chapters of this text relate to the substantive rules for establishing the obligations between parties and the procedural aspects of enforcing those obligations, this chapter concentrates on two stages of enforcement of an established obligation. The two primary subjects of the chapter are the rules relating to the location of litigation — in which territorial unit or units may the plaintiff commence an action to enforce the plaintiff's rights; and secondly, once those rights have been quantified, how may the plaintiff, as judgment creditor, go about enforcing that judgment? In conflict of laws terms, this chapter deals with two of the primary divisions of topic. It deals with jurisdiction and recognition but will not deal with choice of law provisions, except to the extent that choice of law influences decisions on jurisdiction or enforcement.

(a) Jurisdiction and Enforcement

Why is it necessary to deal with the topics of jurisdiction and enforcement at the same time as the substantive rules? There are three primary explanations:

Right Without Remedy. — It is almost trite to state that a right without an appropriate remedy is useless. This applies equally forcefully to the existence of a judgment which cannot be enforced. The failure to address the potential enforceability of a judgment at the time of choice of forum would be a critical error, especially if it were on the basis of dismissing the enforcing rules as a

*This chapter written by Peter J.M. Lown, Q.C., Director, Alberta Law Reform Institute, Professor of Law, University of Alberta.

TAB 6

CED Fraudulent Conveyances and Preferences IV.9.(a)

Canadian Encyclopedic Digest
Fraudulent Conveyances and Preferences
IV — Preferences Under Provincial Statutes
9 — Transactions Beyond Scope of Statutes
(a) — Property Not Exigible in Execution

For print citation information and the currency of the title, please click here.

IV.9.(a)

See Canadian Abridgment: DCR.XII.1 Debtors and creditors — Fraudulent conveyances — General principles

§246 Where a statute renders certain goods free from seizure under execution under any circumstances, the assignment or transfer to a creditor of goods and chattels by an insolvent debtor under circumstances which would otherwise make the transaction void as against his or her other creditors cannot be complained of as a fraudulent preference if the goods and chattels assigned or transferred could not have been taken in execution had the assignment or transfer not been made. [1] Thus, a chattel mortgage or bill of sale, insofar as it covers exemptions, cannot be set aside as a fraudulent preference even though it would constitute such a preference but for the fact that the mortgaged goods were exemptions. [2]

§247 An assignment by way of security of the profit expected to be made out of a contract to do work does not come within statutory provisions relating to fraudulent and preferential assignments inasmuch as the subject matter of the assignment does not consist of assets able to be reached by the creditors at the time it was made. [3]

Footnotes

1 *Robin Hood v. Maple Leaf* (1916), 26 Man. R. 238 (Man. K.B.).

2 *Ashcroft v. Hopkins* (1909), 2 Alta. L.R. 253 (Alta. T.D.); *Bates v. Cannon* (1908), 8 W.L.R. 575 (Man. K.B.); **see also** *Robin Hood v. Maple Leaf* (1916), 26 Man. R. 238 (Man. K.B.); *Bailey v. Howatt* (1914), 6 W.W.R. 1155 (Sask. K.B.).

3 *Blakely v. Gould* (1897), 27 S.C.R. 682 (S.C.C.); *McKillop & Co. v. Royal Bank* (1917), [1917] 1 W.W.R. 1149 (Alta. S.C. (App. Div.)); reversed on other grounds (1918), 56 S.C.R. 220 (S.C.C.).

End of Document

TAB 7

2007 ONCA 425
Ontario Court of Appeal

FL Receivables Trust 2002-A (Administrator of) v. Cobrand Foods Ltd.

2007 CarswellOnt 3697, 2007 ONCA 425, [2007] O.J. No. 2297,
158 A.C.W.S. (3d) 792, 46 C.P.C. (6th) 23, 85 O.R. (3d) 561

PRUDENTIAL SECURITIES CREDIT CORP., LLC in its capacity as Administrator of FL RECEIVABLES TRUST 2002-A on its own behalf and on the behalf of all creditors of Robert Laba (Plaintiff / Respondent in C43408 and Appellant in C42354) and COBRAND FOODS LTD., ROBERT LABA, BARRY O. TELFORD, CHARLES XAVIER and ANGELA LABA (Defendants / Robert Laba, Appellant in C43408 and Respondent in C42354 and Angela Laba, Respondent)

J. Laskin, S. Borins, K. Feldman JJ.A.

Heard: December 13, 2006
Judgment: June 12, 2007
Docket: CA C43408, C42354

Proceedings: affirming *FL Receivables Trust 2002-A (Administrator of) v. Cobrand Foods Ltd.* (2005), 2005 CarswellOnt 10108 (Ont. S.C.J.)

Counsel: Martin Sclisizzi for Appellant / Respondent, Robert Laba
Brett Harrison for Respondent / Appellant, Prudential Securities Credit Corp., LLC
Myron W. Shulgan, Q.C. for Respondent, Angela Laba

Subject: Contracts; Corporate and Commercial; Torts; Civil Practice and Procedure; Insolvency; Family

Table of Authorities

Cases considered by *J. Laskin J.A.*:

Arland v. Taylor (1955), 1955 CarswellOnt 44, [1955] O.R. 131, [1955] 3 D.L.R. 358 (Ont. C.A.) — referred to

Equity Waste Management of Canada Corp. v. Halton Hills (Town) (1997), 40 M.P.L.R. (2d) 107, 1997 CarswellOnt 3270, 103 O.A.C. 324, 35 O.R. (3d) 321 (Ont. C.A.) — referred to

Felker v. Felker (1946), [1946] O.W.N. 368, 1946 CarswellOnt 172 (Ont. C.A.) — considered

Gottardo Properties (Dome) Inc. v. Toronto (City) (1998), (sub nom. *Gottardo Properties (Dome) Inc. v. Regional Assessment Commissioner, Region No. 9)* 111 O.A.C. 272, 162 D.L.R. (4th) 574, 46 M.P.L.R. (2d) 309, 1998 CarswellOnt 3004 (Ont. C.A.) — referred to

Hall v. Pemberton (1974), 50 D.L.R. (3d) 518, 5 O.R. (2d) 438, 1974 CarswellOnt 873 (Ont. C.A.) — considered

Housen v. Nikolaisen (2002), 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, 286 N.R. 1, [2002] 7 W.W.R. 1, 2002 CarswellSask 178, 2002 CarswellSask 179, 2002 SCC 33, 30 M.P.L.R. (3d) 1, 219 Sask. R. 1, 272 W.A.C. 1, [2002] 2 S.C.R. 235 (S.C.C.) — referred to

Koop v. Smith (1915), 8 W.W.R. 1203, 25 D.L.R. 355, 51 S.C.R. 554, 1915 CarswellBC 151 (S.C.C.) — referred to

L. (H.) v. Canada (Attorney General) (2005), 2005 SCC 25, 2005 CarswellSask 268, 2005 CarswellSask 273, 333 N.R. 1, 8 C.P.C. (6th) 199, 24 Admin. L.R. (4th) 1, 262 Sask. R. 1, 347 W.A.C. 1, [2005] 8 W.W.R. 1, 29 C.C.L.T. (3d) 1, 251 D.L.R. (4th) 604, [2005] 1 S.C.R. 401 (S.C.C.) — referred to

Ontario v. O.P.S.E.U. (1990), 37 O.A.C. 218, 1990 CarswellOnt 711 (Ont. Div. Ct.) — referred to

Optical Recording Laboratories Inc., Re (1990), 2 C.B.R. (3d) 64, 75 D.L.R. (4th) 747, 42 O.A.C. 321, (sub nom. *Optical Recording Laboratories Inc. v. Digital Recording Corp.)* 1 O.R. (3d) 131, 1990 CarswellOnt 143 (Ont. C.A.) — referred to

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Waxman v. Waxman (2004), 2004 CarswellOnt 1715, 44 B.L.R. (3d) 165, 186 O.A.C. 201 (Ont. C.A.) — referred to

Statutes considered:

Courts of Justice Act, R.S.O. 1990, c. C.43
Generally — referred to

s. 134(6) — considered

Fraudulent Conveyances Act, R.S.O. 1990, c. F.29
s. 2 — considered

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
Generally — referred to

Words and phrases considered:

badges of fraud

[Per J. Laskin J.A. (S. Borins and K. Feldman JJ.A. concurring):] The crucial question in any fraudulent conveyance action is whether the plaintiff has proved the fraudulent intent of the debtor. While the legal burden to prove fraudulent intent remains on the plaintiff throughout the trial, the plaintiff can raise an inference of fraud sufficient to put a "burden of explanation" on the defendant debtor. The plaintiff typically raises an inference of fraud by putting forward "badges of fraud." These "badges of fraud" vary from case to case. They are no more than typical and suspicious facts that may allow the court to make a finding of fraud absent an explanation from the debtor. See C.R.B. Dunlop, *Creditor-Debtor Law in Canada*, 2d ed. (Toronto: Thomson Canada, 1995) at 613-15.

non-suit

[Per J. Laskin J.A. (S. Borins and K. Feldman JJ.A. concurring):] The term "non-suit" refers to a motion brought by the defendant at the close of the plaintiff's evidence to dismiss the action on the ground that the plaintiff has failed to make out a case for the defendant to answer. Neither the *Courts of Justice Act*, R.S.O. 1990, c. C.43, nor the *Rules of Civil Procedure* [R.R.O. 1990, Reg. 194] specifically provides for non-suit motions, but judges continue to have a recognized jurisdiction to entertain these motions.

principle of deference

[Per J. Laskin J.A. (S. Borins and K. Feldman JJ.A. concurring):] The principle of deference means that an appellate court may substitute its own view of the evidence and draw its own inferences only if the trial judge committed a palpable and overriding error or made findings of fact or drew inferences that are unreasonable or unsupported by the evidence. See *L. (H.) v. Canada (Attorney General)*, [2005] 1 S.C.R. 401 (S.C.C.) at para. 4. However, because the relevant evidence in this case is written, [the plaintiff] submits that this court may make its own findings of fact and draw its own inferences without giving any deference to the trial judge.

That submission has been overtaken by recent decisions of the Supreme Court of Canada and this court. See *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 (S.C.C.), *Schwartz v. R.*, [1996] 1 S.C.R. 254 (S.C.C.), *Equity Waste Management of Canada Corp. v. Halton Hills (Town)* (1997), 35 O.R. (3d) 321 (Ont. C.A.), *Gottardo Properties (Dome) Inc. v. Toronto (City)* (1998), 162 D.L.R. (4th) 574 (Ont. C.A.), and *Waxman v. Waxman* (2004), 44 B.L.R. (3d) 165 (Ont. C.A.). The principle of appellate deference to a trial judge's fact-finding and inference-drawing applies even when the entire trial record is in writing. That is so because the principle of deference is grounded in more than a trial judge's ability to see and hear the witnesses. Deference recognizes that even on a written record, the trial judge "lives through" the trial while a court of appeal reviews the record only through the lens of appellate review. Deference also preserves the integrity of the trial process, maintains the confidence of litigants in that process, reduces the number and length of appeals and therefore, the cost of litigation, and appropriately presumes that trial judges are just as competent as appellate judges to resolve disputes justly.

APPEALS from judgment reported at *FL Receivables Trust 2002-A (Administrator of) v. Cobrand Foods Ltd.* (2005), 2005 CarswellOnt 10108 (Ont. S.C.J.), dismissing one defendant's motion for non-suit, granting another defendant's motion for non-suit, granting plaintiff judgment against one defendant, and dismissing plaintiff's action against another defendant.

***J. Laskin J.A.*:**

A. Overview

1 The plaintiff, Prudential Securities Credit Corp., LLC, claimed against Robert Laba on a guarantee, and against Robert Laba and his wife, Angela Laba, on the ground that Robert's transfer of his interest in two properties to Angela were fraudulent conveyances and thus void under s. 2 of the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29. The action was tried by a judge alone.

2 At the end of Prudential's case, both Robert Laba and Angela Laba brought motions for a non-suit and elected to call no evidence. The trial judge dismissed Robert Laba's motion and granted Angela Laba's motion, with reasons to follow. Later, and without hearing further submissions, he delivered reasons granting Prudential judgment against Robert Laba on his guarantee in the amount of its claim (US $639,348.32 and Can $600.00, together with prejudgment interest of US $139,189.45), and dismissing Prudential's claim against Angela Laba.

3 Both Robert Laba and Prudential have appealed. On his appeal, Robert Laba makes a single submission: the trial judge failed to give him an opportunity to make closing argument. Robert Laba submits that this failure amounted to a miscarriage of justice and must be remedied by a new trial.

4 On its appeal, Prudential submits that in dismissing its action against Angela Laba, the trial judge made three errors. First, he applied the wrong legal test on a non-suit motion. Second, he applied the wrong test for establishing a fraudulent conveyance. And third, he failed to properly assess the evidence in support of Prudential's claim.

B. Background Facts

5 In 1996, Robert Laba became the chief financial officer and a 50 per cent shareholder in T.B. Extreme Foods Limited. Over the next three years, T.B. Extreme acquired twenty-six Taco Bell franchises. In 1999, the defendant, Cobrand Foods Ltd. was incorporated to acquire additional Taco Bell franchises. Robert Laba became the chief financial officer and a director of Cobrand. He was sued on a written guarantee that he gave in connection with a loan from Captec Financial Group Inc. to Cobrand. Prudential is Captec's assignee.

6 Captec was in the business of making loans to franchised restaurant operators for the purchase of restaurant equipment. In November 1999, Captec agreed to finance Cobrand's purchase of equipment for a Taco Bell / Pizza Hut restaurant in Toronto. In April 2000, Captec advanced the loan in the amount of US $523,680.00, and Cobrand gave Captec a promissory note and security over the equipment. Robert Laba guaranteed payment of Cobrand's debts and liabilities in respect of the Captec loan.

7 In March 2001, Cobrand defaulted on the loan. In February 2002, Prudential began this action. It obtained a default judgment against Cobrand, and proceeded to trial against Robert and Angela Laba.

C. Analysis

I. Robert Laba's Appeal

1) Did the trial judge's failure to give Robert Laba an opportunity to make closing argument amount to a miscarriage of justice?

8 The non-suit motions were argued over two and a half days in late July 2004. The trial judge reserved his decision on the motions. Before adjourning court, however, he advised counsel that if the non-suit motions were unsuccessful they should be ready to re-attend for closing argument. On July 30, 2004, the trial judge issued a brief endorsement. He dismissed Robert Laba's non-suit motion and granted Angela Laba's motion, and said, "Written reasons with respect to both motions will follow."

9 The trial judge apparently forgot about reconvening for final argument. Instead, on March 29, 2005, he delivered written reasons in which he not only explained his decision on the non-suit motions, but also went farther, granting judgment against Robert Laba and dismissing the action against Angela Laba.

10 In finding Robert Laba liable on his guarantee, the trial judge said at para. 35 of his reasons:

> [35] For the foregoing reasons, I am satisfied that the plaintiff has raised a *prima facie* case. Accordingly, the motion for non-suit must be dismissed. In fact, as set out above, I am satisfied that the plaintiff has established well beyond a balance of probabilities that Robert Laba is liable on the Guarantee.

11 Robert Laba submits that the right to make closing argument is a substantive right, essential to a fair trial. As he was deprived of this right, albeit inadvertently, he was denied the opportunity to fully present his case. He points out that though he presented argument on the non-suit motion, a plaintiff's burden to defeat a non-suit differs from and is less onerous than its burden to obtain judgment on its claim. Thus, Robert Laba contends that the result of being denied the right to make closing argument amounts to a miscarriage of justice, which can be remedied only by an order for a new trial.

12 Before addressing Robert Laba's submission, I want to say a few words about non-suit motions in civil non-jury trials. The term "non-suit" refers to a motion brought by the defendant at the close of the plaintiff's evidence to dismiss the action on the ground that the plaintiff has failed to make out a case for the defendant to answer. Neither the *Courts of Justice Act*, R.S.O. 1990, c. C.43, nor the *Rules of Civil Procedure* specifically provides for non-suit motions, but judges continue to have a recognized jurisdiction to entertain these motions.

13 Still, I question whether in this province a non-suit motion in a civil non-jury trial has much value. In Ontario, when a defendant moves for a non-suit, the defendant must elect whether to call evidence. See *Ontario v. O.P.S.E.U.* (1990), 37 O.A.C. 218 (Ont. Div. Ct.) at para. 40. If the defendant elects to call evidence, the judge reserves on the motion until the end of the case. If the defendant elects to call no evidence — as Robert Laba elected in this case — then the judge rules on the motion immediately after it has been made.

14 A non-suit motion adds to the time and expense of a trial. And because of the election requirement, it has little practical value. Perhaps a defendant bringing the motion sees a tactical advantage in being able to argue first. To succeed on the motion, however, the defendant must show that the plaintiff has put forward no case to answer, in most lawsuits an onerous task. Why not simply take on the less onerous task of showing that the plaintiff's claim should fail? It is small wonder that most commentators consider that in civil judge alone trials, non-suit motions gain little and are becoming obsolete. See *Phipson on Evidence*, 16th ed. (London: Sweet & Maxwell, 2005) at 274, and John Sopinka, Donald B. Houston & Melanie Sopinka, *The Trial of an Action*, 2d ed. (Toronto: Butterworths Canada, 1999) at 151-52.

15 In this case, I agree with Robert Laba on three points. First, as my discussion above signals, Prudential's burden on the non-suit motion differed from and was less onerous than its burden to obtain judgment on its claim. To defeat the non-suit motion, Prudential had to satisfy the trial judge that it had put forward a *prima facie* case — that it had put forward evidence, which, if believed, would allow the trial judge to decide in its favour. To obtain judgment, Prudential, of course, had to establish its claim on a balance of probabilities.

16 Second, I agree with Robert Laba that the opportunity to make closing argument is a substantive right. And third, I agree that though he did so inadvertently and not deliberately, the trial judge erred in depriving Robert Laba of that opportunity. Because of this error, Robert Laba asks for a new trial.

17 Not every error by a trial judge entitles an aggrieved party to a new trial. Section 134(6) of the *Courts of Justice Act* stipulates that this court should order a new trial only where "some substantial wrong or miscarriage of justice has occurred." This stringent standard reflects the underlying policy that new trials ordinarily are contrary to the public interest. New trials cause increased costs or wasted costs as well as delay in resolving disputes, and are therefore to be avoided unless plainly required by the interests of justice. See *Arland v. Taylor*, [1955] O.R. 131 (Ont. C.A.).

18 Thus, the narrow question on this appeal is whether the trial judge's failure to give Robert Laba an opportunity to make a closing argument caused a miscarriage of justice. I would answer that question, no.

19 There are decisions of this court standing for the proposition that a litigant has a substantive right to present closing argument, and where that right is denied, we should order a new trial. The main case, followed many times, is *Felker v. Felker*, [1946] O.W.N. 368 (Ont. C.A.). In that case, this court held that the defendant was deprived of her substantive right to have her case fully presented because the trial judge gave judgment without giving her an opportunity to present argument. The court ordered a new trial.

20 In the appeal before us, I come to a different conclusion. In doing so, I do not intend in any way to depart from *Felker* and its progeny. But, as is invariably the case, context matters. Here, the context includes three important considerations.

21 First, Robert Laba cannot say that he had no opportunity to present argument after all the evidence was in. To the contrary, he fully argued over the course of two and a half days all the defences to the guarantee available to him. Although he did so on his non-suit motion instead of in final argument, he nonetheless had an opportunity to fully present his side of the case. It seems

to me that is all *Felker* requires. Indeed, the trial judge's reasons show that even on the non-suit motion, Robert Laba argued Prudential had not established its claim against him on a balance of probabilities. At para. 25 of his reasons, the trial judge set out Robert Laba's principal argument: "The principal argument of the defendant is that the plaintiff has failed to prove, on a balance of probabilities, that the Guarantee relates to the Loan."

22 Second, and critically important, Robert Laba has not shown that if he had been given an opportunity to make closing argument, the result would have been different. On appeal, his trial counsel filed an affidavit stating that he expected to have the opportunity to make closing submissions. But, his affidavit is silent on any new arguments that he might have presented.

23 In his factum on appeal, Robert Laba raised but one defence: his guarantee was meant to be an "interim measure", to end once the landlord of the restaurant premises agreed — as it eventually did — to subordinate its interest in Cobrand's equipment to that of Captec. This defence was not even pressed at trial, and was quickly and correctly disposed of by the trial judge at para. 13 of his reasons:

> [13] While Robert Laba has pleaded that he understood the Guarantee to be effective only until the landlord waiver issue was finalized to the satisfaction of Captec, this was not seriously argued at trial and there is no evidence to support this position.

24 Third, when the trial judge released his reasons granting judgment, Robert Laba did not write to him or go back to him to complain that he had been prejudiced in any way by being deprived of the opportunity to make closing argument.

25 In the light of these considerations, I am not persuaded that a miscarriage of justice has occurred. Had Robert Laba been given the opportunity to present a closing argument, I am not satisfied that the result would have been different. I would dismiss his appeal.

II. Prudential's Appeal

1) Did the trial judge apply the wrong test on Angela Laba's non-suit motion?

26 In October 2000, Robert Laba transferred his interest in two properties to his wife, Angela. In its action, Prudential alleged that the transfers were void because they were made with intent to defeat its claim as creditor, contrary to s. 2 of the *Fraudulent Conveyances Act*. Section 2 states:

> Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.

27 At the end of Prudential's case, Angela Laba moved for a non-suit, which the trial judge granted. Prudential submits that by doing so the trial judge applied the wrong test. The factual background of this submission is briefly as follows.

28 As I have said, Robert Laba was a 50 per cent shareholder in T.B. Extreme. T.B. Extreme's lender was the Royal Bank of Canada ("RBC"). In May 1998, Robert Laba gave RBC a personal guarantee of T.B. Extreme's indebtedness limited to $1 million. By 1999, T.B. Extreme was in financial difficulty. In April 2000, Robert Laba gave Captec his personal guarantee of Cobrand's indebtedness.

29 At the time he gave these two guarantees, Robert Laba had an interest in two properties. He held a 50 per cent interest in the matrimonial home at 4 Lyon Court in Leamington, Ontario. Angela Laba held the other 50 per cent. He also held a 50 per cent interest in the property at 39 Erie Street South in Leamington. His father held the other 50 per cent.

30 In the summer of 2000, because of T.B. Extreme's financial difficulties, RBC asked for additional security and threatened to put in a monitor. In July 2000, the Labas entered into a transfer agreement in which Angela consented to a $500,000 mortgage in favour of RBC on a property at 10 Hillview Crescent in Leamington owned by her numbered company, 1220812 Ontario Inc. ("122"). In return, Robert Laba agreed to transfer his interest in 4 Lyon Court and 39 Erie Street South to Angela. Robert

transferred his interest in the properties in October 2000. The trial judge found that when Robert Laba gave his guarantee to Captec, his interest in the two properties was worth approximately $562,000.

31 In February 2001, T.B. Extreme was assigned into bankruptcy. RBC claimed against Robert Laba on his guarantee and against 122 to enforce the mortgage. 122 defended the action, contending that the mortgage was invalid.

32 In resisting Angela's non-suit motion, Prudential put forward what it claimed were numerous "badges of fraud" associated with the transfers. The trial judge itemized these badges at para. 61 of his reasons:

> [61] The plaintiff says Robert Laba conveyed the property "with intent to defeat, hinder, delay or defraud his creditors and others". It says the following "badges of fraud" raise an evidentiary burden on Robert Laba which he has not discharged:
>
> 1. the conveyance represented substantially all of his remaining assets at the time;
>
> 2. Robert Laba continued in possession and used the Properties after the transfers;
>
> 3. the transfers were made at a time when RBC was putting in place a monitor over TB Extreme whose debts Robert Laba had guaranteed;
>
> 4. the deeds refer to nominal consideration which the plaintiff says is untrue if the true consideration was the granting of a mortgage by 122 if called upon in the future;
>
> 5. unusual haste to make the transfers in October, 2000;
>
> 6. retention by Robert Laba of some benefits in 4 Lyon, reflected in his receipt of funds from a later mortgage on 4 Lyon in 2002;
>
> 7. the close relationship between the parties as husband and wife; and
>
> 8. an alleged lack of good consideration.

33 The trial judge nonetheless granted Angela Laba's motion. He concluded, at para. 71, that the "badges of fraud do not, on a balance of probabilities, evidence fraud when considered against the background of the purpose of the Transfer Agreement." According to the trial judge, at para. 69, "it is at least as likely that the Transfer Agreement and the transfers of the Properties were entered into by Robert Laba with a view to having 122 grant the RBC Mortgage in favour of RBC, one of his two creditors, rather than with an intent to defeat, hinder, delay or defraud his creditors."

34 Prudential submits that the trial judge applied the wrong test on the non-suit motion. It argues that the trial judge should not have weighed the competing inferences available from the evidence to determine whether fraud had been established on a balance of probabilities. Instead, he should simply have determined whether Prudential's evidence, assuming it was believed, made out a *prima facie* case, a case for Angela Laba to answer. I agree with this submission.

35 On a non-suit motion, the trial judge undertakes a limited inquiry. Two relevant principles that guide this inquiry are these. First, if a plaintiff puts forward some evidence on all elements of its claim, the judge must dismiss the motion. Second, in assessing whether a plaintiff has made out a *prima facie* case, the judge must assume the evidence to be true and must assign "the most favourable meaning" to evidence capable of giving rise to competing inferences. This court discussed this latter principle in *Hall v. Pemberton* (1974), 5 O.R. (2d) 438 (Ont. C.A.) at 438 -9, quoting *Parfitt v. Lawless* (1872), 41 L.J. P. & M. 68 (Eng. P.D.A.) at 71 -72:

> I conceive, therefore, that in judging whether there is in any case evidence for a jury the Judge must weigh the evidence given, must assign what he conceives to be the most favourable meaning which can reasonably be attributed to any ambiguous statements, and determine on the whole what tendency the evidence has to establish the issue.
>
> .....

> From every fact that is proved, legitimate and reasonable inferences may of course be drawn, and all that is fairly deducible from the evidence is as much proved, for the purpose of a *prima facie* case, as if it had been proved directly. I conceive, therefore, that in discussing whether there is in any case evidence to go to the jury, what the Court has to consider is this, whether, assuming the evidence to be true, and adding to the direct proof all such inferences of fact as in the exercise of a reasonable intelligence the jury would be warranted in drawing from it, there is sufficient to support the issue.

36 In other words, on a non-suit motion the trial judge should not determine whether the competing inferences available to the defendant on the evidence rebut the plaintiff's *prima facie* case. The trial judge should make that determination at the end of the trial, not on the non-suit motion. See John Sopinka, Sidney N. Lederman & Alan W. Bryant, *The Law of Evidence in Canada*, 2d ed. (Toronto: Butterworths Canada, 1999) at 139.

37 In granting Angela Laba's motion, the trial judge went beyond his limited mandate and failed to apply either of the two principles set out above. Ordinarily, where an appellate court reverses a decision to grant a non-suit in a judge alone trial, a new trial is ordered. Prudential, however, does not want a new trial. Instead, it wants this court to decide whether the trial judge erred in concluding that it had not established that the transfers were fraudulent conveyances. Furthermore, although Prudential does request, in the alternative, that the case be sent back for a new trial, in my view, that remedy is not warranted as the trial judge's reasons provide a sufficient basis for this court to determine the merits of Prudential's action.

2) Did the trial judge apply the wrong test for establishing a fraudulent conveyance claim?

38 Prudential submits that by putting the onus on it to establish fraud on a balance of probabilities, the trial judge applied the wrong test. Prudential argues that the trial judge should have engaged in a two-step analysis. First, he should have concluded that the "badges of fraud", on which Prudential relied, gave rise to an inference of fraud and that that inference then put a "burden of explanation" on Angela Laba to show that her husband did not act with an intent to defeat his creditors. See *Rinaldo v. Rosenfeld*, [2001] O.J. No. 4189 (Ont. C.A.). Second, as neither Robert nor Angela Laba put forward any evidence to meet their burden, the trial judge should have found that Prudential was entitled to a judgment against Angela Laba and declared the transfers void. I do not accept Prudential's submission.

39 The crucial question in any fraudulent conveyance action is whether the plaintiff has proved the fraudulent intent of the debtor. While the legal burden to prove fraudulent intent remains on the plaintiff throughout the trial, the plaintiff can raise an inference of fraud sufficient to put a "burden of explanation" on the defendant debtor. The plaintiff typically raises an inference of fraud by putting forward "badges of fraud." These "badges of fraud" vary from case to case. They are no more than typical and suspicious facts that may allow the court to make a finding of fraud absent an explanation from the debtor. See C.R.B. Dunlop, *Creditor-Debtor Law in Canada*, 2d ed. (Toronto: Thomson Canada, 1995) at 613-15.

40 The court, however, is not compelled to draw this inference of fraudulent intent from badges of fraud pleaded by the plaintiff. See *Koop v. Smith* (1915), 51 S.C.R. 554 (S.C.C.) at 558 -59. The court may dismiss a fraudulent conveyance action because it has decided that the surrounding circumstances taken as a whole explain away the plaintiff's evidence. It seems to me that is what the trial judge did in this case.

41 It is clear from his reasons that the trial judge was well aware that it was within his discretion to draw an inference of fraudulent intent from Prudential's alleged badges of fraud. Unfortunately, the trial judge's reasons are not entirely clear on whether he drew this inference. One or two paragraphs in his judgment suggest that he did. On balance, however, on my reading of his reasons, it appears that the trial judge decided not to draw an inference of fraudulent intent and thus not to place the "burden of explanation" on Angela Laba. Instead, he decided Prudential's claim on the basis it had the burden of proof to establish a fraudulent conveyance on a balance of probabilities and did not have the benefit of an inference of fraudulent intent. He looked at all the circumstances surrounding the badges of fraud and drew inferences that explained away Prudential's evidence. He therefore concluded that Prudential had not made out its case.

42 For example, at para. 69 of his reasons, in a passage I have already quoted, he said, "it is at least as likely" that the transfers were made to facilitate the RBC mortgage rather than to defeat his creditors. Implicitly, he concluded Prudential did

not establish a fraudulent intent on a balance of probabilities. Also, at para. 71, he found, "the facts which the plaintiff submits represents badges of fraud do not, on a balance of probabilities, evidence fraud." Again, he determined that Prudential failed to meet its burden. And, more importantly, in several paragraphs, which I discuss below, the trial judge rejected a number of the badges of fraud alleged by Prudential. In my view, these passages demonstrate, as in *Rinaldo*, *supra*, that the trial judge concluded, in the circumstances before him, that Prudential had not met the threshold necessary to put the burden of explanation on Angela Laba. In my view, it was open to him to do so.

43 In the next section of these reasons, I discuss the inferences that the trial judge did draw. On this ground of appeal, it is sufficient to say that the trial judge did not and was entitled not to draw the permissive inference of fraudulent intent. I am therefore not persuaded that he applied the wrong test for establishing a fraudulent conveyance.

3) Did the trial judge fail to properly assess Prudential's evidence?

44 Even accepting that it had the burden throughout to establish that the transfers were fraudulent on a balance of probabilities, Prudential contends that in finding against it the trial judge failed to properly assess the evidence. Central to this contention is Prudential's submission that, as the entire fraudulent conveyance case against Angela Laba was based on a written record, the principle of appellate deference to a trial judge's fact-finding and inference-drawing does not apply.

45 The principle of deference means that an appellate court may substitute its own view of the evidence and draw its own inferences only if the trial judge committed a palpable and overriding error or made findings of fact or drew inferences that are unreasonable or unsupported by the evidence. See *L. (H.) v. Canada (Attorney General)*, [2005] 1 S.C.R. 401 (S.C.C.) at para. 4. However, because the relevant evidence in this case is written, Prudential submits that this court may make its own findings of fact and draw its own inferences without giving any deference to the trial judge.

46 That submission has been overtaken by recent decisions of the Supreme Court of Canada and this court. See *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 (S.C.C.), *Schwartz v. R.*, [1996] 1 S.C.R. 254 (S.C.C.), *Equity Waste Management of Canada Corp. v. Halton Hills (Town)* (1997), 35 O.R. (3d) 321 (Ont. C.A.), *Gottardo Properties (Dome) Inc. v. Toronto (City)* (1998), 162 D.L.R. (4th) 574 (Ont. C.A.), and *Waxman v. Waxman* (2004), 44 B.L.R. (3d) 165 (Ont. C.A.). The principle of appellate deference to a trial judge's fact-finding and inference-drawing applies even when the entire trial record is in writing. That is so because the principle of deference is grounded in more than a trial judge's ability to see and hear the witnesses. Deference recognizes that even on a written record, the trial judge "lives through" the trial while a court of appeal reviews the record only through the lens of appellate review. Deference also preserves the integrity of the trial process, maintains the confidence of litigants in that process, reduces the number and length of appeals and therefore, the cost of litigation, and appropriately presumes that trial judges are just as competent as appellate judges to resolve disputes justly.

47 The principle of deference, therefore, applies to the trial judge's finding that Prudential failed to establish that the transfers were fraudulent. That finding was based on inferences the trial judge drew from the factual record. In drawing those inferences, the trial judge rejected as evidence of fraudulent intent a number of the badges of fraud put forward by Prudential.

48 For example, at para. 66 of his reasons, the trial judge refused to infer that Robert Laba selected 10 Hillview Crescent to defeat his creditors. Instead, he inferred that RBC selected the security on 10 Hillview Crescent for reasons that do not impeach the transfers. At para. 73, the trial judge also drew the inference that Angela Laba would not have consented to the RBC mortgage if she had not received consideration roughly equal in value to the equity in 10 Hillview Crescent.

49 And, faced with a choice of whether the transfers showed an intent to defeat creditors or an attempt to meet the demands of T.B. Extreme's lender, at para. 69, the trial judge drew the inference that the latter was at least as likely as the former. Prudential contends that favouring one creditor over another amounted to a fraudulent conveyance under s. 2 of the *Fraudulent Conveyances Act*. Although this court has held that this statute may apply to conveyances made for the benefit of other creditors, the trial judge correctly concluded that s. 2 requires a fraudulent intent on the part of the debtor regardless of whether one creditor is "favoured" over another. See *Optical Recording Laboratories Inc., Re* (1990), 1 O.R. (3d) 131 (Ont. C.A.) at 139. He refused to find that intent in this case.

50 Finally, at para. 72, the trial judge refused to draw an inference of fraud either from the mere fact that Robert and Angela Laba were husband and wife or from the fact that she later permitted him to take some of the mortgage proceeds on the matrimonial home at 4 Lyon Court for his personal use.

51 Thus, the only question on this branch of the appeal is whether the inferences drawn by the trial judge on which he based his ultimate finding are supported by the evidence or, I might add, by the absence of evidence put forward by Prudential. See *L. (H.)*, *supra*, at para. 74. In my view, they are.

52 When the transfers took place, neither Robert Laba nor Cobrand was insolvent. Neither was in breach of any obligation to Captec. The transfers themselves gave RBC access to about the same amount of security as it would have had access to if Robert Laba had not conveyed the two properties to his wife. Prudential led no evidence to show or suggest that Angela Laba would have consented to the mortgage on 10 Hillview Crescent even if she had received nothing in return. And, Prudential led no evidence to show that Robert and Angela Laba chose 10 Hillview Crescent with a view to defeating his creditors.

53 The trial judge found that the badges of fraud put forward by Prudential did not establish a fraudulent intent on a balance of probabilities. In the light of the record before him, I do not think that the trial judge committed a palpable and overriding error in so finding. I would dismiss Prudential's appeal.

D. Conclusion

54 I would dismiss both Robert Laba's appeal and Prudential's appeal. Although the trial judge erred by not giving Robert Laba an opportunity to make a closing argument, in the context of this case, I do not think that this error caused a miscarriage of justice.

55 The trial judge also erred by going beyond his limited mandate on Angela Laba's non-suit motion. However, in dismissing the action against her, he applied the correct legal test and drew inferences that are reasonably supported by the record.

56 Prudential is entitled to the costs of Robert Laba's appeal, which I would fix in the amount of $6,000, inclusive of disbursements and GST. Angela Laba is entitled to the costs of Prudential's appeal. I would also fix those costs in the amount of $6,000, inclusive of disbursements and GST, but I would then deduct $1,000 for Angela Laba's abandoned cross-appeal on costs. Angela Laba is therefore entitled to $5,000 in costs.

***S. Borins J.A.*:**

I agree.

***K. Feldman J.A.*:**

I agree.

Appeals dismissed.

End of Document

TAB 8

1988 CarswellOnt 121
Ontario Supreme Court, High Court of Justice

Sparling v. Southam Inc.

1988 CarswellOnt 121, [1988] O.J. No. 1745, 12 A.C.W.S. (3d) 205, 41 B.L.R. 22, 66 O.R. (2d) 225

SPARLING (Director Appointed Under Section 253 of the Canada Business Corporations Act) v. SOUTHAM INC. et al.; KERRIGAN et al. (intervenors)

Callaghan A.C.J.H.C.

Judgment: October 27, 1988
Docket: Doc. No. Toronto 23031/87

Counsel: *D.R. O'Connor*, Q.C. and *C.D. Bredt*, for plaintiff.
J.F. Howard, Q.C. and *N. Finkelstein*, for defendant Southam Inc.
D.J.M. Brown, Q.C. and *Ms. J. O'Donnell*, for defendant Torstar Corp.
H.L. Morphy, Q.C. and *S. Block*, for defendant directors G.L. Crawford et al.
K.C. Cancellara, for intervenors P. Kerrigan et al.
P. Anisman, for the objectors.
R.N. Robertson, Q.C., for the objector Imperial Life Assurance Company of Canada.

Subject: Corporate and Commercial

Table of Authorities

Cases considered:

Greenspan v. Bogan, 492 F. 2d 375 — *considered*

Howard Smith Ltd. v. Ampol Petroleum Ltd., [1974] A.C. 821, [1974] 1 All E.R. 1126 (P.C.) — *referred to*

Young v. Katz, 447 F. 2d 431 (Fed. Third Cir. Ct.) — *considered*

Statutes considered:

Canada Business Corporations Act, S.C. 1974-75-76, c. 33 —

s. 234 [now R.S.C. 1985, c. C-44, s. 241]

s. 235(2) [now R.S.C. 1985, c. C-44, s. 242]

s. 253 [now R.S.C. 1985, c. C-44, s. 260]

MOTION to approve settlement under s. 235(2) of Canada Business Corporations Act.

***Callaghan A.C.J.H.C.* (orally):**

1 This is a motion brought by the plaintiff, Frederick H. Sparling, the director appointed under s. 253 of the *Canada Business Corporation Act*, S.C. 1974-75-76, c. 33, (the "Act"), for an order pursuant to s. 235(2) of the Act, approving the settlement of this action.

2 This action was brought by the plaintiff pursuant to s. 234 of the Act, for a declaration that the actions of the defendants in entering into a share exchange agreement, a Southam family agreement and a Southam shareholders' agreement without seeking the approval of the Southam shareholders were oppressive or unfairly prejudicial to or unfairly disregarded the interests of the Southam shareholders.

3 The plaintiff's action was based upon a series of transactions that took place in 1985 which the individual directors believed to be a good business deal for Southam Inc. and which were taken to prevent a "predatory" takeover they were advised was likely imminent.

4 These transactions included:

(i) A Share Exchange Agreement between Southam Inc. and Torstar Corporation ('Torstar') implemented on August 26th, 1985;

(ii) A Voting Trust Agreement among members of the Southam Family Group put in place later in 1985; and

(iii) Certain related arrangements among the two corporations and the Southam Family Group including: a Torstar commitment to support the Southam slate of nominees for election to the Southam Board, and a 'Standstill' Agreement prohibiting Torstar from acquiring additional Southam shares. These arrangements, like the Southam Family Agreement, would expire (unless extended by agreement) on August 26th, 1995.

As an exception to the standstill agreement, Torstar was permitted to acquire (and did acquire) an additional 5 per cent of the outstanding shares of Southam Inc. on the market, but Torstar agreed, however, that if the voting trust among members of the Southam Family Group was put in place, then the Southam Family Group would be entitled to purchase one-half of the shares that Torstar acquired on the market from Torstar at Torstar's cost of acquisition plus carrying costs. After the Southam family agreement was put in place, the Southam Family Group did purchase 2 1/2 per cent of the shares of Southam Inc. from Torstar.

5 The plaintiff requested a number of remedies including, inter alia, the following:

(i) a shareholders' meeting to consider ratification of the Share Exchange Agreement, and in the event that the shareholders chose not to ratify the Agreement, an order that the share exchange transaction be unwound; alternatively, the plaintiff asked that the defendant directors of Southam Inc. who approved the share exchange be required to make a payment to shareholders of Southam Inc. on the basis that the shareholders suffered a loss of value in their shares because of the share exchange and related transactions;

(ii) that Torstar be prohibited from accepting instructions to vote for the Southam slate of Southam Inc. directors;

(iii) that the defendant directors who approved the Share Exchange Agreement be required to account to Southam Inc. for the value of the option given by Torstar to the Southam Family Group with respect to one-half of the 5 percent interest in Southam Inc. acquired by Torstar in the market as permitted under the Standstill Agreement.

6 Seven persons on behalf of the defence and two on behalf of the plaintiff were examined in the course of pre-trial proceedings, and the trial was scheduled to begin on Tuesday, September 20, 1988. From the affidavit of the plaintiff filed, it appears that the plaintiff recognized the expense and the attendant uncertainties in the financial markets that would result from a trial and potential appeals, and that any remedy, given Court processes and potential appeals, might not be achieved for some years. Accordingly, the plaintiff entered into a settlement with the defendants, which settlement is subject to Court approval. The defendants throughout the pre-trial proceedings and presently take the position that they have a good defence to all the

plaintiff's claims and that the share exchange agreement was entered into in good faith and on reasonable grounds and was in the best interest of the corporation and all of its shareholders.

7 The terms of the proposed settlement can be summarized as follows:

(i) subject to any ongoing arrangement that may be approved at a Southam Inc. shareholders meeting, at which meeting Torstar would not vote its shares of Southam and parties to the Southam Family Agreement would not vote in accordance with the procedure in that Agreement, the Share Exchange Agreement, the Southam Family Agreement and the Southam Shareholders Agreement will terminate on June 30, 1990 (rather than August 26, 1995 being the date when they would otherwise terminate unless extended);

(ii) the obligation of Torstar to vote its shares of Southam Inc. in favour of the candidates for election to the Southam Board of Directors designated by the Board of Directors will terminate immediately;

(iii) certain rights of Torstar to purchase shares of Southam Inc. being sold by parties to the Southam Family Agreement and not purchased by other parties to that Agreement will be modified, effective immediately;

(iv) parties to the Southam Family Agreement will pay $1,250,000.00 to Southam Inc. within 60 days, without claiming any consideration or compensation therefor; and

(v) Southam Inc. and Torstar will pay $125,000.00 to defray the plaintiff's costs.

8 Further, it is agreed that the order approving the settlement, if issued, will state that it does not derogate from the rights of other potential claimants under s. 234 of the Act, or otherwise, with respect to the matters complained of in the statement of claim other than the corporate re-organization (rectification) and share option remedies. Further, as to any potential claimant who does not attend at the hearing to consider the settlement, there will be no derogation even with respect to the corporate re-organization (rectification) and share option remedies, if that claimant did not receive notice or if the notice was inadequate.

9 The plaintiff, the director appointed under the Act, believes the settlement to be fair and reasonable.

10 The objectors on this application are appearing pursuant to notices of intention to appear and are five existing shareholders of the defendant Southam Inc., four of whom held shares on August 26, 1985 and acquired further shares thereafter, and one of whom only acquired shares after that date.

11 The objectors, apart from the objector Imperial, ask the Court to withhold approval of the proposed settlement. The main thrust of their submission, as I understand it, is that the plaintiff had a reasonable likelihood of success on the merits of this action in relation to the share exchange agreement. The objectors claim that the allegations in the plaintiff's statement of claim are supported by the examination for discovery of the defendants and that the share exchange agreement at trial would be set aside as not adequately protecting the interests of the Southam Inc. public shareholders.

12 I think I should note that at the outset of this motion I declined the invitation of counsel on behalf of the objectors to review the voluminous discoveries with him. I was satisfied that the concession of the objectors that the directors were acting bona fide and believed that the share exchange agreement in issue made good business sense rendered such a review unnecessary.

13 The concession, in my view, made it clear that the issue as to "primary purpose", would have been a live issue between the parties on the trial of this matter.

14 The objectors further claim that the proposed settlement would deprive the Southam Inc. shareholders of personal rights of action, in that it precludes them from attacking the re-organization attendant upon the share exchange, and furthermore, it precludes any action with respect to the share option remedy which had been sought by the director in the main action.

15 There were subsidiary and collateral objections made with reference to the funds payable to the company by the defendants and in particular with reference to the benefits accruing to the shareholders from those funds as a result of proportional shareholdings. I note these objections and weigh them in the result.

16 Section 235(2) provides as follows:

> An application made or an action brought or intervened in under this Part shall not be stayed, discontinued, settled or dismissed for want of prosecution without the approval of the court given upon such terms as the court thinks fit and, if the court determines that the interests of any complainant may be substantially affected by such stay, discontinuance, settlement or dismissal, the court may order any party to the application or action to give notice to the complainant.

17 In approaching this matter, I believe it should be observed at the outset that the Courts consistently favour the settlement of lawsuits in general. To put it another way, there is an overriding public interest in favour of settlement. This policy promotes the interests of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial Court system.

18 In deciding whether or not to approve a proposed settlement under s. 235(2) of the Act, the Court must be satisfied that the proposal is fair and reasonable to all shareholders. In considering these matters, the Court must recognize that settlements are by their very nature compromises, which need not and usually do not satisfy every single concern of all parties affected. Acceptable settlements may fall within a broad range of upper and lower limits.

19 In cases such as this, it is not the Court's function to substitute its judgment for that of the parties who negotiate the settlement. Nor is it the Court's function to litigate the merits of the action. I would also state that it is not the function of the Court to simply rubber-stamp the proposal.

20 The Court must consider the nature of the claims that were advanced in the action, the nature of the defences to those claims that were advanced in the pleadings, and the benefits accruing and lost to the parties as a result of the settlement.

21 When the director under the Act proposes a settlement for approval, he is acting as a public officer authorized, as parens patriae under the Act not only to institute actions but also to compromise them. Settlements proposed by the director, in my view, run with a strong initial presumption that they are reasonable and fair.

22 That presumption operates where, as here, the director is acting after extensive pre-trial discovery, on the advice of experienced and competent counsel, in circumstances where his negotiations have been conducted at arm's length, and, indeed, in a manner which all parties agree, including the objectors, was bona fide. In this context, the judicial evaluation of a proposed settlement involves a limited inquiry as to whether the potential rewards of successful litigation, with its attendant risks and costs, are outweighed by the benefits of the proposed settlements.

23 The matter was aptly put in two American cases that were cited to me in the course of argument. In a decision of the Federal Third Circuit Court in *Young v. Katz*, 447 F. 2d 431, it is stated:

> It is not necessary in order to determine whether an agreement of settlement and compromise shall be approved that the court try the case which is before it for settlement. Such procedure would emasculate the very purpose for which settlements are made. The court is only called upon to consider and weigh the nature of the claim, the possible defences, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable.

24 In another case cited by all parties in these proceedings, *Greenspan v. Bogan*, 492 F. 2d 375, at p. 381, it is stated:

> ... any settlement is the result of a compromise — each party surrendering something in order to prevent unprofitable litigation, and the risks and costs inherent in taking litigation to completion. A district court, in reviewing a settlement proposal, need not engage in a trial of the merits, for the purpose of settlement is precisely to avoid such a trial. See United Founders Life Ins. Co. v. Consumer's National Life Ins. Co., 447 F. 2d 647 (7th Cir. 1971); Florida Trailer & Equipment

> Co. v. Deal, 284 F. 2d 567, 571 (5th Cir. 1960). *It is only when one side is so obviously correct in its assertions of law and fact that it would be clearly unreasonable to require it to compromise to the extent of the settlement, that to approve the settlement would be an abuse of discretion.*

(emphasis added)

25 While the litigation itself has only been pending 12 months, without the proposed settlement, the trial and ensuing appeals would unquestionably consume additional years in a case of this magnitude and complexity. The defendants throughout have denied liability and quite properly have raised all possible defences. The expense of preparing the case, not only on the issue of liability but on issues such as the assessment of the value of options, would be substantial and time consuming.

26 By the time the final decision would be rendered, the financial markets would have been placed for a long period of time in a state of uncertainty which would impact adversely on the interests of all shareholders involved. I note that this consideration played a role in the decision of the Securities Commission which was cited to me in argument in relation to earlier proceedings with reference to this matter.

27 The objectors in these proceedings represent at the very best count a small percentage of the shareholders. That indicates that most of the shareholders approve the proposed settlement. I cannot let the matter pass without noting that the legal costs of the objectors in this proceeding, save those of Imperial, are all financed by a single investment group (Record p. 217). That is a matter which I believe goes to the weight to be attributed to the objections.

28 This proposal, as noted, comes forward at a point in the litigation when counsel have had an opportunity to assess their positions in the light of the productions and discoveries made by the plaintiff and the defendants herein. Such counsel are acting, in recommending this proposal, with a firm grasp of the strengths and weaknesses of this case, and it is not for this Court to second-guess that professional judgment.

29 In assessing the fairness and reasonableness of the proposal, the Court should also consider the nature of the risks involved in establishing the liability claimed.

30 In this regard, it is noted that the objectors have conceded that the defendant directors believed that the exchange agreement which is in issue in these proceedings made good business sense for the defendant Southam Inc. (see the factum of the objectors, para. 4(f)). Furthermore, it is apparent that there were no statutory or regulatory rules mandating shareholder approval of that exchange. The success of the plaintiff's claim would rest on a Court finding as a fact that the primary purpose of the share exchange was to prevent a takeover. In light of the foregoing, establishing that primary purpose — or the *scienter*, as it is sometimes referred to — would have been a contentious matter, both as a matter of fact and as a matter of determining the applicable law in these circumstances. The "proper purpose" doctrine relied upon by the objectors, as it appears in *Howard Smith Ltd. v. Ampol Petroleum Ltd.*, [1974] A.C. 821, [1974] 1 All E.R. 1126 (P.C.), to put it simply, is not universally accepted; and I do not believe it has been clearly defined as the only applicable doctrine by the Court of Appeal of this province to govern the fiduciary duties and objectives of directors of a target company resisting unsolicited takeover bids. In my view, there were considerable risks attendant upon the plaintiff's claim. There were issues of some legal and factual significance that were open in this matter, and it would be ludicrous to suggest that the plaintiff in this litigation was so obviously correct in his assertions of law and fact that it was unreasonable for him to compromise.

31 While the settlement in a limited sense affects the right to sue of the existing shareholders, as it removes from prospective litigation the unwinding of the share exchange agreement, it does not affect the right of the shareholders to initiate action for any damages they may have sustained as a result of the impugned transactions. It specifically preserves the rights of potential claimants with respect to the matters complained of in the statement of claim.

32 It has been submitted on behalf of Imperial that this Court should direct a vote of a certain group of the public shareholders on the proposed settlement. This submission, while intriguing, is not one which I believe the Court should accept. Aside from the mechanical problems — which would be substantial — in determining such matters as constituency, content of information circulars, etc., I am not convinced that I should derogate from the responsibility placed on the Court by the Act. In this proceeding

there has been extensive notification to all of the shareholders of Southam Inc. and an opportunity afforded them to be heard. A relatively few have appeared. The Act imposes the responsibility on the Court to consider this matter on the basis of the material put before it. I do not believe that that responsibility should be passed on or adjourned pending such a vote. I note that the Ontario Securities Commission, when this matter was brought before it, concluded, after consideration of a similar request, that such sanction was not appropriate (affidavit of R.W. McDowell, Exhibit B, p. 30). For the reasons stated by the commission, I am of the same view and I decline to make such an order.

33 In conclusion, therefore, I accept the recommendation of the director. I am not satisfied that the presumption of fairness and reasonableness mentioned above has been overcome, and I am satisfied that the settlement effects a substantial modification of the original arrangements herein and avoids the costs and uncertainty of what was bound to be very extensive litigation. Accordingly, the application for approval is granted.

34 The order will include a direction that all documents and discoveries are to be made available to shareholders who execute an appropriate confidentiality agreement indicating that such documents and discoveries are for use only in considering prospective litigation. I leave it to counsel to work out the appropriate terms.

35 I have considered the matters of costs and am of the view that this Court has no mandate to deal with costs incurred by these parties before the Ontario Securities Commission. I have concluded that this is not a proper case for costs in any event.

Application granted.

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TAB 9

2000 CarswellOnt 346
Ontario Superior Court of Justice

Epstein v. First Marathon Inc. / Société First Marathon Inc.

2000 CarswellOnt 346, [2000] O.J. No. 452, [2000] O.T.C. 109, 2 B.L.R. (3d) 30, 41 C.P.C. (4th) 159, 94 A.C.W.S. (3d) 1062

Stephen Epstein, Plaintiff and First Marathon Inc./La Société First Marathon Inc., G.F. Kym Anthony, Stanley M. Beck, Cecilia Benattar, Austin C. Beutel, Lawrence S. Bloomberg, Robert D. Brown, Thomas A. Di Giacomo, Lloyd S.D. Fogler, Richard S. Hallisey, Peter L. Jones, Thomas E. Kierans, James D. Meekison and W. David Wood, Defendants

Cumming J.

Heard: November 4, 1999 and February 14, 2000
Judgment: February 16, 2000
Docket: 99-CV-173518

Counsel: *Kirk M. Baert*, for *David A. Klein*, counsel for the plaintiff.
Deborah Berlach, for the individual defendants.
S. Dale Denis and *Joel Farber*, for defendant First Marathon Inc.

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

Table of Authorities

Cases considered by *Cumming J.*:

Dabbs v. Sun Life Assurance Co. of Canada (February 24, 1998), Doc. Toronto 96-CT-022862 (Ont. Gen. Div.) — considered

First Marathon Inc., Re (July 30, 1999), Doc. 99-CL-003444 (Ont. S.C.J. [Commercial List]) — referred to

Greenspun v. Bogan (1974), 492 F.2d 375 (U.S. 1st Cir.) — considered

Montreal Trust Co. v. Churchill Forest Industries (Man.) Ltd., [1971] 4 W.W.R. 542, 21 D.L.R. (3d) 75 (Man. C.A.) — considered

Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re)* 12 O.R. (3d) 500 (Ont. Gen. Div.) — considered

Parsons v. Canadian Red Cross Society (September 22, 1999), Doc. 98-CV-141369, 98-CV-146405 (Ont. S.C.J.) — referred to

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

Smith v. Canadian Tire Acceptance Ltd. (1994), 19 O.R. (3d) 610, 15 B.L.R. (2d) 286, (sub nom. *Canadian Tire Acceptance Ltd. Card Holders v. Canadian Tire Acceptance Ltd.)* 118 D.L.R. (4th) 238 (Ont. Gen. Div.) — applied

Smith v. Canadian Tire Acceptance Ltd. (1995), 26 O.R. (3d) 95 (Ont. C.A.) — referred to

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Sparling v. Southam Inc. (1988), 41 B.L.R. 22, 66 O.R. (2d) 225 (Ont. H.C.) — considered

Stern v. Imasco Ltd. (November 8, 1999), Doc. 99-CV-175110CP (Ont. S.C.J.) — considered

Statutes considered:

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

s. 182 — pursuant to

s. 182(5)(d) — pursuant to

s. 185 — considered

s. 248 — considered

s. 249(2) — considered

Canada Business Corporations Act, R.S.C. 1985, c. C-44
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Class Proceedings Act, 1992, S.O. 1992, c. 6
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s. 29(1) — considered

s. 29(2) — considered

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s. 32(4) — considered

s. 33 — considered

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
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Private Securities Litigation Reform Act of 1995, 109 Stat. 737
Generally — considered

s. 11 — considered

Securities Litigation Uniform Standards Act of 1998, 112 Stat. 3227
Generally — considered

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 26.02 — pursuant to

MOTION by plaintiff seeking order both approving settlement of this settlement and dismissing it without costs.

Cumming J.:

Reasons for Decision

The Motion

1 Pursuant to section 249(2) of the *Ontario Business Corporations Act*, R.S.O. 1990, c. B. 16, as amended [hereinafter *OBCA*], the plaintiff seeks an order both approving the settlement ("Settlement Agreement") of this action and dismissing it without costs. Alternatively, if the Settlement Agreement is not to be approved, the plaintiff seeks an order approving the dismissal of the action without costs pursuant to s. 249(2) of the *OBCA*, or an order approving the dismissal or discontinuing the action under s. 29(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 [hereinafter *CPA*]. All parties have consented to the motion through the terms of the Settlement Agreement

2 A plaintiff is required to move for the court's approval of any settlement of a class proceeding commenced under the *CPA*. Approval in an Ontario class proceeding is required even when the class proceeding has not yet been certified. Subsections 29(1) and (2) of the *CPA* provide:

> (1) A proceeding commenced under this Act and a proceeding certified as a class proceeding under this Act may be discontinued or abandoned only with the approval of the court, on such terms as the court considers appropriate;
>
> (2) A settlement of a class proceeding is not binding unless approved by the court.

3 David A. Klein, counsel for the proposed representative plaintiff, filed a Statement of Claim on July 22, 1999, to initiate a class proceeding. He filed an Amended Statement of Claim on August 19, 1999. This was nine days *after* the Settlement Agreement entered into on August 10, 1999, which is the subject of the instant motion.

4 The purported Amended Statement of Claim drops all references to the claim being a class proceeding under the *CPA*. Amendments to pleadings may be made without leave before the close of pleadings, if the amendment does not include or necessitate the addition, deletion or substitution of a party to the action. Alternatively, such amendments may be made on consent or with leave of the court: rule 26.02 of the *Rules of Civil Procedure* R.R.O. 1990, Reg. 194, as amended. The pleadings were never closed in this proceeding. The defendants served their Notice of Intent to Defend and Notice of Defence on August 3, 1999, but Statements of Defence were never filed.

5 Why did Mr. Klein file an Amended Statement of Claim purporting to re-constitute the proceeding as an individual claim nine days *after* he had entered into the settlement of the class proceeding claim? Mr. Klein did not speak to counsel for the defendants about filing the Amended Statement of Claim. Mr. Klein did not seek the leave of the court to file the Amended Statement of Claim.

6 I infer that the only conceivable purpose for his filing of this amended pleading was that Mr. Klein sought to avoid court scrutiny of the Settlement Agreement under the regime of the *CPA*.

7 The purported Amended Statement of Claim deletes all the proposed class members from the proceeding. In my view, while the absent proposed class members are not formal parties to the proceeding, given s. 29 of the *CPA*, a class proceeding may not be discontinued by being converted into an individual action, without the leave of the court.

8 A Statement of Claim, once commenced under the *CPA*, may not be converted through a unilateral amendment of the pleading by the proposed representative plaintiff into an individual action on behalf of that plaintiff. The purported Amended Statement of Claim in the instant case does not remove the proceeding from the requirement of court approval under s. 29 of the *CPA*.

Background

9 First Marathon Inc. ("First Marathon"), a publicly traded financial services corporation, and National Bank of Canada ("National Bank") announced a merger agreement on June 17, 1999. There was to be a friendly takeover of First Marathon by National Bank for approximately $712 million. National Bank would purchase all the shares of First Marathon and then merge the acquired corporation with a wholly owned subsidiary, Levesque Beaubien Geoffrion Inc. Shareholders of First Marathon would receive shares or cash at their option.

10 The overall transaction was to be structured as an "arrangement" under s. 182 of the *OBCA*.

11 First Marathon obtained an Interim Order from this Court on July 9, 1999, on an *ex parte* basis, in accordance with the common practice. First Marathon was authorized to initiate the "arrangement" proceedings by calling and holding a special meeting of shareholders to consider passing a special resolution approving the "Plan of Arrangement."

12 At this time, the plaintiff, Stephen Epstein, possessed 400 Class A non-voting common shares of First Marathon. The outstanding capital of the corporation consisted of some 23,706,713 Class A shares and some 2,325,750 Class C voting shares.

13 Mr. Epstein then took two initiatives. He commenced this class proceeding on July 22, 1999, against First Marathon and its directors, the individual defendants. He brought the action on behalf of himself and as a representative of a class containing all persons (excluding the defendants and First Marathon's subsidiaries and affiliates) who owned non-voting Class A or Class C shares on June 17, 1999. (The defined class members, for convenience, will be referred to as the "minority shareholders.")

14 The Statement of Claim in the class proceeding action alleges a breach of fiduciary duties and oppression within the ambit of s. 248 of the *OBCA*, and seeks damages in the amount of $300 million. Mr. Epstein claims that the price offered by National Bank in the proposed takeover of First Marathon was insufficient.

15 Before Mr. Justice R.A. Blair, Mr. Epstein then brought an application in the arrangement proceeding to set aside or vary the Interim Order. Mr. Epstein requested that Mr. Justice Blair, pursuant to s. 182(5)(d) of the *OBCA*, make an order appointing Mr. Klein as counsel to represent the interests of the shareholders. Mr. Epstein also sought to have First Marathon pay Mr. Klein's fees and disbursements. Mr. Epstein alleged that the Management Information Circular had made inadequate disclosure to shareholders.

16 Mr. Justice Blair dismissed the application by Reasons for Decision released July 30, 1999: *First Marathon Inc., Re* (July 30, 1999), Doc. 99-CL-003444 (Ont. S.C.J. [Commercial List]) [hereinafter *First Marathon Inc.*]. He pointed out that if the Information Circular was inadequate, then that would be a factor for the Court to consider at the "fairness hearing," when determining whether the arrangement would be sanctioned.

17 Before Mr. Justice Blair, no shareholders — not even the moving party, Mr. Epstein — adduced any evidence suggesting that the existing disclosure was considered to be inadequate. Indeed, the evidence provided suggested exactly the opposite: affidavits from shareholders representing 46.5% of the Class A and Class C shareholders (after excluding those shares held by insiders) claimed the disclosure was adequate. These minority shareholders stated that they wanted to proceed with the announced shareholders' meeting scheduled for August 10, 1999.

18 Mr. Justice Blair dismissed the application to set aside or vary the Interim Order. He also found that "there is not a single piece of evidence..." (para. 25) supporting Mr. Epstein's application to have Mr. Klein appointed representative counsel. No shareholders apart from Mr. Epstein had raised any concerns about the proposed transaction or requested that Klein Lyons represent them. Mr. Justice Blair dismissed the application for the appointment of representative counsel, ordering that costs totaling $7,500.00 be payable forthwith by Mr. Epstein.

19 It is to be noted also that, pursuant to the Interim Order, the Management Information Circular provides for dissenting shareholder rights in accordance with s. 185 of the *OBCA*. This provision allows a dissenting shareholder to apply to the court to fix the fair value of his/her shares.

20 At the special meeting of the shareholders of First Marathon, held on August 10, 1999, the proposed transaction was approved. With respect to the Class A non-voting shareholders, 99.88% of the total votes cast approved of the proposed arrangement. With respect to the Class C voting shareholders, 99.95% of the total votes cast approved of the proposed arrangement. There were no negative votes cast. The shareholders present at the meeting, whether in person or by proxy, represented approximately 80% of the issued and outstanding Class A non-voting shares and 87% of the issued and outstanding Class C voting shares. Thus, the special resolution approving the Plan of Arrangement was duly passed by the shareholders of First Marathon in accordance with the Interim Order made July 9, 1999.

21 First Marathon had filed an application for court approval of the Plan of Arrangement on June 30, 1999, in anticipation of shareholder approval at the special meeting of shareholders to be held August 10, 1999. On August 11, 1999, Mr. Justice Day made an Order declaring the arrangement to be fair and reasonable, and granting final approval of the Plan of Arrangement.

22 The Settlement Agreement, which the court is here being asked to approve, was entered into just hours after the shareholders' meeting held August 10, 1999.

The Settlement Agreement

23 The Settlement Agreement dated August 10, 1999, provides the following: $190,000.00 will be paid to Klein Lyons on account of fees and disbursements; the action will be dismissed without costs; releases will be executed by Klein Lyons and Mr. Epstein; and the parties will keep the terms of the settlement confidential. Payment of the $190,000 is conditional not only upon Klein Lyons and Mr. Epstein fulfilling their obligations under the Settlement Agreement, but also upon the dismissal of the class proceeding. Clause 3 of the Settlement Agreement provides:

> 3. Neither you [being Mr. Klein] nor any other representatives of Klein Lyons, Millberg Weiss or Mr. Epstein will attend at the hearing of the Application scheduled for August 11, 1999 for the purpose of objecting, dissenting and/or in any way opposing the approval of the Plan of Arrangement, as amended, by Court Order. Notwithstanding, you will be available immediately outside of the court room hearing in the event that the Court deems it advisable that submissions be made by you on Mr. Epstein's behalf regarding your lack of objection and/or dissent and/or opposition. In the event you are asked to speak at the fairness hearing you will advise the Court, and the fact is, that you have now determined it is in the best interest of Stephen Epstein to withdraw his objection. You will advise the Court, and the fact is, that you have determined, after reviewing all of the available evidence, that there were no management conflict of interest issues that FMI failed to disclose, there were no collateral benefits and that in view of that determination and overwhelming shareholder approval, the objection is now being withdrawn.

24 Millberg Weiss is an American law firm specializing in securities' class actions brought on behalf of plaintiffs. The record indicates that Millberg Weiss was providing advice to Mr. Klein in respect of Mr. Epstein's class proceeding.

25 The Settlement Agreement does not provide for any benefit to be conferred on any shareholder of First Marathon, including Mr. Epstein. The Settlement Agreement also does not bind any person except the parties to the agreement. No part of the monies to be paid to Mr. Klein is to come from First Marathon, the National Bank or any of their affiliates. The $190,000.00

to be paid to Klein Lyons is to come from the pockets of certain persons who were principals of First Marathon. It seems that Mr. Epstein was not present during the settlement negotiations. Mr. Klein signed the Settlement Agreement on his behalf.

The Submissions in respect of the Issue of Approval of the Settlement Agreement

26 Mr. Baert, counsel representing Mr. Klein in this motion, submits that the settlement was negotiated at arms' length and entered into by the disputants after they had assessed the potential costs and benefits they would likely face in proceeding without a settlement following the shareholders' meeting. That is, counsel for Mr. Klein submits that both sides, in fashioning the settlement, were sensibly avoiding any uncertainties that might arise. Counsel for Mr. Klein submits further that, since the parties assessed the merits of the class proceeding in the negotiations leading up to the settlement, it would be improper for the court retrospectively to second-guess the litigants' resolution of their dispute. Counsel for Mr. Klein submits, as well, that there is nothing in the handling of this case to suggest an abuse of process.

27 Mr. Klein has filed an affidavit in support of the motion. Mr. Epstein has not filed an affidavit. Mr. Klein states that Mr. Epstein is not receiving any personal benefits pursuant to the settlement or otherwise. Counsel for Mr. Klein submits that, having pursued the class proceeding vigorously but being unsuccessful in the orders sought, Mr. Epstein is simply entering into a settlement of his own personal claim for two reasons: to avoid incurring liability for his lawyer's fees and disbursements, and to avoid potential costs exposure to the defendants.

28 Counsel for Mr. Klein, the putative class counsel, submits that, because the proposed settlement does not and cannot possibly adversely affect the rights of any class member, it should be approved.

29 Counsel for Mr. Klein also submits that the purpose of the *CPA*'s stipulation that the court approve all settlements is to prevent collusive settlements between a representative plaintiff and a defendant. Collusive settlements would undermine the interests of absent class members. Undoubtedly, that is one of the policy concerns underpinning the required court approval. Settlements may also jeopardize other policy objectives at the heart of Ontario's *CPA*, as I shall explain below.

30 When ordinary litigation is settled by parties in the normal course of events, the courts generally provide a judgment or order to implement the settlement. The Settlement Agreement is, in effect, private law-making in the form of a contract. There is a public interest in the settlement of court actions. See *Sparling v. Southam Inc.* (1988), 66 O.R. (2d) 225 (Ont. H.C.) at 230-1.

The Objectives of the CPA in Requiring Court Approval of Settlements

31 The *Report of the Attorney General's Advisory Committee on Class Action Reform* (1990) [hereinafter *AG's Report*], prepared prior to the implementation of the *CPA*, states that

> the court should have the power to supervise all settlements, dismissals and discontinuances [,] including the power to order that the class be given a written accounting of the conduct of the proceeding, the result and the planned distribution.... (p. 11)

In *Class Actions: A Guide to the Class Proceedings Act, 1992* (Aurora, Ontario: Canada Law Book, 1992), Michael Cochrane states:

> A court approval of the settlement, from the perspective of the class members, ensures that the representative plaintiff is not settling for improper or inadequate reasons, such as fatigue (for counsel or the representative plaintiff), lucrative side deals or other considerations which might contribute to a representative plaintiff deciding to "cash in the chips" and settle. (p. 62)

32 The *AG's Report* was visibly indebted to the Ontario Law Reform Commission's analysis in *Report on Class Actions* (1982) [hereinafter *Commission Report*]. While establishing that the goals of class-action reform in Ontario should be judicial economy, access to justice and behaviour modification, the *Commission Report* addressed two concerns that had been raised in connection with class-action reform: first, the concern that class actions, by "extorting unjust settlements from defendants," would constitute a form of "legalized blackmail" (p. 146); and second, the fear that class proceedings would "produce compromises unfair to

class members, either because the representative plaintiff has settled with the defendant for a premium on his or her own claim, thereafter discontinuing the class action, or because the class lawyer has settled in a manner designed to maximize legal fees at the expense of the recovery..." (p. 146) available to class members. By emphasizing the importance and broad scope of court approval, the Advisory Committee sought to ease the concerns of commentators who suspected that class-action reform in Ontario would open the floodgates to unnecessary, frivolous litigation.

33 In the context of Mr. Epstein's class proceeding, which has now resulted in a motion seeking court approval of the Settlement Agreement arrived at between the parties August 10, 1999, the Ontario Law Reform Commission's response to those two concerns is instructive.

34 The Commission addresses the concerns of those fearing the proposed class-action reforms:

> The Commission does not accept the contention that persons who serve as representative plaintiffs are, as a general rule, more likely to be dishonest or to commence a suit without merit than those plaintiffs who participate in individual litigation. Similarly, the Commission is not of the view that there is a large number of unscrupulous lawyers in Ontario who would knowingly bring meritless actions against innocent defendants. (p. 148)

35 The Commission's response, however, is qualified by a significant footnote:

> If the Commission is unduly optimistic in this respect, it would seem more appropriate for judges in particular cases, or The Law Society of Upper Canada in the case of repeated misbehaviour, to impose appropriate costs or disciplinary sanctions upon offending lawyers than to reject the adoption of an expanded class action procedure that is needed to provide effective access to the courts. (p. 148)

The requirement of judicial approval is held out as a means of dealing with the potential for abuse of process in specific class proceedings.

36 The ultimate importance of judicial approval to the smooth implementation of class-action reform in Ontario was also underscored by all members of the Ontario legislature who commented upon the proposed *CPA* at various points during its passage through the legislature. [See the comment of then Attorney General Ian Scott, (Ontario, Legislative Assembly, *Debates*, 21 June 1990)]. On November 18th, 1991, Mr. Winninger, on behalf of then Attorney General Howard Hampton, stated the following in respect of the proposed legislation:

> [n]ormal cost rules for litigation will apply, but lawyers and their clients will be permitted to engage in special fee arrangements for such proceedings, subject, however, to the court having final control over all agreements with respect to fees and disbursements (Ontario, Legislative Assembly, *Debate* (18 November 1991) at 350-6) [second reading][emphasis added]

37 On April 27, 1992, Attorney General Howard Hampton added that "[c]lass proceedings raise certain ethical issues, such as the potential conflict of interest between the lawyer's duty to the representative plaintiff and to other members of the class" [Ontario, Legislative Assembly, *Debate* (27 April 1992) at 372]. Mr. Hampton's comment appeared to imply that the court's role in the implementation of class-action reform would be critical to the effectiveness of the new legislation.

38 I refer once again to the *Commission Report*:

> The settlement and discontinuance of class actions is a particularly important issue, and one that should be dealt with in the proposed *Class Actions Act*.... [T]here is a real possibility that, without the benefit of appropriate safeguards, parties and their counsel might be tempted to abuse the class action procedure in reaching a settlement. For example, the representative plaintiff might use the class action to enhance his individual bargaining position, or class members' interests could be sacrificed for lawyers' fees. ....[O]ur recommended provision applies to any action "commenced" under the proposed Act. We have chosen this language to reflect our intention that the provision should unambiguously embrace pre-certification settlements, discontinuances, and dismissals for want of prosecution of class actions, and thereby circumvent problems

> of interpretation similar to those that have occurred in the United States under Rule 23(e). In reaching this conclusion, we have been influenced by the argument that to restrict the proposed provision to the post-certification stage of the proceedings could result in the parties placing an undue premium on early settlement as a means of avoiding, for example, the requirement of court approval and the possibility of having to notify absent class members. Moreover, a contrary rule might encourage collusion and foster the formulation of "secret settlements" during the period prior to certification. (Vol. 3, p. 806).

39 In *Dabbs v. Sun Life Assurance Co. of Canada* (February 24, 1998), Doc. Toronto 96-CT-022862 (Ont. Gen. Div.), Sharpe J., as he then was, articulates the appropriate standard of review in connection with s. 29 of the *CPA*. He states that "the court must find that in all the circumstances the settlement is fair, reasonable and in the best interests of those affected by it" (para. 11). He also establishes that "the parties proposing the settlement bear the onus of satisfying the court that it ought to be approved" (para. 7). *Newberg on Class Actions* (3 rd Edition), para. 11.43, provides a list of eight factors that the court should consider when determining whether to approve a settlement agreement. That list of factors includes the presence of good faith. See also *Parsons v. Canadian Red Cross Society* (September 22, 1999), Doc. 98-CV-141369, 98-CV-146405 (Ont. S.C.J.).

40 The motion before the Court in the instant case raises very important issues which this Court is mandated to consider before approving a settlement. The inference may be made from the record that Mr. Epstein's class proceeding constitutes a so-called "strike action" that, in reality, was initiated by counsel simply for the benefit of counsel.

The American Experience with Strike Actions

41 The term "strike action" or "strike suit" has emerged in the context of certain class proceedings litigation in the United States. The term connotes the commencement and pursuit of a class proceeding where the merits of the claim are not apparent but the nature of the claim and targeted transaction is such that a sizeable settlement can be achieved with some degree of probability. The term suggests a class proceeding that is properly regarded as an abuse of process.

42 The American "strike suit" experience is described by Steven Sharpe and James Reid:

> In the United States, the availability of class action procedures combined with a contingency fee structure for plaintiffs' lawyers has led to the creation of an entrepreneurial sector of the legal profession known as the "strike bar" U.S. strike bar lawyers are motivated by sizable contingency fees and relative freedom to direct litigation according to their own interests. Even defendants who have done nothing wrong face Hobson's choice: to pay for a very expensive battle in the courts and eventually risk a potentially exorbitant jury damage award, or settle. Most defendants eventually swallow their indignation and make the prudent economic choice and, as a result, settlement has become the typical outcome of class action securities litigation in the United States. ("Aspects of Class Action Securities Litigation in the United States" (1997) 28 *Can. Bus. L.J.* 348 at 353-4)

43 The "strike suit" phenomenon has burgeoned into a considerable problem in the United States over the past two decades. Introducing a collection of the papers presented at a conference on class actions and related issues in complex litigation (a conference held at the New York University School of Law's Institute of Judicial Administration in 1995), Professor Samuel Estreicher offers the following observation:

> Class actions ... have their dark, "Frankenstein monster" side.... One source of criticism is that class actions allow lawyers — acting essentially as entrepreneurs without real clients — to engage in a form of "legalized blackmail." This is due to the fact that the sheer costs of defending against class actions create nontrivial settlement values irrespective of the underlying merits of the claims. ("Foreward: Federal Class Actions After 30 Years" (1996) 71:1 *N.Y.U. L. Rev.* 1 at 2) [footnote omitted].

44 Much anxiety has developed in the United States in relation to "strike suits" that have been "filed solely for their settlement value..." (John Avery, "Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995" (1996) 51 *Bus. Law.* 335 at 337). As Elliott J. Weiss puts it:

> securities class actions, particularly those alleging open market fraud, had taken on such an appearance of impropriety that they were especially vulnerable to attack.... [A] relatively small number of plaintiffs' attorneys regularly were filing class actions only hours or days after the disclosure of information that precipitated a major move in the price of a corporation's stock. It seemed apparent, even to people sympathetic to claims of open market fraud, that the moving force behind most class actions was not investors aggrieved by the defendants' alleged misrepresentations but plaintiffs' attorneys seeking to earn potentially large contingent fees. The investors in whose names class action [sic] were filed were mere figureheads; their function was to provide these attorneys with "the key to the courthouse." ("Comment: The Impact to Date of the Lead Plaintiff Provisions of the Private Securities Litigation Reform Act" (1997) 39 *Ariz. L. Rev.* 561 at 561-562) [footnotes omitted].

45 After studying a sample of class action settlements, Professor Janet Cooper Alexander concluded that nearly all settlements resulting from securities class actions were *not* based on the merits of the cases involved. This situation was, in her view, unacceptable:

> A settlement process that does not take the merits into account poses a number of disturbing policy implications. Private enforcement of the securities laws through class action litigation is costly, both to the litigants and to the public. If cases are not resolved according to the merits, then we are not receiving the presumed benefits of this costly system of enforcement. A non-merits-based settlement regime also encourages the filing of more and weaker suits, while undercompensating actual victims of securities violations. ("Do the Merits Matter? A Study of Settlements in Securities Class Actions" (1991) 43 *Stan. L. Rev.* 497 at 501)

46 Because "strike suits" were becoming increasingly frequent in the field of securities litigation, American legislators found it necessary to address perceived abuses to the class-action mechanism by adopting new legislation. The chief aim of the new legislation was to wrest control of the class-action mechanism from entrepreneurial lawyers and nominal plaintiffs. John Avery's article, cited above, reviews the developments that led to this substantial legislative response, which involved the introduction of two new federal statutes: *The Private Securities Litigation Reform Act of 1995*, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.) [hereinafter *Reform Act*] and the *Securities Litigation Uniform Standards Act of 1998*, Pub. L. No. 105-353, 112 Stat. 3227 (1998) (to be codified in scattered sections of 15 U.S.C.) [hereinafter *Unified Standards Act*]. See generally: David M. Levine and Adam C. Pritchard, "The Securities Litigation Uniform Standards Act of 1988: The Sun Sets on California's Blue Sky Laws" (1998) 54 *Bus. Law* 1 at 1-2; Richard H. Walker, David M. Levine and Adam C. Pritchard, "The New Securities Class Action: Federal Obstacles, State Detours" (1997) 39 *Ariz. L. Rev.* 641 at 643; and Professor Jill E. Fisch, "Class Action Reform: Lessons from Securities Litigation" (1997) 39 *Ariz. L. Rev.* 533. Although the efforts at reform have not eliminated the problem of "strike actions," the initiatives are indicative of the need for court supervision of class action settlements.

47 In requiring a mandatory inquiry by the court at the conclusion of each attempted class action, Rule 11 of the *Reform Act* allows for sanctions to be imposed on plaintiffs and lawyers who have brought forward frivolous suits. All of the procedural changes in the *Reform Act*, but perhaps especially the alteration to Rule 11 in the securities law context, have enhanced the supervisory responsibilities of courts that preside over securities class actions.

48 As Professor James D. Cox states: "In each of these developments the Reform Act calls for more aggressive supervision of the class action by the court" ("Making Securities Fraud Class Actions Virtuous" (1997) 39 *Ariz. L. Rev.* 498 at 523) [hereinafter *Making Class Actions Virtuous*].

49 With respect to Rule 11, Professor Cox added the following observation:

> In the case of a "substantial failure of any complaint to comply with any requirement of Rule 11(b)," the court *must* impose a sanction which is presumed be [sic] "an award to the opposing party of the reasonable attorney fees and other expenses incurred in the action." Congress, in enacting this provision, expressed its clear intent for the courts to be tougher on those who file frivolous securities actions than they had been previously or is called for under Rule 11 in other types of

litigation. ...By far the largest change in the operation of Rule 11 in securities litigation is that the prospect of a sanction is not dependent on the motion of an opposing counsel and there is no opportunity to cure the situation by withdrawing the complaint or motion as there is under current Rule 11 which after the 1993 amendment provides a 21-day notice period during which time the object of the sanction can amend or withdraw the complaint or motion. (*Making Class Actions Virtuous, supra* at 522) [footnotes omitted]

50 What bears emphasizing is that, under Rule 11 of the *Reform Act*, class actions in the U.S. do involve court approval of settlements. Under the *Reform Act*, the court's supervisory powers are visibly strengthened.

51 As the American experience suggests, "strike suits," which are lawyer rather than client driven, are disconcerting for two reasons. First, they often severely and unacceptably interfere with standard corporate governance practices, creating unnecessary inefficiencies and bypassing existing regulatory devices.

52 Second, "strike suits" may effectively transform the class-action mechanism from a shield into a sword. When fashioned into a sword by profit-motivated lawyers and shareholder-plaintiffs posing as class representatives, the class proceeding becomes a means of harassing corporate defendants. Such harassment constitutes an abuse of process and a violation of the very goals that the class-action mechanism is expected to further.

The Plaintiff's Class Proceeding

53 Mr. Epstein's purpose in using the class proceeding is certainly raised as an issue in the instant case. Mr. Justice Blair observed that "[c]lass action proceedings and the statutory procedure created for dealing with and approving corporate arrangements are two quite different procedures with two quite different purposes": *First Marathon Inc., supra* para. 11. While a class proceeding founded upon an oppression action under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 may be maintained [see *Stern v. Imasco Ltd.* (November 8, 1999), Doc. 99-CV-175110CP (Ont. S.C.J.)], the instant case in reality raises different issues: it asks whether one minor shareholder, with only a few shares, apparently motivated by an entrepreneurial lawyer, may attempt to interfere with corporate restructuring that is not objected to by any of the corporation's other shareholders.

54 Eleven shareholders with between one-third and one-half of First Marathon's shares indicated through affidavit evidence presented before Blair J. that, in connection with the corporation's proposed restructuring, disclosure had been adequate. These shareholders indicated their willingness to proceed with the shareholders' meeting scheduled for August 10, 1999. The special shareholders' meeting on August 10, 1999, approved the Plan of Arrangement. No votes were cast against approval. No shareholder exercised his/her statutory right of dissent under s. 185 of the *OBCA*. Neither Mr. Epstein nor Mr. Klein brought his professed concerns to the shareholders' meeting for discussion.

55 The disputants in this case arrived at the settlement, for which court approval is now sought, a few hours in advance of the "fairness hearing" before Mr. Justice Day on August 11, 1999, a hearing whose purpose was to get court approval for the merger. The record establishes that Mr. Klein threatened not only to raise his concerns about the Plan of Arrangement to Mr. Justice Day, but also to seek a delay in court approval. This risk provided an inducement to settle.

56 Mr. Klein forwarded a factum by fax to the counsel for First Marathon and National Bank on August 10, 1999. The factum was prepared on behalf of Mr. Epstein as a respondent opposing the application by First Marathon for court approval of the Plan of Arrangement scheduled for the next day, August 11, 1999. In this factum, Mr. Epstein opposed approval of the transaction on the basis of the same concerns he had raised before Mr. Justice Blair in July. The factum stated that the evidence was not yet complete, implying that the question of court approval should at the least be delayed. The factum concluded with the submission that First Marathon had not established that the proposed Plan of Arrangement was "fair and reasonable."

57 Counsel for Mr. Klein now submits that, because the proposed settlement does not adversely affect the rights of any class member, it should be approved. He submits that the Order of Mr. Justice Blair, which dismissed the application to set aside or vary the Interim Order, and the application seeking the appointment of a representative counsel, must be taken as *prima facie* correct. Similarly, the Order of Mr. Justice Day approving the arrangement must be taken as *prima facie* correct.

Hence, the argument goes, nothing in the settlement affects or purports to affect the rights of any class members other than the named plaintiff.

58 In reality there are two possibilities. The first possibility is that Mr. Epstein's allegations in his pleading are frivolous and have no merit. The class proceeding is designed solely for the purpose of creating a perceived risk to the successful conclusion of the Plan of Arrangement and intended takeover of First Marathon. The calculation in launching the class proceeding is that a settlement of the dispute will have some value given that the completion of a $700 million transaction will be thrown into some jeopardy due to the confusion and uncertainty created by the lawsuit. The likelihood of settlement was enhanced by the publicity the newspapers gave to the lawsuit. At best, the commencement of the class proceeding constitutes a speculative venture. If there is not any real merit to the claim, then there is no settlement value based upon merit. The proceeding is in reality a "strike suit."

59 The alternative possibility, necessarily asserted by Mr. Epstein and Mr. Klein, is that the class proceeding was commenced in good faith with honestly held concerns as to the merits of the terms of the proposed takeover. Mr. Epstein claims that the Plan of Arrangement is abusive of minority shareholder rights.

60 The following question must then arise: how can a settlement in secrecy prior to the "fairness hearing" to consider approval of the Plan of Arrangement, conceivably advance the interests of the minority shareholders? The concerns expressed by Mr. Epstein in his Statement of Claim were not advanced at the shareholders' meeting just a few hours before the Settlement Agreement was signed. Mr. Epstein repeated these concerns in the factum presented to First Marathon just hours prior to the signing of the Settlement Agreement. This strategy of silence and secrecy was contrary to the interests of the minority shareholders. It was contrary to the interest of effective shareholder democracy, which is created when informed shareholders make decisions. Indeed, Mr. Klein agrees in the quoted clause 3 of the Settlement Agreement to be available outside the court room on August 11, 1999, at the hearing for court approval by Mr. Justice Day. Mr. Klein agrees to speak in favour of the Arrangement if called upon at the "fairness hearing."

61 While the Settlement Agreement was made known to Mr. Justice Day, the parties to the Settlement Agreement agreed that the fact of the settlement and its terms would be kept secret from the putative class members. If there is any settlement value because of the merits of the class proceeding, then the putative class members would have a right to disclosure of the settlement. The class counsel should not be able to appropriate the entire settlement amount for himself. The settlement value is created by the fact it is a class (and not an individual) proceeding, albeit not yet certified.

62 Mr. Klein's counsel, Mr. Baert, also submits that the proposed settlement is a reasonable response to Mr. Epstein's claim in the circumstances. He says that Mr. Epstein's potential costs exposure is substantial and that Mr. Epstein is personally liable to Mr. Klein for the legal fees and disbursements incurred in the action. Therefore, Mr. Baert argues, the settlement resolves these issues favourably from Mr. Epstein's standpoint. But even allowing (for the sake of argument for the moment) the point as to Mr. Epstein avoiding costs, the more fundamental question remains: if the concerns of Mr. Epstein in respect of the takeover of First Marathon have any perceived merit, how can a secret settlement be in the interest of any class member other than Mr. Epstein? Conversely, if the concerns of Mr. Epstein have no merit, the claim is frivolous and procedurally abusive, and there is no valid settlement value.

63 Section 32(1) of the *CPA* states:

> An agreement respecting fees and disbursements between a solicitor and a representative party shall be in writing and shall,
>
> (a) state the terms under which fees and disbursements shall be paid;
>
> (b) give an estimate of the expected fee, whether contingent on success in the class proceeding or not; and
>
> (c) state the method by which payment is to be made, whether by lump sum, salary or otherwise.

64 Section 32(2) provides that any such agreement is "not enforceable unless approved by the court, on the motion of the solicitor." Mr. Klein has not submitted any such agreement to this Court although invited by the Court to do so. Thus, one can

only speculate as to the terms of any agreement between Mr. Epstein and Mr. Klein as to the payment of fees and disbursements. However, it seems very unlikely that any small shareholder in the position of Mr. Epstein would commence this class proceeding without a contingency fee arrangement, which would make the payment of any fees to his counsel dependent upon success.

65 Subsection 32(4) provides that, if an agreement is not approved, the court may "determine the amount owing," "direct a reference to determine the amount owing," or "direct that the amount owing be determined in any other manner."

66 In the case at hand Mr. Klein is seeking to receive some $190,000.00 through the Settlement Agreement. However, although invited by the Court to do so, no bill of costs has been submitted by Mr. Klein for the Court's consideration.

67 Section 33 of the *CPA* provides for contingency agreements--that is, for payment only in the event of success. While it is not disclosed to the Court whether any agreement exists in the case at hand that provides for payment only in the event of success, the Settlement Agreement makes it obvious there is no success. The settlement provides that no one other than Mr. Klein will receive any part of the proceeds.

68 Abuse of the class-action process is not to be tolerated and costs can, in an appropriate case, be awarded against a person, even a non-party, instigating abusive proceedings. See *Smith v. Canadian Tire Acceptance Ltd.* (1994), 118 D.L.R. (4th) 238 (Ont. Gen. Div.), affirmed (1995), 26 O.R. (3d) 95 (Ont. C.A.), leave to appeal to S.C.C. refused [1996] 3 S.C.R. xiii (S.C.C.) *Bulletin of Proceedings* (p. 1559).

69 In my view, the plaintiff has not met the onus of satisfying the Court that the Settlement Agreement ought to be approved. On the contrary, I find that the record establishes the Court should disapprove of the proposed settlement. In my view, the plaintiff's class proceeding constitutes an example of litigation of the kind the *CPA* was never designed to reward. Approval of the settlement would violate the public-policy objectives underlying the Legislature's enactment of the *CPA*. The important policy objectives of the statute are to foster access to justice, judicial economy and behaviour modification. The plaintiff's class proceeding is counterproductive to all these objectives. Mr. Epstein's action is in the nature of a "strike suit" seen more commonly in the United States.

70 While it may be true that there is not yet a flood of "strike suits" in Canada, the very vitality of the *CPA* depends on the court's ability to deal appropriately with "strike suits" like the one advanced by Mr. Epstein and Mr. Klein.

71 The *CPA* provides authority for the judicial scrutiny and rejection of class-action settlements. As I indicated earlier in referring to the *AG's Report*, the *Commission Report*, and Hansard, the *CPA* was designed to cope with the problems inherent in "strike suits." The *CPA* provides the court with the discretion to reject proposed settlements that make a mockery of the public policy upon which Ontario's class proceedings legislation is based.

72 This court has the authority under s. 29(2) of the *CPA* to reject any proposed settlement that constitutes an abuse of process or that is inconsistent with the purposes of the legislation. Moreover, apart from its statutory authority under s. 29, this court possesses the inherent jurisdiction to prevent an abuse of process. This inherent jurisdiction is commented upon by Freedman C.J.M. in *Montreal Trust Co. v. Churchill Forest Industries (Man.) Ltd.* (1971), 21 D.L.R. (3d) 75 (Man. C.A.), at pp. 80-1. Freedman C.J.M. observes that "inherent jurisdiction is frequently invoked to prevent abuse of the process of a Court by staying or dismissing a vexatious action.... (p. 80); that "[i]nherent jurisdiction is derived not from any statute or rule but from the very nature of the Court as a superior Court of law..."; and that "[i]nherent jurisdiction cannot, of course, be exercised so as to conflict with a statute or rule.... [I]t is a special and extraordinary power, it should be exercised only sparingly and in a clear case" (p. 81).

73 In *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]), at para. 4, Mr. Justice Farley further emphasizes the required compatibility between statutory authority and the exercise of inherent jurisdiction: "inherent jurisdiction is not limitless; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play." In supporting this view, Mr. Justice Farley cites a helpful passage from *Halsbury's* (4th ed., vol. 37, para. 14):

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

74 In the instant case, which is a clear one, I find that this court has the authority under s. 29(2) of the *CPA* to dismiss the settlement proposal advanced by the parties. Moreover, apart from the authority invested in this court under s. 29, the court may, if necessary, draw upon its inherent jurisdiction, as described above, to dismiss the settlement proposal, since it constitutes an abuse of the substance and procedure of the *CPA*. This is a case in which inherent jurisdiction may be exercised in a fashion compatible with statutory authority.

75 The court's duty to evaluate and rule upon the proposed settlement plan in the instant case is analogous to the court's duty in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.) [hereinafter *Olympia & York Developments Ltd.*], to evaluate a proposed plan of compromise or arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 [hereinafter *CCAA*]. In *Olympia & York Developments Ltd.*, *supra*, Mr. Justice R.A. Blair discusses the "general principles to be applied in the exercise of the court's discretion..." In evaluating the plan proposed in that case, he stated that the plan must comply strictly with statutory requirements; that the proposed plan must not be tainted by conduct that is not authorized by the CCAA; and that the plan should be fair and reasonable. These same principles, if one substitutes the *CPA* for the *CCAA*, offer some guidance as to the proper exercise of judicial discretion in the case at bar.

76 In exercising either the judicial discretion conferred upon me by s. 29 of the CPA or this court's inherent jurisdiction to address instances of procedural abuse, I have determined that the settlement proposal advanced by the parties should be dismissed. In rejecting the proposal, I am cognizant of the fact that approving a settlement tainted by bad faith or unethical behaviour would constitute an abuse of judicial discretion. In *Greenspun v. Bogan*, 492 F.2d 375 (U.S. 1st Cir. 1974), at p. 381, in a passage cited with approval in *Dabbs*, *supra*, by Mr. Justice Sharpe, it was stated that "when one side is so obviously correct in its assertions of law and fact that it would be clearly unreasonable to require it to compromise in the extent of the settlement, ... to approve the settlement would be an abuse of discretion." It would be an abuse of judicial discretion in the instant case to approve of the compromise represented by the proposed settlement.

77 Counsel for Mr. Klein submits that, if approval of the settlement is not forthcoming under s. 29(2) of the *CPA*, then, alternatively, the Court should still dismiss the class proceeding under s. 249(2) of the *OBCA*, as requested in the Notice of Motion. The Settlement Agreement is structured in such a way that Mr. Klein is to receive his $190,000.00 simply upon the action being dismissed without costs.

78 As I have said, approval of the settlement under the CPA is a pre-condition to dismissal of the class proceeding. A settlement that cannot gain Court approval to depart through the front door of the *CPA* cannot avoid scrutiny by escaping through some back door exit. I do not approve of the settlement on the basis of the terms set forth in the Settlement Agreement.

Disposition

79 On the facts of the instant case, I hold that it is appropriate to deny the motion seeking court approval of the settlement. In view of the court's supervisory mandate under section 29(2) the *CPA* and the important policy objectives that the statute is intended to serve, I do not give court approval to the terms of the Settlement Agreement. I exercise my authority and discretion under s. 29(1) of the *CPA* to order that the proceeding be dismissed without costs and on the basis and condition there is to be no payment of any monies to Klein Lyons, under the Settlement Agreement or otherwise, as a consequence of the dismissal of the action.

Motion dismissed.

End of Document

TAB 10

2010 ONSC 1708
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2010 CarswellOnt 1754, 2010 ONSC 1708, 192 A.C.W.S. (3d) 368, 63 C.B.R. (5th) 44, 81 C.C.P.B. 56

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 NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION (Applicants)

Morawetz J.

Heard: March 3-5, 2010
Judgment: March 26, 2010
Docket: 09-CL-7950

Counsel: Derrick Tay, Jennifer Stam, Suzanne Wood for Applicants
Lyndon Barnes, Adam Hirsh for Nortel Directors
Benjamin Zarnett, Gale Rubenstein, C. Armstrong, Melaney Wagner for Monitor, Ernst & Young Inc.
Arthur O. Jacques for Nortel Canada Current Employees
Deborah McPhail for Superintendent of Financial Services (non-PBGF)
Mark Zigler, Susan Philpott for Former and Long-Term Disability Employees
Ken Rosenberg, M. Starnino for Superintendent of Financial Services in its capacity as Administrator of the Pension Benefit Guarantee Fund
S. Richard Orzy, Richard B. Swan for Informal Nortel Noteholder Group
Alex MacFarlane, Mark Dunsmuir for Unsecured Creditors' Committee of Nortel Networks Inc.
Leanne Williams for Flextronics Inc.
Barry Wadsworth for CAW-Canada
Pamela Huff for Northern Trust Company, Canada
Joel P. Rochon, Sakie Tambakos for Opposing Former and Long-Term Disability Employees
Robin B. Schwill for Nortel Networks UK Limited (In Administration)
Sorin Gabriel Radulescu for himself
Guy Martin for himself, Marie Josee Perrault
Peter Burns for himself
Stan and Barbara Arnelien for themselves

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

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Calpine Canada Energy Ltd., Re (2007), 2007 CarswellAlta 1050, 2007 ABQB 504, 35 C.B.R. (5th) 1, 415 A.R. 196, 33 B.L.R. (4th) 68 (Alta. Q.B.) — referred to

Calpine Canada Energy Ltd., Re (2007), 35 C.B.R. (5th) 27, 410 W.A.C. 25, 417 A.R. 25, 2007 ABCA 266, 2007 CarswellAlta 1097, 80 Alta. L.R. (4th) 60, 33 B.L.R. (4th) 94 (Alta. C.A. [In Chambers]) — referred to

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 1998 CarswellOnt 3346, 5 C.B.R. (4th) 299, 72 O.T.C. 99 (Ont. Gen. Div. [Commercial List]) — considered

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Generally — referred to

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s. 11(4) — referred to

Pension Benefits Act, R.S.O. 1990, c. P.8
Generally — referred to

MOTION by insolvent corporation for court approval of settlement agreement under Companies' Creditors Arrangement Act.

***Morawetz J.*:**

Introduction

1 On January 14, 2009, Nortel Networks Corporation ("NNC"), Nortel Networks Limited "(NNL"), Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation (collectively, the "Applicants") were granted a stay of proceedings pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") and Ernst & Young Inc. was appointed as Monitor.

2 The Applicants have historically operated a number of pension, benefit and other plans (both funded and unfunded) for their employees and pensioners, including:

(i) Pension benefits through two registered pension plans, the Nortel Networks Limited Managerial and Non-Negotiated Pension Plan and the Nortel Networks Negotiated Pension Plan (the "Pension Plans"); and

(ii) Medical, dental, life insurance, long-term disability and survivor income and transition benefits paid, except for survivor termination benefits, through Nortel's Health and Welfare Trust (the "HWT").

3 Since the CCAA filing, the Applicants have continued to provide medical, dental and other benefits, through the HWT, to pensioners and employees on long-term disability ("Former and LTD Employees") and active employees ("HWT Payments") and have continued all current service contributions and special payments to the Pension Plans ("Pension Payments").

4 Pension Payments and HWT Payments made by the Applicants to the Former and LTD Employees while under CCAA protection are largely discretionary. As a result of Nortel's insolvency and the significant reduction in the size of Nortel's operations, the unfortunate reality is that, at some point, cessation of such payments is inevitable. The Applicants have attempted to address this situation by entering into a settlement agreement (the "Settlement Agreement") dated as of February 8, 2010, among the Applicants, the Monitor, the Former Employees' Representatives (on their own behalf and on behalf of the parties they represent), the LTD Representative (on her own behalf and on behalf of the parties she represents), Representative Settlement Counsel and the CAW-Canada (the "Settlement Parties").

5 The Applicants have brought this motion for approval of the Settlement Agreement. From the standpoint of the Applicants, the purpose of the Settlement Agreement is to provide for a smooth transition for the termination of Pension Payments and HWT Payments. The Applicants take the position that the Settlement Agreement represents the best efforts of the Settlement Parties to negotiate an agreement and is consistent with the spirit and purpose of the CCAA.

6 The essential terms of the Settlement Agreement are as follows:

(a) until December 31, 2010, medical, dental and life insurance benefits will be funded on a pay-as-you-go basis to the Former and LTD Employees;

(b) until December 31, 2010, LTD Employees and those entitled to receive survivor income benefits will receive income benefits on a pay-as-you-go basis;

(c) the Applicants will continue to make current service payments and special payments to the Pension Plans in the same manner as they have been doing over the course of the proceedings under the CCAA, through to March 31, 2010, in the aggregate amount of $2,216,254 per month and that thereafter and through to September 30, 2010, the Applicants shall make only current service payments to the Pension Plans, in the aggregate amount of $379,837 per month;

(d) any allowable pension claims, in these or subsequent proceedings, concerning any Nortel Worldwide Entity, including the Applicants, shall rank *pari passu* with ordinary, unsecured creditors of Nortel, and no part of any such HWT claims shall rank as a preferential or priority claim or shall be the subject of a constructive trust or trust of any nature or kind;

(e) proofs of claim asserting priority already filed by any of the Settlement Parties, or the Superintendent on behalf of the Pension Benefits Guarantee Fund are disallowed in regard to the claim for priority;

(f) any allowable HWT claims made in these or subsequent proceedings shall rank *pari passu* with ordinary unsecured creditors of Nortel;

(g) the Settlement Agreement does not extinguish the claims of the Former and LTD Employees;

(h) Nortel and, *inter alia*, its successors, advisors, directors and officers, are released from all future claims regarding Pension Plans and the HWT, provided that nothing in the release shall release a director of the Applicants from any matter referred to in subsection 5.1(2) of the CCAA or with respect to fraud on the part of any Releasee, with respect to that Releasee only;

(i) upon the expiry of all appeals and rights of appeal in respect thereof, Representative Settlement Counsel will withdraw their application for leave to appeal the decision of the Court of Appeal, dated November 26, 2009, to the Supreme Court of Canada on a with prejudice basis; [1]

(j) a CCAA plan of arrangement in the Nortel proceedings will not be proposed or approved if that plan does not treat the Pension and HWT claimants *pari passu* to the other ordinary, unsecured creditors ("Clause H.1"); and

(k) if there is a subsequent amendment to the *Bankruptcy and Insolvency Act* ("BIA") that "changes the current, relative priorities of the claims against Nortel, no party is precluded by this Settlement Agreement from arguing the applicability" of that amendment to the claims ceded in this Agreement ("Clause H.2").

7 The Settlement Agreement does *not* relate to a distribution of the HWT as the Settlement Parties have agreed to work towards developing a Court-approved distribution of the HWT corpus in 2010.

8 The Applicants' motion is supported by the Settlement Parties and by the Board of Directors of Nortel.

9 The Official Committee of Unsecured Creditors of Nortel Networks Inc. ("UCC"), the informal Nortel Noteholder Group (the "Noteholders"), and a group of 37 LTD Employees (the "Opposing LTD Employees") oppose the Settlement Agreement.

10 The UCC and Noteholders oppose the Settlement Agreement, principally as a result of the inclusion of Clause H.2.

11 The Opposing LTD Employees oppose the Settlement Agreement, principally as a result of the inclusion of the third party releases referenced in [6h] above.

The Facts

A. Status of Nortel's Restructuring

12 Although it was originally hoped that the Applicants would be able to restructure their business, in June 2009 the decision was made to change direction and pursue sales of Nortel's various businesses.

13 In response to Nortel's change in strategic direction and the impending sales, Nortel announced on August 14, 2009 a number of organizational updates and changes including the creation of groups to support transitional services and management during the sales process.

14 Since June 2009, Nortel has closed two major sales and announced a third. As a result of those transactions, approximately 13,000 Nortel employees have been or will be transferred to purchaser companies. That includes approximately 3,500 Canadian employees.

15 Due to the ongoing sales of Nortel's business units and the streamlining of Nortel's operations, it is expected that by the close of 2010, the Applicants' workforce will be reduced to only 475 employees. There is a need to wind-down and rationalize benefits and pension processes.

16 Given Nortel's insolvency, the significant reduction in Nortel's operations and the complexity and size of the Pension Plans, both Nortel and the Monitor believe that the continuation and funding of the Pension Plans and continued funding of medical, dental and other benefits is not a viable option.

B. The Settlement Agreement

17 On February 8, 2010 the Applicants announced that a settlement had been reached on issues related to the Pension Plans, and the HWT and certain employment related issues.

18 Recognizing the importance of providing notice to those who will be impacted by the Settlement Agreement, including the Former Employees, the LTD Employees, unionized employees, continuing employees and the provincial pension plan regulators ("Affected Parties"), Nortel brought a motion to this Court seeking the approval of an extensive notice and opposition process.

19 On February 9, 2010, this Court approved the notice program for the announcement and disclosure of the Settlement (the "Notice Order").

20 As more fully described in the Monitor's Thirty-Sixth, Thirty-Ninth and Thirty-Ninth Supplementary Reports, the Settlement Parties have taken a number of steps to notify the Affected Parties about the Settlement.

21 In addition to the Settlement Agreement, the Applicants, the Monitor and the Superintendent, in his capacity as administrator of the Pension Benefits Guarantee Fund, entered into a letter agreement on February 8, 2010, with respect to certain matters pertaining to the Pension Plans (the "Letter Agreement").

22 The Letter Agreement provides that the Superintendent will not oppose an order approving the Settlement Agreement ("Settlement Approval Order"). Additionally, the Monitor and the Applicants will take steps to complete an orderly transfer of the Pension Plans to a new administrator to be appointed by the Superintendent effective October 1, 2010. Finally, the Superintendent will not oppose any employee incentive program that the Monitor deems reasonable and necessary or the creation of a trust with respect to claims or potential claims against persons who accept directorships of a Nortel Worldwide Entity in order to facilitate the restructuring.

Positions of the Parties on the Settlement Agreement

The Applicants

23 The Applicants take the position that the Settlement is fair and reasonable and balances the interests of the parties and other affected constituencies equitably. In this regard, counsel submits that the Settlement:

(a) eliminates uncertainty about the continuation and termination of benefits to pensioners, LTD Employees and survivors, thereby reducing hardship and disruption;

(b) eliminates the risk of costly and protracted litigation regarding Pension Claims and HWT Claims, leading to reduced costs, uncertainty and potential disruption to the development of a Plan;

(c) prevents disruption in the transition of benefits for current employees;

(d) provides early payments to terminated employees in respect of their termination and severance claims where such employees would otherwise have had to wait for the completion of a claims process and distribution out of the estates;

(e) assists with the commitment and retention of remaining employees essential to complete the Applicants' restructuring; and

(f) does not eliminate Pension Claims or HWT Claims against the Applicants, but maintains their quantum and validity as ordinary and unsecured claims.

24 Alternatively, absent the approval of the Settlement Agreement, counsel to the Applicants submits that the Applicants are not required to honour such benefits or make such payments and such benefits could cease immediately. This would cause undue hardship to beneficiaries and increased uncertainty for the Applicants and other stakeholders.

25 The Applicants state that a central objective in the Settlement Agreement is to allow the Former and LTD Employees to transition to other sources of support.

26 In the absence of the approval of the Settlement Agreement or some other agreement, a cessation of benefits will occur on March 31, 2010 which would have an immediate negative impact on Former and LTD Employees. The Applicants submit that extending payments to the end of 2010 is the best available option to allow recipients to order their affairs.

27 Counsel to the Applicants submits that the Settlement Agreement brings Nortel closer to finalizing a plan of arrangement, which is consistent with the sprit and purpose of the CCAA. The Settlement Agreement resolves uncertainties associated with the outstanding Former and LTD Employee claims. The Settlement Agreement balances certainty with clarity, removing litigation risk over priority of claims, which properly balances the interests of the parties, including both creditors and debtors.

28 Regarding the priority of claims going forward, the Applicants submit that because a deemed trust, such as the HWT, is not enforceable in bankruptcy, the Former and LTD Employees are by default *pari passu* with other unsecured creditors.

29 In response to the Noteholders' concern that bankruptcy prior to October 2010 would create pension liabilities on the estate, the Applicants committed that they would not voluntarily enter into bankruptcy proceedings prior to October 2010. Further, counsel to the Applicants submits the court determines whether a bankruptcy order should be made if involuntary proceedings are commenced.

30 Further, counsel to the Applicants submits that the court has the jurisdiction to release third parties under a Settlement Agreement where the releases (1) are connected to a resolution of the debtor's claims, (2) will benefit creditors generally and (3) are not overly broad or offensive to public policy. See *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 92 O.R. (3d) 513 (Ont. C.A.), [*Metcalfe*] at para. 71, leave to appeal refused, (S.C.C.) and *Grace Canada Inc., Re* (Ont. S.C.J. [Commercial List]) [*Grace 2008*] at para. 40.

31 The Applicants submit that a settlement of the type put forward should be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all the circumstances. Elements of fairness and reasonableness include balancing the interests of parties, including any objecting creditor or creditors, equitably (although not necessarily equally); and ensuring that the agreement is beneficial to the debtor and its stakeholders generally, as per *Air Canada, Re* (Ont. S.C.J. [Commercial List]) [*Air Canada*]. The Applicants assert that this test is met.

The Monitor

32 The Monitor supports the Settlement Agreement, submitting that it is necessary to allow the Applicants to wind down operations and to develop a plan of arrangement. The Monitor submits that the Settlement Agreement provides certainty, and does so with input from employee stakeholders. These stakeholders are represented by Employee Representatives as mandated by the court and these Employee Representatives were given the authority to approve such settlements on behalf of their constituents.

33 The Monitor submits that Clause H.2 was bargained for, and that the employees did give up rights in order to have that clause in the Settlement Agreement; particularly, it asserts that Clause H.1 is the counterpoint to Clause H.2. In this regard, the Settlement Agreement is fair and reasonable.

34 The Monitor asserts that the court may either (1) approve the Settlement Agreement, (2) not approve the Settlement Agreement, or (3) not approve the Settlement Agreement but provide practical comments on the applicability of Clause H.2.

Former and LTD Employees

35 The Former Employees' Representatives' constituents number an estimated 19,458 people. The LTD Employees number an estimated 350 people between the LTD Employee's Representative and the CAW-Canada, less the 37 people in the Opposing LTD Employee group.

36 Representative Counsel to the Former and LTD Employees acknowledges that Nortel is insolvent, and that much uncertainty and risk comes from insolvency. They urge that the Settlement Agreement be considered within the scope of this reality. The alternative to the Settlement Agreement is costly litigation and significant uncertainty.

37 Representative Counsel submits that the Settlement Agreement is fair and reasonable for all creditors, but especially the represented employees. Counsel notes that employees under Nortel are unique creditors under these proceedings, as they are not sophisticated creditors and their personal welfare depends on receiving distributions from Nortel. The Former and LTD Employees assert that this is the best agreement they could have negotiated.

38 Representative Counsel submits that bargaining away of the right to litigate against directors and officers of the corporation, as well at the trustee of the HWT, are examples of the concessions that have been made. They also point to the giving up of the right to make priority claims upon distribution of Nortel's estate and the HWT, although the claim itself is not extinguished. In exchange, the Former and LTD Employees will receive guaranteed coverage until the end of 2010. The Former and LTD Employees submit that having money in hand today is better than uncertainty going forward, and that, on balance, this Settlement Agreement is fair and reasonable.

39 In response to allegations that third party releases unacceptably compromise employees' rights, Representative Counsel accepts that this was a concession, but submits that it was satisfactory because the claims given up are risky, costly and very uncertain. The releases do not go beyond s. 5.1(2) of the CCAA, which disallows releases relating to misrepresentations and wrongful or oppressive conduct by directors. Releases as to deemed trust claims are also very uncertain and were acceptably given up in exchange for other considerations.

40 The Former and LTD Employees submit that the inclusion of Clause H.2 was essential to their approval of the Settlement Agreement. They characterize Clause H.2 as a no prejudice clause to protect the employees by not releasing any future potential benefit. Removing Clause H.2 from the Settlement Agreement would be not the approval of an agreement, but rather the creation of an entirely new Settlement Agreement. Counsel submits that without Clause H.2, the Former and LTD Employees would not be signatories.

CAW

41 The CAW supports the Settlement Agreement. It characterizes the agreement as Nortel's recognition that it has a moral and legal obligation to its employees, whose rights are limited by the laws in this country. The Settlement Agreement temporarily alleviates the stress and uncertainty its constituents feel over the winding up of their benefits and is satisfied with this result.

42 The CAW notes that some members feel they were not properly apprised of the facts, but all available information has been disclosed, and the concessions made by the employee groups were not made lightly.

Board of Directors

43 The Board of Directors of Nortel supports the Settlement Agreement on the basis that it is a practical resolution with compromises on both sides.

Opposing LTD Employees

44 Mr. Rochon appeared as counsel for the Opposing LTD Employees, notwithstanding that these individuals did not opt out of having Representative Counsel or were represented by the CAW. The submissions of the Opposing LTD Employees were compelling and the court extends it appreciation to Mr. Rochon and his team in co-ordinating the representatives of this group.

45 The Opposing LTD Employees put forward the position that the cessation of their benefits will lead to extreme hardship. Counsel submits that the Settlement Agreement conflicts with the spirit and purpose of the CCAA because the LTD Employees are giving up legal rights in relation to a $100 million shortfall of benefits. They urge the court to consider the unique circumstances of the LTD Employees as they are the people hardest hit by the cessation of benefits.

46 The Opposing LTD Employees assert that the HWT is a true trust, and submit that breaches of that trust create liabilities and that the claim should not be released. Specifically, they point to a $37 million shortfall in the HWT that they should be able to pursue.

47 Regarding the third party releases, the Opposing LTD Employees assert that Nortel is attempting to avoid the distraction of third party litigation, rather than look out for the best interests of the Former and LTD Employees. The Opposing LTD Employees urge the court not to release the only individuals the Former and LTD Employees can hold accountable for any breaches of trust. Counsel submits that Nortel has a common law duty to fund the HWT, which the Former and LTD Employees should be allowed to pursue.

48 Counsel asserts that allowing these releases (a) is not necessary and essential to the restructuring of the debtor, (b) does not relate to the insolvency process, (c) is not required for the success of the Settlement Agreement, (d) does not meet the requirement that each party contribute to the plan in a material way and (e) is overly broad and therefore not fair and reasonable.

49 Finally, the Opposing LTD Employees oppose the *pari passu* treatment they will be subjected to under the Settlement Agreement, as they have a true trust which should grant them priority in the distribution process. Counsel was not able to provide legal authority for such a submission.

50 A number of Opposing LTD Employees made in person submissions. They do not share the view that Nortel will act in their best interests, nor do they feel that the Employee Representatives or Representative Counsel have acted in their best interests. They shared feelings of uncertainty, helplessness and despair. There is affidavit evidence that certain individuals will be unable to support themselves once their benefits run out, and they will not have time to order their affairs. They expressed frustration and disappointment in the CCAA process.

UCC

51 The UCC was appointed as the representative for creditors in the U.S. Chapter 11 proceedings. It represents creditors who have significant claims against the Applicants. The UCC opposes the motion, based on the inclusion of Clause H.2, but otherwise the UCC supports the Settlement Agreement.

52 Clause H.2, the UCC submits, removes the essential element of finality that a settlement agreement is supposed to include. The UCC characterizes Clause H.2 as a take back provision; if activated, the Former and LTD Employees have compromised nothing, to the detriment of other unsecured creditors. A reservation of rights removes the finality of the Settlement Agreement.

53 The UCC claims it, not Nortel, bears the risk of Clause H.2. As the largest unsecured creditor, counsel submits that a future change to the BIA could subsume the UCC's claim to the Former and LTD Employees and the UCC could end up with nothing at all, depending on Nortel's asset sales.

Noteholders

54 The Noteholders are significant creditors of the Applicants. The Noteholders oppose the settlement because of Clause H.2, for substantially the same reasons as the UCC.

55 Counsel to the Noteholders submits that the inclusion of H.2 is prejudicial to the non-employee unsecured creditors, including the Noteholders. Counsel submits that the effect of the Settlement Agreement is to elevate the Former and LTD Employees, providing them a payout of $57 million over nine months while everyone else continues to wait, and preserves their rights in the event the laws are amended in future. Counsel to the Noteholders submits that the Noteholders forego millions of dollars while remaining exposed to future claims.

56 The Noteholders assert that a proper settlement agreement must have two elements: a real compromise, and resolution of the matters in contention. In this case, counsel submits that there is no resolution because there is no finality in that Clause H.2 creates ambiguity about the future. The very object of a Settlement Agreement, assert the Noteholders, is to avoid litigation by withdrawing claims, which this agreement does not do.

Superintendent

57 The Superintendent does not oppose the relief sought, but this position is based on the form of the Settlement Agreement that is before the Court.

Northern Trust

58 Northern Trust, the trustee of the pension plans and HWT, takes no position on the Settlement Agreement as it takes instructions from Nortel. Northern Trust indicates that an oversight left its name off the third party release and asks for an amendment to include it as a party released by the Settlement Agreement.

Law and Analysis

A. Representation and Notice Were Proper

59 It is well settled that the Former Employees' Representatives and the LTD Representative (collectively, the "Settlement Employee Representatives") and Representative Counsel have the authority to represent the Former Employees and the LTD Beneficiaries for purposes of entering into the Settlement Agreement on their behalf: *see Grace 2008*, *supra* at para 32.

60 The court appointed the Settlement Employee Representatives and the Representative Settlement Counsel. These appointment orders have not been varied or appealed. Unionized employees continue to be represented by the CAW. The Orders appointing the Settlement Employee Representatives expressly gave them authority to represent their constituencies "for the purpose of settling or compromising claims" in these Proceedings. Former Employees and LTD Employees were given the right to opt out of their representation by Representative Settlement Counsel. After provision of notice, only one former employee and one active employee exercised the opt-out right.

B. Effect of the Settlement Approval Order

61 In addition to the binding effect of the Settlement Agreement, many additional parties will be bound and affected by the Settlement Approval Order. Counsel to the Applicants submits that the binding nature of the Settlement Approval Order on all affected parties is a crucial element to the Settlement itself. In order to ensure all Affected Parties had notice, the Applicants obtained court approval of their proposed notice program.

62 Even absent such extensive noticing, virtually all employees of the Applicants are represented in these proceedings. In addition to the representative authority of the Settlement Employee Representatives and Representative Counsel as noted

above, Orders were made authorizing a Nortel Canada Continuing Employees' Representative and Nortel Canada Continuing Employees' Representative Counsel to represent the interests of continuing employees on this motion.

63 I previously indicated that "the overriding objective of appointing representative counsel for employees is to ensure that the employees have representation in the CCAA process": *Nortel Networks Corp., Re* (Ont. S.C.J. [Commercial List]) at para 16. I am satisfied that this objective has been achieved.

64 The Record establishes that the Monitor has undertaken a comprehensive notice process which has included such notice to not only the Former Employees, the LTD Employees, the unionized employees and the continuing employees but also the provincial pension regulators and has given the opportunity for any affected person to file Notices of Appearance and appear before this court on this motion.

65 I am satisfied that the notice process was properly implemented by the Monitor.

66 I am satisfied that Representative Counsel has represented their constituents' interests in accordance with their mandate, specifically, in connection with the negotiation of the Settlement Agreement and the draft Settlement Approval Order and appearance on this Motion. There have been intense discussions, correspondence and negotiations among Representative Counsel, the Monitor, the Applicants, the Superintendent, counsel to the Board of the Applicants, the Noteholder Group and the Committee with a view to developing a comprehensive settlement. NCCE's Representative Counsel have been apprised of the settlement discussions and served with notice of this Motion. Representatives have held Webinar sessions and published press releases to inform their constituents about the Settlement Agreement and this Motion.

C. Jurisdiction to Approve the Settlement Agreement

67 The CCAA is a flexible statute that is skeletal in nature. It has been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". *Nortel Networks Corp., Re* (Ont. S.C.J. [Commercial List]) at paras. 28-29, citing *Metcalfe*, *supra*, at paras. 44 and 61.

68 Three sources for the court's authority to approve pre-plan agreements have been recognized:

(a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;

(b) the power of the court to make an order "on such terms as it may impose" pursuant to s. 11(4) of the CCAA; and

(c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects: see *Nortel Networks Corp., Re* (Ont. S.C.J. [Commercial List]) at para. 30, citing *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (Ont. Gen. Div. [Commercial List]) [*Canadian Red Cross*] at para. 43; *Metcalfe*, *supra* at para. 44.

69 In *Stelco Inc., Re* (2005), 78 O.R. (3d) 254 (Ont. C.A.), the Ontario Court of Appeal considered the court's jurisdiction under the CCAA to approve agreements, determining at para. 14 that it is not limited to preserving the *status quo*. Further, agreements made prior to the finalization of a plan or compromise are valid orders for the court to approve: *Grace 2008*, *supra* at para. 34.

70 In these proceedings, this court has confirmed its jurisdiction to approve major transactions, including settlement agreements, during the stay period defined in the Initial Order and prior to the proposal of any plan of compromise or arrangement: see, for example, *Nortel Networks Corp., Re* (Ont. S.C.J. [Commercial List]); *Nortel Networks Corp., Re* (Ont. S.C.J. [Commercial List]) and *Nortel Networks Corp., Re*, 2010 ONSC 1096 (Ont. S.C.J. [Commercial List]).

71 I am satisfied that this court has jurisdiction to approve transactions, including settlements, in the course of overseeing proceedings during a CCAA stay period and prior to any plan of arrangement being proposed to creditors: see *Calpine Canada Energy Ltd., Re* (Alta. C.A. [In Chambers]) [*Calpine*] at para. 23, affirming (Alta. Q.B.); *Canadian Red Cross*, *supra*; *Air Canada*, *supra*; *Grace 2008*, *supra*, and *Grace Canada Inc., Re* (Ont. S.C.J. [Commercial List]) [*Grace 2010*], leave to appeal to the C.A. refused February 19, 2010; *Nortel Networks Corp., Re*, 2010 ONSC 1096 (Ont. S.C.J. [Commercial List]).

D. Should the Settlement Agreement Be Approved?

72 Having been satisfied that this court has the jurisdiction to approve the Settlement Agreement, I must consider whether the Settlement Agreement *should* be approved.

73 A Settlement Agreement can be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all circumstances. What makes a settlement agreement fair and reasonable is its balancing of the interests of all parties; its equitable treatment of the parries, including creditors who are not signatories to a settlement agreement; and its benefit to the Applicant and its stakeholders generally.

i) Sprit and Purpose

74 The CCAA is a flexible instrument; part of its purpose is to allow debtors to balance the conflicting interests of stakeholders. The Former and LTD Employees are significant creditors and have a unique interest in the settlement of their claims. This Settlement Agreement brings these creditors closer to ultimate settlement while accommodating their special circumstances. It is consistent with the spirit and purpose of the CCAA.

ii) Balancing of Parties' Interests

75 There is no doubt that the Settlement Agreement is comprehensive and that it has support from a number of constituents when considered in its totality.

76 There is, however, opposition from certain constituents on two aspects of the proposed Settlement Agreement: (1) the Opposing LTD Employees take exception to the inclusion of the third party releases; (2) the UCC and Noteholder Groups take exception to the inclusion of Clause H.2.

Third Party Releases

77 Representative Counsel, after examining documentation pertaining to the Pension Plans and HWT, advised the Former Employees' Representatives and Disabled Employees' Representative that claims against directors of Nortel for failing to properly fund the Pension Plans were unlikely to succeed. Further, Representative Counsel advised that claims against directors or others named in the Third Party Releases to fund the Pension Plans were risky and could take years to resolve, perhaps unsuccessfully. This assisted the Former Employees' Representatives and the Disabled Employees' Representative in agreeing to the Third Party Releases.

78 The conclusions reached and the recommendations made by both the Monitor and Representative Counsel are consistent. They have been arrived at after considerable study of the issues and, in my view, it is appropriate to give significant weight to their positions.

79 In *Grace 2008*, *supra*, and *Grace 2010*, *supra*, I indicated that a Settlement Agreement entered into with Representative Counsel that contains third party releases is fair and reasonable where the releases are necessary and connected to a resolution of claims against the debtor, will benefit creditors generally and are not overly broad or offensive to public policy.

80 In this particular case, I am satisfied that the releases are necessary and connected to a resolution of claims against the Applicants.

81 The releases benefit creditors generally as they reduces the risk of litigation against the Applicants and their directors, protect the Applicants against potential contribution claims and indemnity claims by certain parties, including directors, officers and the HWT Trustee; and reduce the risk of delay caused by potentially complex litigation and associated depletion of assets to fund potentially significant litigation costs.

82 Further, in my view, the releases are not overly broad or offensive to public policy. The claims being released specifically relate to the subject matter of the Settlement Agreement. The parties granting the release receive consideration in the form of both immediate compensation and the maintenance of their rights in respect to the distribution of claims.

Clause H.2

83 The second aspect of the Settlement Agreement that is opposed is the provision known as Clause H.2. Clause H.2 provides that, in the event of a bankruptcy of the Applicants, and notwithstanding any provision of the Settlement Agreement, if there are any amendments to the BIA that change the current, relative priorities of the claims against the Applicants, no party is precluded from arguing the applicability or non-applicability of any such amendment in relation to any such claim.

84 The Noteholders and UCC assert that Clause H.2 causes the Settlement Agreement to not be a "settlement" in the true and proper sense of that term due to a lack of certainty and finality. They emphasize that Clause H.2 has the effect of undercutting the essential compromises of the Settlement Agreement in imposing an unfair risk on the non-employee creditors of NNL, including NNI, after substantial consideration has been paid to the employees.

85 This position is, in my view, well founded. The inclusion of the Clause H.2 creates, rather than eliminates, uncertainty. It creates the potential for a fundamental alteration of the Settlement Agreement.

86 The effect of the Settlement Agreement is to give the Former and LTD Employees preferred treatment for certain claims, notwithstanding that priority is not provided for in the statute nor has it been recognized in case law. In exchange for this enhanced treatment, the Former Employees and LTD Beneficiaries have made certain concessions.

87 The Former and LTD Employees recognize that substantially all of these concessions could be clawed back through Clause H.2. Specifically, they acknowledge that future Pension and HWT Claims will rank *pari passu* with the claims of other ordinary unsecured creditors, but then go on to say that should the BIA be amended, they may assert once again a priority claim.

88 Clause H.2 results in an agreement that does not provide certainty and does not provide finality of a fundamental priority issue.

89 The Settlement Parties, as well as the Noteholders and the UCC, recognize that there are benefits associated with resolving a number of employee-related issues, but the practical effect of Clause H.2 is that the issue is not fully resolved. In my view, Clause H.2 is somewhat inequitable from the standpoint of the other unsecured creditors of the Applicants. If the creditors are to be bound by the Settlement Agreement, they are entitled to know, with certainty and finality, the effect of the Settlement Agreement.

90 It is not, in my view, reasonable to require creditors to, in effect, make concessions in favour of the Former and LTD Employees today, and be subject to the uncertainty of unknown legislation in the future.

91 One of the fundamental purposes of the CCAA is to facilitate a process for a compromise of debt. A compromise needs certainty and finality. Clause H.2 does not accomplish this objective. The inclusion of Clause H.2 does not recognize that at some point settlement negotiations cease and parties bound by the settlement have to accept the outcome. A comprehensive settlement of claims in the magnitude and complexity contemplated by the Settlement Agreement should not provide an opportunity to re-trade the deal after the fact.

92 The Settlement Agreement should be fair and reasonable in all the circumstances. It should balance the interests of the Settlement Parties and other affected constituencies equitably and should be beneficial to the Applicants and their stakeholders generally.

93 It seems to me that Clause H.2 fails to recognize the interests of the other creditors of the Applicants. These creditors have claims that rank equally with the claims of the Former Employees and LTD Employees. Each have unsecured claims against the Applicants. The Settlement Agreement provides for a transfer of funds to the benefit of the Former Employees and LTD

Employees at the expense of the remaining creditors. The establishment of the Payments Charge crystallized this agreed upon preference, but Clause H.2 has the effect of not providing any certainty of outcome to the remaining creditors.

94 I do not consider Clause H.2 to be fair and reasonable in the circumstances.

95 In light of this conclusion, the Settlement Agreement cannot be approved in its current form.

96 Counsel to the Noteholder Group also made submissions that three other provisions of the Settlement Agreement were unreasonable and unfair, namely:

(i) ongoing exposure to potential liability for pension claims if a bankruptcy order is made before October 1, 2010;

(ii) provisions allowing payments made to employees to be credited against employees' claims made, rather than from future distributions or not to be credited at all; and

(iii) lack of clarity as to whether the proposed order is binding on the Superintendent in all of his capacities under the *Pension Benefits Act* and other applicable law, and not merely in his capacity as Administrator on behalf of the Pension Benefits Guarantee Fund.

97 The third concern was resolved at the hearing with the acknowledgement by counsel to the Superintendent that the proposed order would be binding on the Superintendent in all of his capacities.

98 With respect to the concern regarding the potential liability for pension claims if a bankruptcy order is made prior to October 1, 2010, counsel for the Applicants undertook that the Applicants would not take any steps to file a voluntary assignment into bankruptcy prior to October 1, 2010. Although such acknowledgment does not bind creditors from commencing involuntary bankruptcy proceedings during this time period, the granting of any bankruptcy order is preceded by a court hearing. The Noteholders would be in a position to make submissions on this point, if so advised. This concern of the Noteholders is not one that would cause me to conclude that the Settlement Agreement was unreasonable and unfair.

99 Finally, the Noteholder Group raised concerns with respect to the provision which would allow payments made to employees to be credited against employees' claims made, rather than from future distributions, or not to be credited at all. I do not view this provision as being unreasonable and unfair. Rather, it is a term of the Settlement Agreement that has been negotiated by the Settlement Parties. I do note that the proposed treatment with respect to any payments does provide certainty and finality and, in my view, represents a reasonable compromise in the circumstances.

Disposition

100 I recognize that the proposed Settlement Agreement was arrived at after hard-fought and lengthy negotiations. There are many positive aspects of the Settlement Agreement. I have no doubt that the parties to the Settlement Agreement consider that it represents the best agreement achievable under the circumstances. However, it is my conclusion that the inclusion of Clause H.2 results in a flawed agreement that cannot be approved.

101 I am mindful of the submission of counsel to the Former and LTD Employees that if the Settlement Agreement were approved, with Clause H.2 excluded, this would substantively alter the Settlement Agreement and would, in effect, be a creation of a settlement and not the approval of one.

102 In addition, counsel to the Superintendent indicated that the approval of the Superintendent was limited to the proposed Settlement Agreement and would not constitute approval of any altered agreement.

103 In *Grace 2008*, *supra*, I commented that a line-by-line analysis was inappropriate and that approval of a settlement agreement was to be undertaken in its entirety or not at all, at para. 74. A similar position was taken by the New Brunswick Court of Queen's Bench in *Wandlyn Inns Limited (Re)* (1992), 15 C.B.R. (3d) 316 (N.B. Q.B.). I see no reason or basis to deviate from this position.

104 Accordingly, the motion is dismissed.

105 In view of the timing of the timing of the release of this decision and the functional funding deadline of March 31, 2010, the court will make every effort to accommodate the parties if further directions are required.

106 Finally, I would like to express my appreciation to all counsel and in person parties for the quality of written and oral submissions.

Motion dismissed.

Footnotes

1 On March 25, 2010, the Supreme Court of Canada released the following: *Donald Sproule et al. v. Nortel Networks Corporation et al.* (Ont.) (Civil) (By Leave) (33491) (The motions for directions and to expedite the application for leave to appeal are dismissed. The application for leave to appeal is dismissed with no order as to costs./La requête en vue d'obtenir des directives et la requête visant à accélérer la procédure de demande d'autorisation d'appel sont rejetées. La demande d'autorisation d'appel est rejetée; aucune ordonnance n'est rendue concernant les dépens.): <http://scc.lexum.umontreal.ca/en/news_release/2010/10-03-25.3a/10-03-25.3a.html>

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TAB 11

2007 ABCA 266
Alberta Court of Appeal (In Chambers)

Calpine Canada Energy Ltd., Re

2007 CarswellAlta 1097, 2007 ABCA 266, [2007] A.W.L.D. 3481, [2007] A.J. No. 917, 161 A.C.W.S. (3d) 370, 33 B.L.R. (4th) 94, 35 C.B.R. (5th) 27, 410 W.A.C. 25, 417 A.R. 25, 80 Alta. L.R. (4th) 60

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

And In the Matter of Calpine Canada Energy Limited, Calpine Canada Power Ltd., Calpine Canada Energy Finance ULC, Calpine Energy Services Canada Ltd., Calpine Canada Resources Company, Calpine Canada Power Services Ltd., Calpine Canada Energy Finance II ULC, Calpine Natural Gas Services Limited and 3094479 Nova Scotia Company (the "CCAA Applicants")

Calpine Power L.P. (Appellant / Applicant (Creditor)) and The CCAA Applicants and Calpine Energy Services Canada Partnership, Calpine Canada Natural Gas Partnership and Calpine Canadian Saltend Limited Partnership (Respondents / Applicants)

Calpine Canada Natural Gas Partnership (Respondent / Applicant / CCAA Party) and Calpine Energy Services Canada Partnership and Lisa Winslow, Trustee of Calpine Greenfield Commercial Trust (Respondents / (CCAA Applicant and Interested Parties)) and Calpine Power L.P. (Appellant / Applicant / (Creditor in CCAA Proceedings))

C. O'Brien J.A.

Heard: August 15, 2007
Judgment: August 17, 2007
Docket: Calgary Appeal 0701-0222-AC, 0701-0223-AC

Proceedings: refusing leave to appeal *Calpine Canada Energy Ltd., Re* (2007), 2007 CarswellAlta 1050, 2007 ABQB 504 (Alta. Q.B.)

Counsel: P.T. Linder, Q.C., R. Van Dorp for Applicant, CPL
L.B. Robinson, Q.C., S.F. Collins, J.A. Carfagnini for CCAA Applicants and the CCAA Parties (Respondents)
H.A. Gorman for Ad Hoc ULCI Noteholders Committee
P.H. Griffin, U. Sheikh for Calpine Corporation and other US Debtors
F.R. Dearlove for HSBC
P. McCarthy, Q.C., J. Kruger for Ernst & Young Inc., the Monitor
N.S. Rabinovitch for Lien Debtholders
R. De Waal for Unsecured Creditors Committee

Subject: Insolvency

Table of Authorities

Cases considered by *C. O'Brien J.A.*:

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Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 1998 CarswellOnt 3346, 5 C.B.R. (4th) 299, 72 O.T.C. 99 (Ont. Gen. Div. [Commercial List]) — referred to

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

Liberty Oil & Gas Ltd., Re (2003), 2003 ABCA 158, 2003 CarswellAlta 684, 44 C.B.R. (4th) 96 (Alta. C.A.) — followed

Playdium Entertainment Corp., Re (2001), 2001 CarswellOnt 3893, 18 B.L.R. (3d) 298, 31 C.B.R. (4th) 302 (Ont. S.C.J. [Commercial List]) — referred to

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

Stelco Inc., Re (2005), 204 O.A.C. 216, 78 O.R. (3d) 254, 2005 CarswellOnt 6283, 15 C.B.R. (5th) 288 (Ont. C.A.) — referred to

T. Eaton Co., Re (1999), 14 C.B.R. (4th) 288, 1999 CarswellOnt 3542 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

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

s. 4 — considered

s. 5 — considered

s. 6 — considered

s. 11(4) — referred to

APPLICATION by creditor for stay pending appeal and leave to appeal from judgment reported at *Calpine Canada Energy Ltd., Re* (2007), 2007 CarswellAlta 1050, 2007 ABQB 504, 35 C.B.R. (5th) 1, 33 B.L.R. (4th) 68 (Alta. Q.B.), granting application for approval of settlement.

***C. O'Brien J.A.*:**

Introduction

1 Calpine Power L.P. (CLP) applies for a stay pending appeal and leave to appeal three orders granted on July 24, 2007 in a proceeding under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (CCAA). At the request of

counsel, the applications have been dealt with on an expedited basis. Oral submissions were heard on August 15, at the close of which I undertook to deliver judgment by the end of the week. I do so now.

Background facts

2 In December 2005, Calpine Canada Energy Limited, Calpine Canada Power Ltd., Calpine Canada Energy Finance ULC, Calpine Energy Services Canada Ltd., Calpine Canada Resources Company, Calpine Canada Power Services Ltd., Calpine Canada Energy Finance II ULC, Calpine Natural Gas Services Limited, and 3094479 Nova Scotia Company (CCAA Applicants) sought and obtain protection under the CCAA. At the same time, the parties referred to as the US Debtors sought and obtained similar protection under Chapter 11 of the U. S. Bankruptcy Code.

3 A monitor, Ernst & Young Inc., was appointed under the CCAA proceedings and a stay of proceedings was ordered against the CCAA Applicants and against Calpine Energy Services Canada Partnership, Calpine Canada Natural Gas Partnership and Calpine Canadian Saltend Limited Partnership. The latter three parties collectively are referred to as the CCAA Parties and those parties together with the CCAA Applicants as the CCAA Debtors.

4 This insolvency is extremely complex, involving many related corporations and partnerships, and highly intertwined legal and financial obligations. The goal of restructuring and realizing maximum value for assets has been made more difficult by a number of cross-border issues.

5 As described in the Monitor's 23rd Report, dated June 28, 2007, the CCAA Debtors and the US Debtors concluded that the most appropriate way to resolve the issues between them was to concentrate on reaching a consensual global agreement that resolved virtually all the material cross-border issues between them. The parties negotiated a global settlement agreement (GSA) subject to the approval of both Canadian and U. S. courts, execution of the GSA and the sale by Calpine Canada Resources Company of its holdings of Calpine Canada Energy Finance ULC (ULC1) Notes in the face amount of US$359,770,000 (the CCRC ULC1 Notes). Counsel at the oral hearing informed me that the Notes were sold on August 14, 2007, yielding a net amount of approximately US $403 million, an amount exceeding the face amount.

6 On July 24, 2007, the CCAA Applicants sought and obtained three orders. First, an order approving the terms of the GSA and directing the various parties to execute such documents and implement the transactions necessary to give effect to the GSA. Second, an order permitting CCRC and ULC1 to take the necessary steps to sell the CCRC ULC1 Notes. Third, an extension of the stay contemplated by the initial CCAA order to December 20, 2007. No objection was taken to the latter two orders and both were granted. The supervising judge also, in brief oral reasons, approved the GSA with written reasons to follow. Written Reasons for Judgment were subsequently filed on July 31, 2007: *Calpine Canada Energy Ltd., Re*, 2007 ABQB 504 (Alta. Q.B.). The reasons are careful and detailed. They fully set out the relevant facts and canvas the applicable law and as I see no need to repeat the facts and authorities, the reasons should be read in conjunction with these relatively short reasons dealing with the applications arising therefrom.

7 The applications to the supervising judge were made concurrently with applications by the US Debtors to the US Bankruptcy Court in New York state, the applications proceeding simultaneously by video conference. The applications to the US Court, including an application for approval of the GSA, were also granted.

8 The applicant, CLP, the Calpine Canada Energy Finance II ULC (ULC2) Indenture Trustee and a group referring to itself as the "Ad Hoc Committee of Creditors of Calpine Canada Resources Company" opposed the approval of the GSA. CPL is the only party seeking leave to appeal.

9 CLP submits that the supervising judge erred in concluding that the GSA was not a compromise or plan of arrangement and therefore, sections 4 and 5 of the CCAA did not apply and no vote by creditors was necessary.

10 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.

11 CLP further submits that the jurisdiction of the supervising judge to approve the GSA is governed by section 6 of the CCAA. Section 6 provides:

Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(b) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the Bankruptcy and Insolvency Act or is in the course of being wound up under the Winding-up and Restructuring Act, on the trustee in bankruptcy or liquidator and contributories of the company.

12 The supervising judge found that the GSA is not linked to or subject to a plan of arrangement and does not compromise the rights of creditors that are not parties to it or have not consented to it, and it does not have the effect of unilaterally depriving creditors of contractual rights without their participation in the GSA. She concluded that the GSA was not a compromise or arrangement for the purposes of section 4 of the CCAA. In the course of her reasons she cites a number of cases for support that the court has jurisdiction to review and approve transactions and settlement agreements during the stay period of a CCAA proceedings if an agreement is fair and reasonable and will be beneficial to the debtor and its stakeholders generally.

Test for leave to appeal

13 This Court has repeatedly stated, for example in *Liberty Oil & Gas Ltd., Re*, 2003 ABCA 158, 44 C.B.R. (4th) 96 (Alta. C.A.), at paras. 15-16, that the test for leave under the CCAA involves a single criterion that there must be serious and arguable grounds that are of real and significant interest to the parties. The four factors used to assess whether this criterion is present are:

(1) Whether the point on appeal is of significance to the practice;

(2) Whether the point raised is of significance to the action itself;

(3) Whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and

(4) Whether the appeal will unduly hinder the progress of the action.

14 In assessing these factors, consideration should also be given to the applicable standard of review: *Canadian Airlines Corp., Re*, 2000 ABCA 149, 261 A.R. 120 (Alta. C.A. [In Chambers]). Having regard to the commercial nature of the proceedings which often require quick decisions, and to the intimate knowledge acquired by a supervising judge in overseeing a CCAA proceedings, appellate courts have expressed a reluctance to interfere, except in clear cases: *Smoky River Coal Ltd., Re*, 1999 ABCA 179, 237 A.R. 326 (Alta. C.A.) at para. 61.

Analysis

15 The standard of review plays a significant, if not decisive, role in the outcome of this application for leave to appeal. The supervising judge, on the record of evidence before her, found that the GSA was "not a plan of compromise or arrangement with creditors" (Reasons, para. 51). This was a finding of fact, or at most, a finding of mixed law and fact. The applicant has identified no extricable error of law so the applicable standard is palpable or overriding error.

16 The statute itself contains no definition of a compromise or arrangement. Moreover, it does not appear that a compromise or an arrangement has been *proposed* between a debtor company and either its unsecured or secured creditors, or any class of them within the scope of sections 4 or 5 of the CCAA. Neither the company, a creditor, nor anyone made application to convene a meeting under those sections.

17 Rather, the GSA settles certain intercorporate claims between certain Canadian Calpine entities and certain US Calpine entities subject to certain conditions, including the approvals both of the Court of Queen's Bench of Alberta and of the US Bankruptcy Court.

18 This is not to minimize the magnitude, significance and complexity of the issues dealt with in the intercorporate settlement which, by definition, was not between arm's length companies. The material cross-border issues are identified in the 23rd Report of the monitor and listed by the supervising judge (Reasons, para. 5).

19 It is implicit in her reasons, if not express, that the supervising judge accepted the analysis of the monitor, and found that the GSA would likely ultimately result in payment in full of all Canadian creditors, including CLP. CLP does not challenge this finding, but points out that payment is not assured, and rightly relies upon its status as a creditor to challenge the approval in the meantime until such time as it has been paid.

20 The supervising judge further found that the GSA "does not compromise the rights of creditors that are not parties to it or have not consented to it, and it certainly does not have the effect of unilaterally depriving creditors of contractual rights without their participation in the GSA" (Reasons, para. 51). CPL challenges this finding. In order to succeed in its proposed appeal, CPL must also demonstrate palpable and overriding error in these further findings of the supervising judge which once again, involve findings of fact or of mixed law and fact.

Application in this case

21 CPL submits that the "fundamental problem" with the approval granted by the supervising judge is that the GSA is in reality a plan of arrangement because it settles virtually all matters in dispute in the Canadian CCAA estate and therefore, entitles the applicant to a vote. CPL argues that the GSA must be an arrangement or compromise within the meaning of sections 4, 5 and 6 of the CCAA because, in its view, the GSA requires non party creditors to make concessions, re-orders the priorities of creditors and distributes assets of the estate.

22 The supervising judge acknowledged at the outset of her analysis that if the GSA were a plan of arrangement or compromise, a vote by creditors would be necessary (Reasons, para. 41). However, she was satisfied that the GSA did not constitute a plan of arrangement with creditors.

23 The applicant conceded that a CCAA supervising judge has jurisdiction to approve transactions, including settlements in the course of overseeing proceedings during a stay period and prior to any plan of arrangement being proposed to creditors. This concession was proper having regard to case authority recognizing such jurisdiction and cited in the reasons of the supervising judge, including *Air Canada, Re* (2004), 47 C.B.R. (4th) 169 (Ont. S.C.J. [Commercial List]), *Playdium Entertainment Corp., Re* (2001), 31 C.B.R. (4th) 302 (Ont. S.C.J. [Commercial List]), *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]), *T. Eaton Co., Re* (1999), 14 C.B.R. (4th) 288 (Ont. S.C.J. [Commercial List]) and *Stelco Inc., Re* (2005), 78 O.R. (3d) 254 (Ont. C.A.).

24 The power to approve such transactions during the stay is not spelled out in the CCAA. As has often been observed, the statute is skeletal. The approval power in such instances is usually said to be found either in the broad powers under section 11(4) to make orders other than on an initial application to effectuate the stay, or in the court's inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of the debtor until it can present a plan: *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]) at para. 8.

25 Hunt, J.A. in delivering the judgment of this Court in *Smoky River Coal*considered the history of the legislation and its objectives in allowing the company to take steps to promote a successful eventual arrangement. She concluded at para. 53:

> These statements about the goals and operation of the CCAA support the view that the discretion under s. 11(4) should be interpreted widely.

and further at para. 60:

> To summarize, the language of s. 11(4) is very broad. The CCAA must be interpreted in a remedial fashion.

26 In my view, there is no serious issue as to the jurisdiction of a supervising judge to approve a settlement agreement between consenting parties prior to consideration of a plan of arrangement pursuant to section 6 of the CCAA. The fact that the GSA is not a simple agreement between two parties, but rather resolves a number of complex issues between a number of parties, does not affect the jurisdiction of the court to approve the agreement if it is for the general benefit of all parties and otherwise meets the tests identified in the reasons of the supervising judge.

27 CPL urges that the legal issue for determination by this Court is where the line is to be drawn to say when a settlement becomes a compromise or arrangement, thus requiring a vote under section 6 before the court can grant approval. It suggests that it would be useful to this practice area for the court to set out the criteria to be considered in this regard.

28 An element of compromise is inherent in a settlement as there is invariably some give and take by the parties in reaching their agreement. The parties to the GSA made concessions for the purpose of gaining benefits. It is obvious that something more than compromise between consenting parties within a settlement agreement is required to constitute an arrangement or compromise for purposes of the CCAA as if that were not so, no settlement agreement could be approved without a vote of the creditors. As noted, that is contrary to case authority accepted by all parties to these applications.

29 The CCAA deals with compromises or arrangements sought to be imposed upon creditors generally, or classes of creditors, and a vote is a necessary mechanism to determine whether the appropriate majority of the creditors proposed to be affected support the proposed compromise or arrangement.

30 As pointed out by the supervising judge, a settlement will almost always have an impact on the financial circumstances of a debtor. A settlement will invariably have an effect on the size of the estate available for other claimants (Reasons, para. 62).

31 Whether or not a settlement constitutes a plan of arrangement requiring a vote will be dependent upon the factual circumstances of each case. Here, the supervising judge carefully reviewed the circumstances and concluded, on the basis of a number of the fact findings, that there was no plan of arrangement within the meaning of the CCAA, and that the settlement merited approval. She recognized the peculiar circumstances which distinguishes this case, and observed at para. 76 of her Reasons:

> The precedential implications of this approval must be viewed in the context of the unique circumstances that have presented a situation in which all valid claims of Canadian creditors likely will be paid in full. This outcome, particularly with respect to a cross-border insolvency of exceptional complexity, is unlikely to be matched in other insolvencies, and therefore, a decision to approve this settlement agreement will not open any floodgates.

32 At the time of granting her approval, the supervising judge had been overseeing the conduct of these CCAA proceedings since their inception — some 18 months earlier. She had the benefit of the many reports of the monitor and was familiar with

the record of the proceedings. Her determination of this issue is entitled to deference in the absence of legal error or palpable and overriding error of fact.

33 CPL submits that the GSA compromises its rights and claims, and thus, challenges the express finding of the supervising judge that the settlement neither compromises the rights of creditors before it, nor deprives them of their existing contractual rights. The applicant relies upon the following effects of the GSA in making this submission:

(i) a priority payment of $75 million out of the proceeds of the sale of bonds owned by Calpine Canada Resources Company;

(ii) the release of a potential claim against Calpine Canada Energy Limited, the parent of Calpine Canada Resources Company, which is a partner of Calpine Energy Services Canada Ltd., against which CPL has a claim;

(iii) the dismissal of a claim by Calpine Canada Energy Limited against Quintana Canada Holdings LLC, thereby depleting Calpine Canada Energy Limited of a potential asset which that company could use to satisfy any potential claim by CPL for any shortfall, were it not for the release of claims against Calpine Canada Energy Limited (see (ii) above); and

(iv) the dismissal of the Greenfield Action brought by another CCAA Debtor against Calpine Energy Services Canada Ltd. for an alleged fraudulent conversion of its interest in Greenfield LP which was developing a 1005 Megawatt generation plant.

34 For purposes of the CCAA proceedings, the applicant is a creditor of Calpine Energy Services Canada Ltd., Calpine Canada Power Ltd. and perhaps, also, Calpine Canada Resources Company. The GSA does not change its status as a creditor of those companies, nor does it bar the applicant from any existing claims against those companies.

35 In my view, the submission of the applicant does not show any palpable and overriding error in the findings of the supervising judge that the right of creditors not parties to the GSA have not been compromised or taken away. Firstly, there is no compromise of debt if such indebtedness, as ultimately found due to the applicant, is paid in full, which is the likely result as found by the supervising judge, albeit she acknowledged that this result was not guaranteed (Reasons, para. 81). Secondly, and in any event, the fact that the GSA impacts upon the assets of the debtor companies, against which the applicant may ultimately have a claim for any shortfall experienced by it, is a common feature of any settlement agreement and as earlier explained, does not automatically result in a vote by the creditors. The further fact that one of the affected assets of the debtor companies is a cause of action, or perhaps, more correctly, a possible cause of action, does not abrogate the rights of a creditor albeit there may be less monies to be realized at the end of the day.

36 The GSA does not usurp the right of the creditors to vote on a plan of arrangement if it becomes necessary to propose such a plan to the creditors. As explained by the supervising judge, the settlement between the CCAA Debtors and the US Debtors unlocked the Canadian proceedings to meaningful progress in asset realization and claims resolution, and provided the mechanisms for resolving the remaining issues and significant creditor claims, and the clarification of priorities.

37 It is correct, of course, that if the claims of CPL are paid in full in the course of the CCAA proceedings, it will never be necessary for it to vote on a plan of arrangement. The applicant should have no complaint with that result. On the other hand, if the claims are not satisfied, it seems likely a plan of arrangement will ultimately be proposed to the applicant, who will then have its right to vote on any such plan.

38 CPL argues that the supervising judge was not entitled to assess the merits of the GSA *vis-à-vis* the creditors as this was a matter for the exclusive business judgment of the creditors and to be exercised by their vote. As became apparent during the course of its submissions, if a vote were required, from the perspective of the CPL, this would give it veto power over the GSA. Unless clearly mandated by the statute, this is a result to be avoided. While it is understandable that an individual creditor seeks to obtain as much leverage as possible in order to enhance its negotiating position, the objectives and purposes of the CCAA could easily be frustrated in such circumstances by the self interest of a single creditor. Court approval requires, as a

primary consideration, the determination that an agreement is fair and reasonable and will be beneficial to the debtor and its stakeholders generally. As the supervising judge noted, court approval of settlements and major transaction can and often is given over the objections of one or more parties because the court must act for the greater good consistent with the purpose and spirit and within the confines of the legislation.

39 I am not persuaded that the applicant has demonstrated any reasonably arguable error of law in the reasons of the supervising judge or any palpable and overriding errors in her findings of fact or findings of mixed fact and law. In the absence of any such error, it follows that she had discretion to approve the GSA, which she exercised based upon her assessment of the merits and reasonableness of the settlement, and other factors in accordance with the principles set out in the authorities, cited in her reasons, governing the approval of transactions, including settlements, during the stay period prior to a plan of arrangement being submitted to the creditors.

Conclusion

40 CPL has failed to establish serious and arguable grounds for granting leave. In particular, two of the factors used to assess whether this criterion is present have not been met. It has not been demonstrated that the point on appeal is of significance to the parties having regard to the fact dependent nature of whether a plan of arrangement has been proposed to creditors. More importantly, having regard to the standard of review and the findings of the supervising judge, the applicant has not demonstrated that the appeal for which leave is sought is *prima facie* meritorious.

41 The application for leave is dismissed. It follows that the application for a stay likewise fails and is dismissed.

42 Finally, I would be remiss if I did not acknowledge the excellent quality of the submissions, both written and oral, of counsel on these applications. The submissions were of great assistance in permitting the application to be dealt with in an abbreviated time frame.

Application dismissed.

End of Document

TAB 12

2003 CarswellOnt 5296
Ont. Superior Court of Justice [Commercial List]

Air Canada, Re

2003 CarswellOnt 5296, [2003] O.J. No. 5319, 128 A.C.W.S. (3d) 9, 47 C.B.R. (4th) 163

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

AND IN THE MATTER OF SECTION 191 OF THE CANADA BUSINESS CORPORATIONS ACT, R.S.C. 1985, c. C-44, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF AIR CANADA AND THOSE SUBSIDIARIES LISTED ON SCHEDULE "A"

APPLICATION UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Farley J.

Heard: December 17, 2003
Judgment: December 17, 2003
Written reasons: December 21, 2003
Docket: 03-CL-4932

Counsel: David R. Byers, Timothy Banks, Karen Park for Applicants, Air Canada
James P. Dube, Susan M. Grundy for Lufthansa
Aubrey Kauffman for Ad Hoc Committee of Financial Creditors
Gregory Azeff for GECAS
A. Cobb for Trinity Time Investments Limited
Joseph Bellissimo for Ad Hoc Aircraft Lessor/Lender Group
Erik Penz for Unsecured Creditors Committee
Jeremy Dacks for GE Capital
Peter J. Osborne, Monique Jilesen for Monitor

Subject: Insolvency; Corporate and Commercial

Table of Authorities

Cases considered by *Farley J.*:

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1999), 1999 CarswellOnt 3123 (Ont. S.C.J. [Commercial List]) — considered

Sammi Atlas Inc., Re (1998), 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — considered

Statutes considered:

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

Generally — referred to

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

APPLICATION for approval of Agreement in course of proceedings under Companies' Creditors Arrangement Act.

***Farley J.*:**

1 On December 17, 2003 at the end of the hearing, I wrote a very short Endorsement approving the Canada-Germany Co-operation Agreement ("Agreement") between Air Canada ("AC") and Deutsche Lufthansa Aktiengesellschaft ("LH") promising that I would provide reasons in due course. These are those reasons.

2 The Agreement was supported by all those appearing except for certain bondholders represented by Mr. Kauffman. His submissions were that AC and LH were attempting to have LH "gain an advantage over other creditors to which it is not otherwise entitled," indicating that this was being done in "precisely the same manner disapproved by Justice Blair" in *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re*, [1999] O.J. No. 3657 (Ont. S.C.J. [Commercial List]) at paragraph 10. The Court must always be concerned that there not be ill-founded arm-twisting of a CCAA applicant, such that the Applicant and its creditors and other stakeholders are put to a significant disadvantage. These concerns were generally addressed in the Report of the Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform of March 15, 2002 by recommendations 15-17. I attach a copy of those recommendations and the commentary as an appendix (Appendix "A") to these reasons. Perhaps it would be salutary if the critical vendor issue were addressed in a somewhat strengthened way if it were made clear that not more than, say one-half or one-third of a pre-filing debt could be "pressured out" of an applicant so that there might be some sharing of the pain by the critical vendor of what the other unsecured vendors were experiencing. Any such "pressured out" payment would leave to be accounted for in the plan of re-organization with respect to the balance of the debt which would be compromised. In any event, it would appear to me that in exercising its discretion, the Court ought to take into account the extent and nature of support of interested parties as to the payment to a critical vendor.

3 In the subject case, I find that the relationship with LH has been extremely beneficial to AC and it is reasonably expected that the benefit will continue to increase during the currency of the Agreement to 2009 and that the arrangements contemplated therein would likely not be possible to duplicate with any other airline (given LH's dominant position in Europe and its facility to be able to seamlessly be able to give AC's passengers to Eastern Europe and other promising areas of the world). Indeed, it would be extremely disruptive if the relationship were not continued. (LH indicated that it would terminate its relationship at the earliest opportunity if the Agreement were not approved). I note, in this regard that there was no direct evidence; however, there was no request for an adjournment or even cross-examination on the Brewer AC affidavit in this regard (which may suggest that Mr. Kauffman's concern here was more technical than practical - but he has a legitimate concern about this practice, which in my view is to be avoided in future absent justifiable and unusual circumstances). However, I do note that the Monitor in its 16th Report did not indicate that it had any concerns (after its extensive investigation of the situation) as to the legitimacy of the concern about the danger to AC or the *bona fides* of LH's caution.

4 The future net benefit to AC of the future arrangements and cooperation is expected to be substantial and considerably in excess of the pre-filing debt to LH which is to be paid over time pursuant to the terms of the Agreement.

5 The cost to AC to attempt to obtain even part of the benefit through alliances through other airlines, if possible, would be extremely expensive.

6 Taking these various factors into consideration, it is understandable that there was considerable support from the others taking part in this hearing. The Monitor has helpfully ruled out a potential double recovery issue vis-à-vis LH payments and

the Kreditanstalt für Wiederaufbau ("KfW") loan transaction. These are documented by the LH and KfW letters at Tab C of the Monitor's 16th Report.

7 In *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]), I observed at page 173 that, in dealing with creditors under the CCAA, equitable treatment is not necessarily equal treatment and that the objective should be fair, reasonable and equitable treatment.

8 With respect to *Red Cross, supra*, I note that the concern there of Blair, J. was that there was to be a lump sum payment out of the existing assets in what would be the CCAA Estate, which payment would diminish that estate out of which the other creditors would be paid. In contrast, the Agreement provides for payments to LH in the future and which are reasonably expected to be paid out of the future net profits guaranteed by AC and if the relationship with LH now consolidated and confirmed by the Agreement. See Blair, J.'s views in this regard at paragraphs 12-14:

> ¶ 12 . . . [R] egardless of the merits of the settlement as between its immediate parties or the apparent worthiness of its beneficiaries, I am not persuaded that a strong unsecured creditor and the debtor can effectively isolate a particular claim and carve it out of the CCAA proceedings by simple expedient of entering into an agreement purporting to settle their future relations.
>
> ¶ 13 The foregoing is premised, of course, on the lump sum payment which is made as part of the Settlement being paid out of a fund which is not a segregated trust fund and, therefor [sic], something outside of the CCAA proceedings . . . .
>
> ¶ 14 . . . In my view, it must be determined, however, before approval can be given to the pay equity settlement. If the Homemakers' Fund from which the $10.2 million payment is to be made is, indeed, a segregated trust fund whose participants are agreeable to its being used for the purposes indicated, I would have no difficulty in approving the Settlement. Clearly it would be in the interests of the Red Cross, the Union and the employees in question, and all of the Red Cross Claimants to have the pay equity claim dealt with in the fashion proposed, if that were the case. In the absence of such a determination, however, I am not prepared to grant such approval, for the reasons articulated above (emphasis added).

9 In the result, I am of the view that the truly extraordinary and indeed it seems to me unique relationship of LH and AC which is so beneficial to AC and reasonably expected to be even more so in the future is to the overall benefit of the creditors and stakeholders of AC generally. If it were not approved and implemented, then AC and its creditors and stakeholders would probably be dealt a severe body blow which could well have a devastating effect upon the question of AC successfully emerging from this CCAA process. The Agreement is therefore approved.

10 Appendix attached.

Order accordingly.

Appendix — "A"

15. Provide (in both CCAA and BIA proposal cases) that no payments are to be made or security granted with respect to pre-filing unsecured claims without prior court approval (obtained after the initial order), except that with the prior written consent of the monitor/trustee (unless otherwise ordered by the court) the following pre-filing claims can be paid:

(a) source deductions;

(b) wages (including accrued vacation pay), benefits and sales tax remittances not yet due or not more than seven (7) days overdue at the date of filing; and

(c) reasonable professional fees (subject to subsequent assessment) incurred with respect to the filing.

16. Provide (in both CCAA and BIA proposal cases) that no payments are to be made or additional security granted with respect to pre-filing secured claims (including security leases) that are subject to the stay without the prior approval of the court.

17. Provide that during a reorganization proceeding if there is no readily available alternative source of reasonably equivalent supply, then in order to prevent hostage payments the court has jurisdiction, on notice to the affected persons, to order any existing critical suppliers of goods and services (even though not under pre-filing contractual obligation to provide goods or services) to supply the debtor during the reorganization proceeding on normal pricing terms so long as effective arrangements are made to assure payment for post-filing supplies.

These three proposals complement one another and balance a prohibition on payment of pre-filing claims with important carve outs to recognize particular needs and interests. Proposal #15 prohibits payments being made or security granted to pre-filing unsecured claims without prior court approval. This prohibits the debtor from giving a preference to unsecured creditors, to the prejudice of more senior creditors or other unsecured creditors. However, the recommendation also recognizes that there are circumstances where it is in the interests of the debtor company as well as the general body of creditors to make payments. These include source deductions such as income tax, employment insurance and pension deductions, wages, accrued vacation pay, benefits and sales tax remittances that are not yet due or not more than 7 days overdue when the debtor files its application. In such cases, the debtor corporation, with the prior written consent of the monitor or trustee, can pay the claims without the cost and delay of having to obtain a court order.

This meets fairness objectives in that employees are being paid specified amounts and will be encouraged to stay through the restructuring. Tax remittances held in trust can also be paid for a limited period. The monitor or trustee acts as a check on behalf of the court and the general body of creditors in approving the payments. The debtor can go to the court if it believes that the monitor or trustee is withholding consent without valid reason.

The debtor would also be permitted to pay reasonable professional fees incurred with respect to the filing, also with the prior written consent of the monitor or trustee and subject to subsequent assessment by the court. This will facilitate timely filing of CCAA applications and commencement of the restructuring negotiations, and should prevent excessive appearances before the court. The subsequent assessment condition provides creditors with an avenue to object to these payments if they believe that they are excessive or unreasonable.

Proposal #16 is a prohibition on payments to be made or additional security to be granted to pre-filing secured creditors. This is aimed at ensuring both that a preference is not given to one or more secured creditors and that such creditors are not in a position to extract hostage payments from the debtor company during the stay period. Thus it is aimed at protection of the general body of creditors. Payments can be made or additional security granted if the court gives prior approval. Thus the general prohibition is tempered by granting the court discretion in its supervisory capacity to approve payments or security where appropriate.

Proposal #17 then recognizes that there may be instances in which there is no readily available alternate source of supply that is reasonably equivalent to the goods or services of a particular supplier. In order to prevent that creditor from extracting hostage payments during the restructuring proceeding, i.e. from demanding credit on excessive terms because the debtor has no ability to contract with another supplier, the recommendation puts in place a mechanism for the court to supervise the issue of continued supply of goods and services. The court would have the jurisdiction, on notice to the affected persons, to order an existing critical supplier of goods and services, even where it was not under a pre-filing contractual obligation to continue supplying, to supply the debtor company during the reorganization proceeding. The court would have authority to order this on normal pricing terms, as long as effective arrangements were made to ensure payment for post-filing supplies. Thus the creditor would be required to continue to supply for a fixed period on normal pricing terms, but it would not be required to accept normal payment terms and the arrangement for payment by the debtor would have to satisfy the court that it was effective and timely. If the supplier had legitimate reasons for refusing to supply or for requesting increased pricing (for example, in order to recover extraordinary costs), the court would have authority to protect the supplier.

These three proposals together allow the debtor some discretion in respect of allowing payments, under supervision of the court-appointed officer, while ensuring that the general body of creditors is protected from the debtor preferring pre-existing creditors or being held hostage by a critical supplier. The fairness objectives are that it allows the debtor to continue to receive needed supplies and services, while balancing the interests and prejudice to other creditors. In terms of efficiency objectives, there is likely to be need for fewer court appearances if all stakeholders, including court-appointed officers and creditors, are given clear guidelines on the scope and ability to make payments or grant additional security during the stay period.

End of Document

TAB 13

1998 CarswellOnt 1145
Ontario Court of Justice, General Division [Commercial List]

Sammi Atlas Inc., Re

1998 CarswellOnt 1145, [1998] O.J. No. 1089, 3 C.B.R. (4th) 171, 59 O.T.C. 153, 78 A.C.W.S. (3d) 10

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

In The Matter of the Courts of Justice Act, R.S.O. 1990, c.C.43

In The Matter of a Plan of Compromise or Arrangement of Sammi Atlas Inc.

Farley J.

Heard: February 27, 1998
Judgment: February 27, 1998
Docket: 97-BK-000219, B230/97

Counsel: *Norman J. Emblem*, for the applicant, Sammi Atlas Inc.
James Grout, for Agro Partners, Inc.
Thomas Matz, for the Bank of Nova Scotia.
Jay Carfagnini and *Ben Zarnett*, for Investors' Committee.
Geoffrey Morawetz, for the Trade Creditors' committee.
Clifton Prophet, for Duk Lee.

Subject: Insolvency; Corporate and Commercial

Table of Authorities

Cases considered by *Farley J.*:

Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303 (Ont. C.A.) — applied

Campeau Corp., Re (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) — applied

Central Guaranty Trustco Ltd., Re (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) — applied

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) — applied

Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada, 34 B.C.L.R. (2d) 122, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363 (B.C. C.A.) — referred to

Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re)* 12 O.R. (3d) 500 (Ont. Gen. Div.) — applied

Statutes considered:

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

Generally — referred to

MOTION for approval and sanctioning of plan of compromise and arrangement under *Companies' Creditors Arrangement Act*; MOTION by creditor for amendment of plan.

***Farley J.*:**

1 This endorsement deals with two of the motions before me today:

1) Applicant's motion for an order approving and sanctioning the Applicant's Plan of Compromise and Arrangement, as amended and approved by the Applicant's unsecured creditors on February 25, 1998; and

2) A motion by Argo Partners, Inc. ("Argo"), a creditor by way of assignment, for an order directing that the Plan be amended to provide that a person who, on the record date, held unsecured claims shall be entitled to elect treatment with respect to each unsecured claim held by it on a claim by claim basis (and not on an aggregate basis as provided for in the Plan).

2 As to the Applicant's sanction motion, the general principles to be applied in the exercise of the court's discretion are:

1) there must be strict compliance with all statutory requirements and adherence to the previous orders of the court;

2) all materials filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the *Companies' Creditors Arrangement Act* ("CCAA"); and

3) the Plan must be fair and reasonable.

See *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.); affirmed (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) at p.201; *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.) at p.506.

3 I am satisfied on the material before me that the Applicant was held to be a corporation as to which the CCAA applies, that the Plan was filed with the court in accordance with the previous orders, that notices were appropriately given and published as to claims and meetings, that the meetings were held in accordance with the directions of the court and that the Plan was approved by the requisite majority (in fact it was approved 98.74% in number of the proven claims of creditors voting and by 96.79% dollar value, with Argo abstaining). Thus it would appear that items one and two are met.

4 What of item 3 - is the Plan fair and reasonable? A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment. One must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights: see *Campeau Corp., Re* (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) at p.109. It is recognized that the CCAA contemplates that a minority of creditors is bound by the Plan which a majority have approved - subject only to the court determining that the Plan is fair and reasonable: see *Northland Properties Ltd.* at p.201; *Olympia & York Developments Ltd.* at p.509. In the present case no one appeared today to oppose the Plan being sanctioned: Argo merely wished that the Plan be amended to accommodate its particular concerns. Of course, to the extent that Argo would be benefited by such an amendment, the other creditors would in effect be disadvantaged since the pot in this case is based on a zero sum game.

5 Those voting on the Plan (and I note there was a very significant "quorum" present at the meeting) do so on a business basis. As Blair J. said at p.510 of *Olympia & York Developments Ltd.*:

> As the other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspects of the Plan, descending into the negotiating arena and substituting my own view of what is a fair and

> reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas.

The court should be appropriately reluctant to interfere with the business decisions of creditors reached as a body. There was no suggestion that these creditors were unsophisticated or unable to look out for their own best interests. The vote in the present case is even higher than in *Central Guaranty Trustco Ltd., Re* (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) where I observed at p.141:

> ... This on either basis is well beyond the specific majority requirement of CCAA. Clearly there is a very heavy burden on parties seeking to upset a plan that the required majority have found that they could vote for; given the overwhelming majority this burden is no lighter. This vote by sophisticated lenders speaks volumes as to fairness and reasonableness.
>
> The Courts should not second guess business people who have gone along with the Plan....

6 Argo's motion is to amend the Plan - after it has been voted on. However I do not see any exceptional circumstances which would support such a motion being brought now. In *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.) the Court of Appeal observed at p.15 that the court's jurisdiction to amend a plan should "be exercised sparingly and in exceptional circumstances only" even if the amendment were merely technical and did not prejudice the interests of the corporation or its creditors and then only where there is jurisdiction under the CCAA to make the amendment requested, I was advised that Argo had considered bringing the motion on earlier but had not done so in the face of "veto" opposition from the major creditors. I am puzzled by this since the creditor or any other appropriate party can always move in court before the Plan is voted on to amend the Plan; voting does not have anything to do with the court granting or dismissing the motion. The court can always determine a matter which may impinge directly and materially upon the fairness and reasonableness of a plan. I note in passing that it would be inappropriate to attempt to obtain a preview of the court's views as to sanctioning by brining on such a motion. See my views in *Central Guaranty Trustco Ltd., Re* at p.143:

> ... In *Algoma Steel Corp. v. Royal Bank* (1992), 8 O.R. (3d) 449, the Court of Appeal determined that there were exceptional circumstances (unrelated to the Plan) which allowed it to adjust *where no interest was adversely affected.* The same cannot be said here. FSTQ aside from s.11(c) of the CCAA also raised s.7. I am of the view that s.7 allows an amendment after an adjournment - *but not after a vote has been taken.* (emphasis in original)

What Argo wants is a substantive change; I do not see the jurisdiction to grant same under the CCAA.

7 In the subject Plan creditors are to be dealt with on a sliding scale for distribution purposes only: with this scale being on an aggregate basis of all claims held by one claimant:

> i) $7,500 or less to receive cash of 95% of the proven claim;
>
> ii) $7,501 - $100,000 to receive cash of 90% of the first $7,500 and 55% of balance; and;
>
> iii) in excess of $100,000 to receive shares on a formula basis (subject to creditor agreeing to limit claims to $100,000 so as to obtain cash as per the previous formula).

Such a sliding scale arrangement has been present in many proposals over the years. Argo has not been singled out for special treatment; others who acquired claims by assignment have also been affected. Argo has acquired 40 claims; all under $100,000 but in the aggregate well over $100,000. Argo submitted that it could have achieved the result that it wished if it had kept the individual claims it acquired separate by having them held by a different "person"; this is true under the Plan as worded. Conceivably if this type of separation in the face of an aggregation provision were perceived to be inappropriate by a CCAA applicant, then I suppose the language of such a plan could be "tightened" to eliminate what the applicant perceived as a loophole. I appreciate Argo's position that by buying up the small claims it was providing the original creditors with liquidity but this should not be a determinative factor. I would note that the sliding scale provided here does recognize (albeit imperfectly) that small claims may be equated with small creditors who would more likely wish cash as opposed to non-board lots of shares which would not be as liquidate as cash; the high percentage cash for those proven claims of $7,500 or under illustrates the desire not to have the "little person" hurt - at least any more than is necessary. The question will come down to balance - the plan must be efficient and attractive enough for it to be brought forward by an applicant with the realistic chance of its succeeding (and perhaps in that regard be "sponsored" by significant creditors) and while not being too generous so that the future of the applicant on an ongoing basis would be in jeopardy: at the same time it must gain enough support amongst the creditor body for it to gain the requisite majority. New creditors by assignment may provide not only liquidity but also a benefit in providing a block of support for a plan which may not have been forthcoming as a small creditor may not think it important to do so. Argo of course has not claimed it is a "little person" in the context of this CCAA proceeding.

8 In my view Argo is being treated fairly and reasonably as a creditor as are all the unsecured creditors. An aggregation clause is not inherently unfair and the sliding scale provisions would appear to me to be aimed at "protecting (or helping out) the little guy" which would appear to be a reasonable policy.

9 The Plan is sanctioned and approved; Argo's aggregation motion is dismissed.

Addendum:

10 I reviewed with the insolvency practitioners (legal counsel and accountants) the aspect that industrial and commercial concerns in a CCAA setting should be distinguished from "bricks and mortgage" corporations. In their reorganization it is important to maintain the goodwill attributable to employee experience and customer (and supplier) loyalty; this may very quickly erode with uncertainty. Therefore it would, to my mind be desirable to get down to brass tacks as quickly as possible and perhaps a reasonable target (subject to adjustment up or down according to the circumstances including complexity) would be for a six month period from application to Plan sanction.

Motion for approval granted; motion for amendment dismissed.

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TAB 14

Court File No. 09-CL-7950

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE	)	WEDNESDAY, THE 14TH
	)	
MR. JUSTICE MORAWETZ	)	DAY OF JANUARY, 2009

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 NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION (the "Applicants")

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

FIFTH AMENDED AND RESTATED INITIAL ORDER

THIS APPLICATION, made by the Applicants, pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA") was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the affidavit of John Doolittle sworn January 14, 2009 (the "Doolittle Affidavit") and the Exhibits thereto, the affidavit of John Doolittle sworn June 22, 2009 (the "June Affidavit") and the Exhibits thereto, the report dated January 14, 2009 of Ernst & Young Inc. ("E&Y"), the proposed monitor, and on hearing the submissions of counsel for the Applicants, counsel for the boards of directors of Nortel Networks Corporation and Nortel Networks Limited, counsel for E&Y, counsel for Export Development Canada ("EDC"), Flextronics

Telecom Systems Ltd., no one else appearing on this Application and on reading the consent of E&Y to act as the Monitor,

SERVICE

1. THIS COURT ORDERS that the time for service of the Notice of Application and the Application Record is hereby abridged so that this Application is properly returnable today and hereby dispenses with further service thereof.

APPLICATION

2. THIS COURT ORDERS AND DECLARES that each of the Applicants is a "debtor company" to which the CCAA applies.

PLAN OF ARRANGEMENT

3. THIS COURT ORDERS that each of the Applicants shall have the authority to file and may, subject to further order of this Court, file with this Court a plan of compromise or arrangement (hereinafter referred to as the "Plan") between, *inter alia*, such Applicant and one or more classes of its secured and/or unsecured creditors as it deems appropriate.

POSSESSION OF PROPERTY AND OPERATIONS

4. THIS COURT ORDERS that each of the Applicants shall remain in possession and control of its current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate including all proceeds thereof (the "Property"). Subject to further Order of this Court, each of the Applicants shall continue to carry on business in a manner consistent with the preservation of its business (the "Business") and Property. Each of the Applicants shall be authorized and empowered to continue to retain and employ the employees, consultants, agents, experts, brokers, accountants, legal counsel, financial advisors and such other persons (collectively "Assistants") currently retained or employed by such Applicant, with liberty to retain such further Assistants as such Applicant deems reasonably necessary or desirable for the Business or to carry out the terms of this Order or for the purposes of the Plan.

5. THIS COURT ORDERS that the Applicants shall be entitled to continue to utilize the central cash management system currently in place as described in the Doolittle Affidavit or replace it with another substantially similar central cash management system (the "Cash Management System") and that any present or future bank or banks providing the Cash Management System shall not be under any obligation whatsoever to inquire into the propriety, validity or legality of any transfer, payment, collection or other action taken under the Cash Management System, or as to the use or application by the Applicants of funds transferred, paid, collected or otherwise dealt with in the Cash Management System; shall be entitled to provide the Cash Management System without any liability in respect thereof to any Person (as hereinafter defined) other than the Applicants, pursuant to the terms of the documentation applicable to the Cash Management System; and shall be, in its capacity as provider of the Cash Management System, an unaffected creditor under the Plan with regard to any claims or expenses it may suffer or incur in connection with the provision of the Cash Management System.

6. THIS COURT ORDERS that each of the Applicants, either on its own behalf or on behalf of another Applicant, shall be entitled but not required to pay the following expenses whether incurred prior to, on or after the date of this Order:

(a) all outstanding and future wages, salaries and employee benefits (including, but not limited to, employee medical and similar benefit plans, relocation and tax equalization programs, the Incentive Plan (as defined in the Doolittle Affidavit) and employee assistance programs), current service, special and similar pension benefit payments, vacation pay, commissions and employee and director expenses, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements;

(b) compensation to employees in respect of any payments made to employees prior to the date of this Order by way of the issuance of cheques or electronic transfers, which are subsequently dishonoured due to the commencement of proceedings under the CCAA;

(c) all outstanding and future amounts owing to or in respect of individuals working as independent contractors in connection with the Business;

(d) the fees and disbursements of any Assistants retained or employed in accordance with paragraph 4 hereof;

(e) subject to the consent of the Monitor, amounts owing by one of more of the Applicants in respect of its Customer Programs (as defined in the Doolittle Affidavit);

(f) subject to consent of the Monitor, amounts owing by one or more of the Applicants to any other Nortel Company (as defined in the Doolittle Affidavit) in order to settle their inter-company accounts and make inter-company loans in the ordinary course of business, including as a result of the Nortel Companies' Transfer Pricing Model (as defined in the Doolittle Affidavit); and

(g) subject to the consent of the Monitor, amounts owing to the Applicants' carriers and warehousemen.

7. THIS COURT ORDERS that, except as otherwise provided to the contrary herein, each of the Applicants shall be entitled but not required to pay all reasonable expenses incurred by it in carrying on the Business in the ordinary course on and after the date of this Order, and in carrying out the provisions of this Order, which expenses shall include, without limitation:

(a) all expenses and capital expenditures reasonably necessary for the preservation of the Property or the Business including, without limitation, payments on account of insurance (including directors and officers insurance) and maintenance and security services;

(b) payment for goods or services actually supplied to the Applicants on or after the date of this Order;

(c) with the written approval of the Monitor, the posting of additional cash collateral into existing cash collateral accounts (collectively, and together with the cash collateral posted as at February 10, 2009, the "LC Cash Collateral") held by either or both of ABN AMRO Bank N.V., Canada Branch ("ABN") and Royal Bank of Canada ("RBC") as additional and continuing security for existing, renewed and new letters of credit, letters of guarantee, surety bonds, and similar instruments (collectively, "LCs") issued (whether before or after January 14, 2009) for the account of or requested by the Applicants or any of them to third parties pursuant to the existing letter of credit agreements between the Applicants and ABN and RBC and any amendments thereto made with the written approval of the Monitor, and for any foreign exchange losses incurred by ABN and its correspondent banks, if any, under LCs issued in currencies other than Canadian dollars, U.S. dollars, British pounds sterling and Euros, on the following basis:

(i) the posting of such additional cash collateral is for the purposes of paragraph 10 hereof specifically permitted herein and authorized hereby and shall not and will not constitute a fraudulent preference, fraudulent conveyance, oppressive conduct, settlement or other challengeable, voidable or reviewable transaction under any applicable law;

(ii) the aggregate of all cash collateral that may be posted (inclusive of the cash collateral posted as at February 10, 2009) in respect of LCs issued in Canadian dollars, U.S. dollars, British pounds sterling and Euros shall not exceed the amount of U.S.$40 million (converting Canadian dollars at the Bank of Canada's Noon spot exchange rate for any day), provided that the LC Banks shall have no liability in the event that cash collateral is posted in an amount that exceeds such maximum and the validity of their claims with respect to any or all of the LC Cash Collateral shall not be limited, lessened or otherwise impaired in any way as a result of such excess; and

(iii) cash collateral may be posted in respect of LCs issued by ABN in any other currencies in such amounts as are required by the provisions of the applicable letter of credit agreement, including any amendments thereto made with the written approval of the Monitor as security for ABN's exposure to foreign exchange losses;

(d) if the same is not guaranteed by EDC, payment of any indebtedness of the Applicants to the LC Banks (as defined in paragraph 10A hereof) when due under the LC Agreements (as defined in paragraph 10A hereof) by way of set-off and transfer of LC Cash Collateral posted as at January 14, 2009 or posted thereafter pursuant to the LC Agreements and subparagraph (c) above;

(e) without limiting (d), payment of costs and expenses of the LC Banks in connection with the amendment and enforcement of rights under the LC Agreements and any related guarantee bonds issued by EDC if so provided for under an applicable LC Agreement, whether incurred before or after February 10, 2009, including by way of set-off and transfer of LC Cash Collateral;

(f) the posting of cash collateral in favour of Export Development Canada ("EDC") (collectively, the "EDC Cash Collateral") pursuant to the second amended and restated short-term support agreement between Nortel Networks Limited ("NNL") and EDC dated April 24, 2009, as amended by the amending agreement between NNL and EDC dated June 18, 2009, and the cash collateral agreement between NNL and EDC dated June 18, 2009 and any further amendments to the foregoing made with the written approval of the Monitor (collectively, the "EDC Support Agreements"), on the basis that the EDC Support Agreements are hereby ratified and approved and the posting of such cash collateral is for the purposes of paragraph 10 hereof specifically permitted herein and authorized hereby and shall not and will not constitute a fraudulent preference, fraudulent conveyance, oppressive conduct, settlement or other challengeable, voidable or reviewable transaction under any applicable law;

(g) payment of any indebtedness of NNL to EDC under the EDC Support Agreements by way of set-off or transfer of EDC Cash Collateral posted as at June 29, 2009 or posted thereafter pursuant to the EDC Support Agreements and subparagraph (f) above; and

(h) without limiting (g), payment of costs and expenses of EDC provided for under the EDC Support Agreements by way of set-off or transfer of EDC Cash Collateral, to the extent provided for in the EDC Support Agreements.

7A. THIS COURT ORDERS that no provision of this Order shall require EDC to provide its approval for any proposed amendments to any of the LC Agreements pursuant to any agreement between EDC and any of the LC Banks.

8. THIS COURT ORDERS that the each of the Applicants shall remit, in accordance with legal requirements, or pay:

(a) any statutory deemed trust amounts in favour of the Crown in right of Canada or of any Province thereof or any other taxation authority which are required to be deducted from employees' wages, including, without limitation, amounts in respect of (i) employment insurance, (ii) Canada Pension Plan, (iii) Quebec Pension Plan, and (iv) income taxes;

(b) all goods and services or other applicable sales taxes (collectively, "Sales Taxes") required to be remitted by such Applicant in connection with the sale of goods and services by such Applicant, but only where such Sales Taxes are accrued or collected after the date of this Order, or where such Sales Taxes were accrued or collected prior to the date of this Order but not required to be remitted until on or after the date of this Order; and

(c) any amount payable to the Crown in right of Canada or of any Province or Territory thereof or any political subdivision thereof or any other taxation authority in respect of municipal realty, municipal business or other taxes, assessments or levies of any nature or kind which are entitled at law to be paid in priority to claims of secured creditors and which are attributable to or in respect of the carrying on of the Business by such Applicant.

9. THIS COURT ORDERS that until such time as an Applicant delivers a notice in writing to repudiate a real property lease in accordance with paragraph 11(c) of this Order (a "Notice of Repudiation"), each Applicant shall pay all amounts constituting rent or payable as rent under

real property leases (including, for greater certainty, common area maintenance charges, utilities and realty taxes and any other amounts payable to the landlord under the lease) or as otherwise may be negotiated by such Applicant and the landlord from time to time ("Rent"), for the period commencing from and including the date of this Order, monthly on the first day of each month, in advance (but not in arrears). On the date of the first of such payment, any arrears relating to the period commencing from and including the date of this Order shall also be paid. Upon delivery of a Notice of Repudiation, such Applicant shall pay all Rent due for the notice period stipulated in paragraph 11(c) of this Order, to the extent that Rent for such period has not already been paid.

10. THIS COURT ORDERS that, except as specifically permitted herein, each of the Applicants is hereby directed, until further Order of this Court: (a) to make no payments of principal, interest thereon or otherwise on account of amounts owing by such Applicant to any of its creditors as of this date unless such payments have been approved by the Monitor; (b) to grant no security interests, trust, liens, charges or encumbrances upon or in respect of any of its Property; and (c) to not grant credit or incur liabilities except in the ordinary course of business unless such obligation has been approved by the Monitor.

10A. THIS COURT ORDERS that, notwithstanding paragraph 10 hereof,

(a) the existing letter of credit agreements between the Applicants and ABN, RBC and Citibank, N.A. acting through its Canadian branch ("Citibank") and any amendments thereto made after January 14, 2009 with the written approval of the Monitor, together with any agreements entered into by the Applicants or any of them with any other lenders with the written approval of the Monitor providing letter of credit facilities or similar facilities to the Applicants or any of them (including those which may be the subject of EDC guarantee bonds issued pursuant to the EDC Support Facility) (collectively, the "LC Agreements"), and the issuance or renewal of LC's pursuant thereto by ABN, RBC, Citibank and any other lenders (collectively, the "LC Banks"), together with any payments made by the Applicants or EDC with respect thereto; and

(b) the EDC Support Agreements and any amendments thereto made after June 18, 2009 with the written consent of the Monitor, together with any payments made by NNL with respect thereto,

are specifically permitted herein and authorized hereby and shall not and will not constitute fraudulent preferences, oppressive conduct, settlements or other challengeable, voidable or reviewable transactions under any applicable law

10B. THIS COURT ORDERS that, notwithstanding any other provision in this Order, no LC Bank shall be required to issue a letter of credit to the Applicants or any of them and EDC shall not be required to provide any Secured Support to the Applicants or any of them.

RESTRUCTURING

11. THIS COURT ORDERS that each of the Applicants shall, have the right to:

(a) permanently or temporarily cease, downsize or shut down any of its business or operations and to dispose of redundant or non-material assets not exceeding CDN$10,000,000 in any one transaction or CDN$50,000,000 in the aggregate, subject to paragraph (c), if applicable;

(b) terminate the employment of such of its employees or temporarily lay off such of its employees as it deems appropriate and to deal with the consequences thereof in the Plan or on further order of the Court;

(c) in accordance with paragraphs 12 and 13, vacate, abandon or quit the whole but not part of any leased premises and/or repudiate any real property lease and any ancillary agreements relating to any leased premises, on not less than seven (7) days notice in writing to the relevant landlord on such terms as may be agreed upon between the Applicant and such landlord, or failing such agreement, to deal with the consequences thereof in the Plan;

(d) repudiate such of its arrangements or agreements of any nature whatsoever, including, without limitation, any of its deferred compensation, or bonus plans, change of control plans, stock options or restructured stock unit plans and shareholder rights plans whether oral or written, as such Applicant may deem appropriate on such terms as may be agreed upon between such Applicant or any one of them and such counter-parties, or failing such agreement, to deal with the consequences thereof in the Plan; and

(e) pursue all avenues of refinancing and offers for material parts of its Business or Property, in whole or part, subject to prior approval of this Court being obtained before any material refinancing or any sale (except as permitted by subparagraph (a), above);

all of the foregoing to permit the Applicants to proceed with an orderly restructuring of the Business (the "Restructuring").

12. THIS COURT ORDERS that each of the Applicants shall provide each of the relevant landlords with notice of such Applicant's intention to remove any fixtures from any leased premises at least seven (7) days prior to the date of the intended removal. The relevant landlord shall be entitled to have a representative present in the leased premises to observe such removal and, if the landlord disputes such Applicant's entitlement to remove any such fixture under the provisions of the lease, such fixture shall remain on the premises and shall be dealt with as agreed between any applicable secured creditors, such landlord and such Applicant, or by further Order of this Court upon application by such Applicant on at least two (2) days notice to such landlord and any such secured creditors. If such Applicant repudiates the lease governing such leased premises in accordance with paragraph 11(c) of this Order, it shall not be required to pay Rent under such lease pending resolution of any such dispute (other than Rent payable for the notice period provided for in paragraph 11(c) of this Order), and the repudiation of the lease shall be without prejudice to such Applicant's claim to the fixtures in dispute.

13. THIS COURT ORDERS that if a Notice of Repudiation is delivered, then (a) during the notice period prior to the effective time of the repudiation, the landlord may show the affected leased premises to prospective tenants during normal business hours, on giving the Applicants and the Monitor 24 hours' prior written notice, and (b) at the effective time of the repudiation, the relevant landlord shall be entitled to take possession of any such leased premises without waiver of or prejudice to any claims or rights such landlord may have against the Applicants in

respect of such lease or leased premises and such landlord shall be entitled to notify the Applicants of the basis on which it is taking possession and to gain possession of and re-lease such leased premises to any third party or parties on such terms as such landlord considers advisable, provided that nothing herein shall relieve such landlord of its obligation to mitigate any damages claimed in connection therewith.

NO PROCEEDINGS AGAINST THE APPLICANTS OR THE PROPERTY

14. THIS COURT ORDERS that until and including February 13, 2009 or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced, or continued against or in respect of any of the Applicants or the Monitor, or affecting the Business or the Property, except with the written consent of the affected Applicant and the Monitor, or with leave of this Court, and any and all Proceedings currently under way against or in respect of the affected Applicant or affecting the Business or the Property are hereby stayed and suspended pending further Order of this Court.

NO EXERCISE OF RIGHTS OR REMEDIES

15. THIS COURT ORDERS that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the Applicants or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the affected Applicant and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower the Applicants to carry on any business which the Applicants are not lawfully entitled to carry on, (ii) exempt the Applicants from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

NO INTERFERENCE WITH RIGHTS

16. THIS COURT ORDERS that during the Stay Period, no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any right, renewal right,

contract, agreement, licence or permit in favour of or held by the Applicants, except with the written consent of the Applicants and the Monitor, or leave of this Court.

CONTINUATION OF SERVICES

17. THIS COURT ORDERS that during the Stay Period, all Persons having oral or written agreements with the Applicants or with third parties on behalf of the Applicants, or statutory or regulatory mandates for the supply of goods and/or services, including without limitation all computer software, communication and other data services, centralized banking services, payroll services, employment agency services, insurance, transportation services, utility, leasing or other services to the Business or to any of the Applicants, are hereby restrained until further Order of this Court from discontinuing, altering, interfering with or terminating the supply of such goods or services as may be required by the applicable Applicant and that such Applicant shall be entitled to the continued use of its current premises, telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the normal prices or charges for all such goods or services received after the date of this Order are paid by such Applicant, in accordance with normal payment practices of such Applicant, as applicable, or such other practices as may be agreed upon by the supplier or service provider and the affected Applicant and the Monitor, or as may be ordered by this Court.

NON-DEROGATION OF RIGHTS

18. THIS COURT ORDERS that, notwithstanding anything else contained herein, no creditor of the Applicants shall be under any obligation after the making of this Order to advance or re-advance any monies or otherwise extend any credit to the Applicants. Nothing in this Order shall derogate from the rights conferred and obligations imposed by the CCAA.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

19. THIS COURT ORDERS that during the Stay Period, and except as permitted by subsection 11.5(2) of the CCAA, no Proceeding may be commenced or continued against any of the former, current or future directors or officers of the Applicants with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Applicants whereby the directors or officers are alleged under any law to be

liable in their capacity as directors or officers for the payment or performance of such obligations, until a compromise or arrangement in respect of the Applicants, if one is filed, is sanctioned by this Court or is refused by the creditors of the Applicants or this Court.

DIRECTORS AND OFFICERS

20. THIS COURT ORDERS that each of the Applicants shall indemnify its directors and officers from all claims, costs, charges and expenses relating to the failure of such Applicant, after the date hereof, to make payments of the nature referred to in subparagraphs 6(a), 6(b), 8(a), 8(b) and 8(c) of this Order or for the Applicants' failure to make payments in respect of employer health tax or workers' compensation which they sustain or incur by reason of or in relation to their respective capacities as directors and/or officers except to the extent that, with respect to any officer or director, such officer or director has actively participated in the breach of any related fiduciary duties or has been grossly negligent or guilty of wilful misconduct.

21. THIS COURT ORDERS that the directors and officers of the Applicants shall be entitled to the benefit of and are hereby granted a charge (the "Directors' Charge") on the Property, which charge shall not exceed an aggregate amount of CDN $45 million, as security for the indemnities provided in paragraph 20 of this Order as well as for fees and disbursements of their legal counsel. The Directors' Charge shall have the priority set out in paragraphs 42 and 44 herein.

21A. THIS COURT ORDERS that, to the extent that any one or more of proven Claims (as defined below), together with the fees and disbursements of legal counsel to the directors and officers of the Applicants, individually or in the aggregate, exceed the amount of CDN $45 million, each such proven Claim against such directors and officers shall be reduced *pro rata* so that the aggregate of all such proven Claims, together with the fees and disbursements of legal counsel to such directors and officers, shall not exceed the amount of CDN $45 million and such excess amounts of all such proven Claims and any other Claims are hereby and shall be forever barred, disallowed, enjoined, released, discharged and extinguished as against the directors and officers of the Applicants. Provided, however, that nothing in this paragraph 21A shall operate to release any director or officer of an Applicant in respect of such excess amount of any such Claim where, in respect of such Claim, such director or officer has actively participated in the breach of any related fiduciary duties or has been grossly negligent or guilty of wilful misconduct.

In this paragraph 21A, "Claim" shall mean any claim (contingent, liquidated or unliquidated, proven or unproven, known or unknown) or any legal proceeding or action of any nature or kind, in these proceedings or any subsequent receivership or bankruptcy proceedings or in any other proceedings or in any other forum whatsoever, against one or more of the directors or officers of any one or more of the Applicants relating to the failure of any of the Applicants, after the date of this Order, to make payments of the nature referred to in subparagraphs 6(a), 6(b), 8(a), 8(b) and 8(c) of this Order or the Applicants' failure to make payments in respect of employer health tax or workers' compensation, which are or may be directly or indirectly advanced, asserted, re-asserted, refiled or made by any person, governmental or regulatory authority or other entity against one or more of the directors or officers of any one or more of the Applicants, to the extent that such Claim is not covered under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified in accordance with paragraph 20 of this Order

22. THIS COURT ORDERS that, notwithstanding any language in any applicable insurance policy to the contrary, (a) no insurer shall be entitled to be subrogated to or claim the benefit of the Directors' Charge, and (b) each of the Applicants' directors and officers shall only be entitled to the benefit of the Directors' Charge to the extent that they do not have coverage under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified in accordance with paragraph 20 of this Order.

23. THIS COURT ORDERS that each of NNC's and NNL's directors shall be entitled to receive remuneration in cash on a current basis at current compensation levels (less an overall U.S.$25,000 reduction) notwithstanding the terms of, or elections made under, the Directors' Compensation Plan.

APPOINTMENT OF MONITOR

24. THIS COURT ORDERS that E&Y is hereby appointed pursuant to the CCAA as the Monitor, an officer of this Court, to monitor the Property and the Applicants' conduct of the

Business with the powers and obligations set out in the CCAA or set forth herein and that each of the Applicants and its officers, directors, and Assistants shall advise the Monitor of all material steps taken by such Applicant pursuant to this Order, and shall co-operate fully with the Monitor in the exercise of its powers and discharge of its obligations.

25. THIS COURT ORDERS that the Monitor, in addition to its prescribed rights and obligations under the CCAA, is hereby directed and empowered to:

(a) monitor the Applicants' receipts and disbursements;

(b) provide the consents contemplated herein;

(c) report to this Court at such times and intervals as the Monitor may deem appropriate with respect to matters relating to the Property, the Business, and such other matters as may be relevant to the proceedings herein;

(d) advise the Applicants in their preparation of the Applicants' cash flow statements and any other reporting to the Court or otherwise;

(e) advise the Applicants in their development of the Plan or Plans and any amendments to such Plan or Plans;

(f) assist the Applicants, to the extent required by the Applicants, with the Restructuring;

(g) assist the Applicants, to the extent required by the Applicants, with the holding and administering of creditors' or shareholders' meetings for voting on the Plan or Plans;

(h) have full and complete access to the books, records and management, employees and advisors of the Applicants and to the Business and the Property to the extent required to perform its duties arising under this Order;

(i) be at liberty to engage independent legal counsel or such other persons as the Monitor deems necessary or advisable respecting the exercise of its powers and performance of its obligations under this Order including, without limitation, one or more entities related to or affiliated with the Monitor;

(j) consider, and if deemed advisable by the Monitor, prepare a report and assessment on the Plan or Plans;

(k) assist the Applicants with respect to any insolvency proceedings commenced by or with respect to any other Nortel Company (as defined in the Doolittle Affidavit) in any foreign jurisdiction (collectively, "Foreign Proceedings") and report to this Court, as it deems appropriate, on the Foreign Proceedings with respect to matters relating to the Applicants;

(l) apply as the foreign representative of the Applicants, for recognition of these proceedings as "Foreign Main Proceedings", pursuant to Chapter 15 of the United States Bankruptcy Code, 11 U.S.C. §101 (the "U.S. Bankruptcy Code") or similar legislation in any other jurisdiction; and

(m) perform such other duties as are required by this Order or by this Court from time to time.

26. THIS COURT ORDERS that the Monitor shall not take possession of the Property and shall take no part whatsoever in the management or supervision of the management of the Business and shall not, by fulfilling its obligations hereunder, be deemed to have taken or maintained possession or control of the Business or Property, or any part thereof.

27. THIS COURT ORDERS that nothing herein contained shall require the Monitor to occupy or to take control, care, charge, possession or management (separately and/or collectively, "Possession") of any of the Property that might be environmentally contaminated, might be a pollutant or a contaminant, or might cause or contribute to a spill, discharge, release or deposit of a substance contrary to any federal, provincial or other law respecting the protection, conservation, enhancement, remediation or rehabilitation of the environment or relating to the disposal of waste or other contamination including, without limitation, the *Canadian Environmental Protection Act*, the *Ontario Environmental Protection Act*, the *Ontario Water Resources Act*, or the *Ontario Occupational Health and Safety Act* and regulations

thereunder (the "Environmental Legislation"), provided however that nothing herein shall exempt the Monitor from any duty to report or make disclosure imposed by applicable Environmental Legislation. The Monitor shall not, as a result of this Order or anything done in pursuance of the Monitor's duties and powers under this Order, be deemed to be in Possession of any of the Property within the meaning of any Environmental Legislation, unless it is actually in possession.

28. THIS COURT ORDERS that that the Monitor shall provide any creditor of the Applicants with information provided by the Applicants in response to reasonable requests for information made in writing by such creditor addressed to the Monitor. The Monitor shall not have any responsibility or liability with respect to the information disseminated by it pursuant to this paragraph. In the case of information that the Monitor has been advised by the Applicants is confidential, the Monitor shall not provide such information to creditors unless otherwise directed by this Court or on such terms as the Monitor and the Applicants may agree.

29. THIS COURT ORDERS that, in addition to the rights and protections afforded the Monitor under the CCAA or as an officer of this Court, the Monitor shall incur no liability or obligation as a result of its appointment and the fulfilment of its duties or the carrying out of the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Monitor by the CCAA or any applicable legislation.

30. THIS COURT ORDERS that the Monitor, counsel to the Monitor, counsel to the Applicants and counsel to directors shall be paid their reasonable fees and disbursements incurred both before and after the making of the Order, in each case at their standard rates and charges, by the Applicants as part of the costs of these proceedings. Each of the Applicants is hereby authorized and directed to pay the accounts of the Monitor, counsel for the Monitor, counsel for the Applicants and counsel to directors on a weekly basis and, in addition, each of the Applicants is hereby authorized to pay to: (a) the Monitor and its Canadian and U.S. counsel a retainer in the aggregate amount of CDN$750,000; and (b) counsel to the Applicants a retainer in the amount of CDN$750,000 (collectively, the "Retainers") to be held by them as security for payment of their respective fees and disbursements outstanding from time to time.

31. THIS COURT ORDERS that the Monitor and its legal counsel shall pass their accounts from time to time, and for this purpose the accounts of the Monitor and its legal counsel are hereby referred to a judge of the Commercial List of the Ontario Superior Court of Justice.

32. THIS COURT ORDERS that the Monitor, counsel to the Monitor, if any, and the Applicants' counsel shall be entitled to the benefit of and are hereby granted a charge (the "Administration Charge") on the Property, which charge shall not exceed an aggregate amount of $5,000,000, as security for their professional fees and disbursements incurred at the standard rates and charges of the Monitor and such counsel, both before and after the making of this Order in respect of these proceedings. The Administration Charge shall have the priority set out in paragraphs 42 and 44 hereof.

EDC

33. Intentionally Deleted.

INTERCOMPANY LOANS

34. THIS COURT ORDERS to the extent that an Applicant receives a post-filing inter-company loan or other transfer (including goods and services) from a Chapter 11 Entity (as defined in the Doolittle Affidavit) (including as a result of the Applicants' cash management system or otherwise) (each such Applicant, a "Beneficiary Applicant"), and such post-filing inter-company loan or other transfer is made (each an "Advance") by a Chapter 11 Entity (together with NNL for the purposes of paragraph 34A below, a "Protected Entity"), then, subject to the limitations set forth in this paragraph:

(a) the Protected Entity shall have a proven and valid claim against such Beneficiary Applicant for the amount of such Advance (each, an "Inter-company Reimbursement Claim"), which Inter-company Reimbursement Claim shall bear interest at a rate agreed between the applicable Beneficiary Applicant and Protected Entity from time to time for the period in accordance with past practice; and

(b) all of the Property of the Beneficiary Applicant, is hereby charged by a mortgage, lien and security interest (such mortgage, lien and security interest, "Inter-company Charge") in favour of each of the Protected Entities as security for payment of the Inter-company Reimbursement Claim (including principal, interest and expenses) by the applicable Beneficiary Applicant to the corresponding Protected Entity.

34A. THIS COURT ORDERS that the Inter-Company Charge shall also secure any Advances made by NNL to Nortel Networks Technology Corporation ("NNTC") on or after January 14, 2009 and that NNL shall be a "Protected Entity" and NNTC shall be a "Beneficiary Applicant" in respect of such Advances.

35. THIS COURT ORDERS that the Inter-company Charge shall also secure the Remaining Revolver Claim (as defined in the Final Canadian Funding and Settlement Agreement dated as of December 22, 2009 among, *inter alia*, the Applicants and NNI) as also evidenced by the Secured Promissory Note dated as of February 16, 2010 in the principal amount of U.S.$62,700,000 given by NNL to NNI.

36. THIS COURT ORDERS the Inter-company Charge shall be junior, subject and subordinate only to the other Charges (defined below), and any other future charges against such Beneficiary Applicant that, by the Court order creating them, are expressly stated to be senior to the Inter-company Charges entered after notice and a hearing.

37. THIS COURT ORDERS that pending further order of this Court, an Inter-company Charge shall be a "silent" charge and the Protected Entity shall forbear from exercising, and shall not be entitled to exercise, any right or remedy relating to any Inter-company Reimbursement Claim held by such party, including, without limitation, as to seeking relief from the stay granted hereunder, or seeking any sale, foreclosure, realization upon repossession or liquidation of any Property of a Beneficiary Applicant, or taking any position with respect to any disposition of the Property, the business operations, or the reorganization of a Beneficiary Applicant. An Inter-company Charge automatically, and without further action of any person or entity of any kind, shall be released or otherwise terminated to the extent that Property subject to such Inter-company Charge is sold or otherwise disposed of in accordance with the terms of this Order or

further order of this Court after notice and a hearing, with respect to the effect of an Inter-company Charge on any sale of Property by any Beneficiary Applicant.

38. THIS COURT ORDERS that the Beneficiary Applicants may sell Property, in accordance with the terms of this Order or further order of this Court after notice and a hearing, in each case free and clear of any Inter-company Charge, with such Inter-company Charge attaching to the proceeds of sale in the same priority and subject to the same limitations and restrictions as existed in respect of the Property sold.

INTERIM GROUP SUPPLIER PROTOCOL AGREEMENT

39. THIS COURT ORDERS that the Applicants be and are hereby authorized to enter into a group supplier protocol agreement (the "Interim GSPA") substantially in the form attached as Exhibit "C" to the Doolittle Affidavit which agreement shall be effective upon the appointment of the Administrators in the United Kingdom, and the Applicants are hereby authorized to perform each of their obligations, if any, under the Interim GSPA. The obligations of the Applicants under the Interim GSPA shall be secured by the Inter-Company Charge.

NNI LOAN

40. THIS COURT ORDERS that the amended and restated loan agreement entered into between NNL, as borrower, NNTC and the other Applicants as guarantors, and Nortel Networks Inc. ("NNI") as lender (the "NNI Loan Agreement"), substantially in the form attached as Exhibit "B" to the Affidavit of John Doolittle sworn March 27, 2009 providing for a revolving loan facility of up to U.S.$200 million is hereby approved and each of the Applicants is hereby directed to execute and to comply with its obligations under the NNI Loan Agreement.

41. Intentionally deleted.

41A. Intentionally deleted.

41B. Intentionally deleted.

41C. Intentionally deleted.

EXCESS FUNDING CHARGE

41D. THIS COURT ORDERS that as security for NNL's obligation to repay to NNI the Contingent Payment (as defined in the Interim Funding Agreement, as defined in the June Affidavit) along with interest, if any, NNI shall be entitled to the benefit of and is hereby granted a charge on the Property (the "Excess Funding Charge"). The Excess Funding Charge shall have the priority set out in paragraphs 42 and 44 hereof.

SHORTFALL CHARGE

41E. THIS COURT ORDERS that as security for any obligation of NNL to make the Shortfall Payments (as defined in the Interim Funding Agreement, as defined in the June Affidavit), Nortel Networks UK Limited shall be entitled to the benefit of and is hereby granted a charge on the Property (the "Shortfall Charge"). The Shortfall Charge shall have the priority set out in paragraphs 42 and 44 hereof.

VALIDITY AND PRIORITY OF CHARGES CREATED BY THIS ORDER

42. THIS COURT ORDERS that the priorities of the Administration Charge, the Excess Funding Charge, the Directors' Charge, the Inter-company Charge, the Shortfall Charge, the Payments Charge and the Nortel Special Incentive Plan Charge on all Property shall be as follows:

First – the Administration Charge;

Second – the Excess Funding Charge

Third – the Directors' Charge; and

Fourth -

(a) the Inter-Company Charge;

(b) the Shortfall Charge,

which Inter-company Charge and Shortfall Charge shall rank *pari passu* with one another.

Fifth -

(a) the Payments Charge (as defined in the employee Settlement Approval Order of this Court made on March 31, 2010); and

(b) the Nortel Special Incentive Plan Charge (as defined in the order approving the Nortel Special Incentive Plan of this Court made on March 8, 2010),

which Payments Charge and Nortel Special Incentive Plan Charge shall rank *pari passu* with one another.

43. THIS COURT ORDERS that the filing, registration or perfection of the Administration Charge, Excess Funding Charge, the Directors' Charge, the Inter-company Charge, the Shortfall Charge, the Payments Charge and the Nortel Special Incentive Plan Charge (collectively, the "Charges") shall not be required, and that the Charges shall be valid and enforceable for all purposes, including as against any right, title or interest filed, registered, recorded or perfected subsequent to the Charges coming into existence, notwithstanding any such failure to file, register, record or perfect. Notwithstanding anything herein, the Charges shall not attach to the Retainers.

44. THIS COURT ORDERS that each of the Charges (all as constituted and defined herein), shall subject to this paragraph 44 and to paragraph 46 herein constitute a charge on the Property secured thereunder, and such Charges shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise (collectively, "Encumbrances") in favour of any Person. For greater certainty,

(a) the Charges shall attach to the LC Cash Collateral junior in priority to any rights or Encumbrances in favour of LC Banks in respect of LC Cash Collateral and only to the extent of the rights of the Applicants to the return of any LC Cash Collateral from the LC Banks following the exercise of the rights of the LC Banks as against any such LC Cash Collateral pursuant to the LC Agreements or section 18.1 of the CCAA, and

(b) the Charges shall attach to the EDC Cash Collateral junior in priority to any rights or Encumbrances in favour of EDC in respect of EDC Cash Collateral and only to the extent of the rights of NNL to the return of any EDC Cash Collateral from EDC following the exercise of the rights of EDC as against any such EDC Cash Collateral pursuant to the EDC Support Agreements or section 18.1 of the CCAA

notwithstanding anything to the contrary contained in this Order.

45. THIS COURT ORDERS that except as otherwise expressly provided for herein, or as may be approved by this Court, the Applicants shall not grant any Encumbrances over any Property that rank in priority to, or *pari passu* with, any of the Charges charging such Property, unless the Applicants also obtain the prior written consent of the Monitor and the beneficiaries of such Charges, or by further Order of this Court.

46. THIS COURT ORDERS that none of the Charges, the LC Agreements and the EDC Support Agreements shall be rendered invalid or unenforceable and the rights and remedies of the chargees entitled to the benefit of the Charges (collectively, the "Chargees") thereunder, the rights of the LC Banks under LC Agreements and the rights of EDC under the EDC Support shall not otherwise be limited or impaired in any way by (a) the pendency of these proceedings and the declarations of insolvency made herein; (b) any application(s) for bankruptcy order(s) issued pursuant to BIA, or any bankruptcy order made pursuant to such applications; (c) the filing of any assignments for the general benefit of creditors made pursuant to the BIA; (d) the provisions of any federal or provincial statutes; or (e) any negative covenants, prohibitions or other similar provisions with respect to borrowings, incurring debt or the creation of Encumbrances, contained in any existing loan documents, lease, sublease, offer to lease or other agreement (collectively, an "Agreement") which binds the Applicants, and notwithstanding any provision to the contrary in any Agreement:

(a) the creation of the Charges, the entering into of the LC Agreements and the issuance or renewal of LC's thereunder and the entering into of the EDC Support

Agreements and the provision of Secured Support, as defined and contemplated thereunder, shall not create or be deemed to constitute a breach by any of the Applicants of any Agreement to which it is a party;

(b) none of the Chargees, the LC Banks and EDC shall have any liability to any Person whatsoever as a result of any breach of any Agreement caused by or resulting from, the creation of the Charges, the entering into of the LC Agreements or the issuance or renewal of LC's thereunder or the entering into of the EDC Support Agreements and the provision of Secured Support; and

(c) the payments made by the Applicants pursuant to this Order and the granting of the Charges and the entering into of the LC Agreements and the EDC Support Agreements do not and will not constitute fraudulent preferences, fraudulent conveyances, oppressive conduct, settlements or other challengeable, voidable or reviewable transactions under any applicable law.

47. THIS COURT ORDERS that any Charge created by this Order over leases of real property in Canada shall only be a Charge in the Applicants' interest in such real property leases.

FLEXTRONICS AMENDING AGREEMENT

48. THIS COURT ORDERS that the Flextronics Amending Agreement in the form attached as Exhibit "B" to the Doolittle Affidavit be and is hereby approved and NNL is hereby authorized and directed to comply with its obligations thereunder.

CROSS-BORDER PROTOCOL

49. THIS COURT ORDERS that the cross-border protocol, as amended, in the form attached as Schedule "A" hereto be and is hereby approved and shall become effective upon its approval by the United States Bankruptcy Court for the District of Delaware and the parties to these proceedings and any other Person shall be governed by it and shall comply with the same.

FOREIGN PROCEEDINGS

50. THIS COURT ORDERS that the Monitor is hereby authorized and directed to apply for recognition of these proceedings as "Foreign Main Proceedings" in the United States pursuant to Chapter 15 of the U.S. Bankruptcy Code.

51. THIS COURT HEREBY REQUESTS the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada, the United States, the United Kingdom or elsewhere, to give effect to this Order and to assist the Applicants, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Applicants and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Applicants and the Monitor and their respective agents in carrying out the terms of this Order.

52. THIS COURT ORDERS that each of the Applicants and the Monitor be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order.

SERVICE AND NOTICE

53. THIS COURT ORDERS that the Monitor shall, within ten (10) business days of the date of entry of this Order, send notice of this Order and the commencement of the within proceedings to the Applicants' known creditors, other than employees and creditors to which the Applicants owe less than $5,000, at their addresses as they appear on the Applicants' records, and shall promptly send a copy of this Order (a) to all parties filing a Notice of Appearance in respect of this Application, and (b) to any other interested Person requesting a copy of this Order, and the Monitor is relieved of its obligation under Section 11(5) of the CCAA to provide similar notice, other than to supervise this process. The Monitor, on behalf of the Applicants, shall, in its discretion, be entitled to engage a third party mailing service in order to assist or complete the mailing. Any such service provider shall be considered an "Assistant" hereunder.

54. THIS COURT ORDERS that the Applicants and the Monitor be at liberty to serve this Order, any other materials and orders in these proceedings, and any notices or other correspondence, by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery or electronic transmission to the Applicants' creditors or other interested parties at their respective addresses as last shown on the records of the Applicants and that any such service or notice by courier, personal delivery or electronic transmission shall be deemed to be received on the next business day following the date of forwarding thereof, or if sent by ordinary mail, on the third business day after mailing.

55. THIS COURT ORDERS that the Applicants, the Monitor, and any party who has filed a Notice of Appearance may serve any court materials in these proceedings by e-mailing a PDF or other electronic copy of such materials to counsels' email addresses as recorded on the Service List from time to time, in accordance with the E-filing protocol of the Commercial List to the extent practicable, and the Monitor may post a copy of any or all such materials on its website at http://www.ey.com/ca/nortel.

GENERAL

56. THIS COURT ORDERS that any of the Applicants or the Monitor may from time to time apply to this Court for advice and directions in the discharge of its powers and duties hereunder.

57. THIS COURT ORDERS that nothing in this Order shall prevent the Monitor from acting as an interim receiver, a receiver, a receiver and manager, or a trustee in bankruptcy of the Applicants, the Business or the Property.

58. THIS COURT ORDERS that any interested party (including the Applicants and the Monitor) may apply to this Court to vary or amend this Order on not less than seven (7) days notice to any other party or parties likely to be affected by the order sought or upon such other notice, if any, as this Court may order.

59. THIS COURT ORDERS that this Order and all of its provisions are effective as of 12:01 a.m. Eastern Standard Time on the date of this Order.

ENTERED AT / INSCRIT A TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

FEB 2 5 2011

PER / PAR: NB

SCHEDULE "A" – CROSS-BORDER PROTOCOL

Attached.

CROSS-BORDER INSOLVENCY PROTOCOL

This cross-border insolvency protocol (the "Protocol") shall govern the conduct of all parties in interest in the Insolvency Proceedings (as such term is defined herein).

The Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (the "Guidelines") attached as Schedule "A" hereto, shall be incorporated by reference and form part of this Protocol. Where there is any discrepancy between the Protocol and the Guidelines, this Protocol shall prevail.

A. Background

1. Nortel Networks Inc. ("NNI") is the wholly owned U.S. subsidiary of Nortel Networks Limited ("NNL"), the principal Canadian operating subsidiary of Nortel Networks Corporation ("NNC"). NNC is a telecommunications company headquartered in Toronto, Ontario, Canada. NNI is incorporated under Delaware law and is headquartered in Richardson, Texas.

2. NNI and certain of its affiliates (collectively, the "U.S. Debtors"),[1] have commenced reorganization proceedings (the "U.S. Proceedings") under chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq*. (the "Bankruptcy Code"), in the United States Bankruptcy Court for the District of Delaware (the "U.S. Court"), and such cases have been consolidated (for procedural purposes only) under Case No. 09-10138 (KG). The U.S. Debtors are continuing in possession of their respective properties and are operating and managing their businesses, as debtors in possession, pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in the U.S. Proceedings. On January 22, 2009,

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[1] The Debtors in the U.S. Proceedings (as defined herein) are: NNI, Nortel Networks Capital Corporation, Nortel Altsystems Inc., Nortel Altsystems International Inc., XROS, Inc., Sonoma Systems, QTERA Corporation, CoreTek, Inc., Nortel Networks Applications Management Solutions Inc., Nortel Networks Optical Components Inc., Nortel Networks HPOCS Inc., Architel Systems (U.S.) Corporation, Nortel Networks International Inc., Northern Telecom International Inc. and Nortel Networks Cable Solutions Inc.

the Office of United States Trustee (the "U.S. Trustee") appointed an official committee of unsecured creditors (the "Creditors Committee") in the U.S. Proceeding. An ad hoc committee of bondholders (the "Bondholders Committee") has also been organized.

3. On January 14, 2009, the U.S. Debtors' ultimate corporate parent NNC, NNI's direct corporate parent NNL (together with NNC and their affiliates, including the U.S. Debtors, "Nortel"), and certain of their Canadian affiliates (collectively, the "Canadian Debtors")[2] filed an application with the Ontario Superior Court of Justice (the "Canadian Court") under the Companies' Creditors Arrangement Act (Canada) (the "CCAA"), seeking relief from their creditors (collectively, the "Canadian Proceedings"). The Canadian Debtors have obtained an initial order of the Canadian Court (as amended and restated, the "Canadian Order"), under which, inter alia: (a) the Canadian Debtors have been determined to be entitled to relief under the CCAA; (b) Ernst & Young Inc. has been appointed as monitor (the "Monitor") of the Canadian Debtors, with the rights, powers, duties and limitations upon liabilities set forth in the CCAA and the Canadian Order; and (c) a stay of proceedings in respect of the Canadian Debtors has been granted.

4. The Monitor filed petitions and obtained an order in the U.S. Court granting recognition of the Canadian Proceedings under chapter 15 of the Bankruptcy Code (the "Chapter 15 Proceedings"). NNI also filed an application and obtained an order in the Canadian Court pursuant to section 18.6 of the CCAA recognizing the U.S. Proceedings as "foreign proceedings" in Canada and giving effect to the automatic stay thereunder in Canada. None of the U.S. Debtors or Canadian Debtors are applicants in both the U.S. Proceedings and Canadian Proceedings.

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2 The Canadian Debtors include the following entities: NNC, NNL, Nortel Networks Technology Corporation, Nortel Networks Global Corporation and Nortel Networks International Corporation.

5. For convenience, (a) the U.S. Debtors and the Canadian Debtors shall be referred to herein collectively as the "Debtors," (b) the U.S. Proceedings and the Canadian Proceedings shall be referred to herein collectively as the "Insolvency Proceedings," and (c) the U.S. Court and the Canadian Court shall be referred to herein collectively as the "Courts", and each individually as a "Court."

B. Purpose and Goals

6. Though full and separate plenary proceedings are pending in the United States for the U.S. Debtors and in Canada for the Canadian Debtors, the implementation of administrative procedures and cross-border guidelines is both necessary and desirable to coordinate certain activities in the Insolvency Proceedings, protect the rights of parties thereto, ensure the maintenance of the Courts' respective independent jurisdiction and give effect to the doctrines of comity. Accordingly, this Protocol has been developed to promote the following mutually desirable goals and objectives in the Insolvency Proceedings:

a. harmonize and coordinate activities in the Insolvency Proceedings before the Courts;

b. promote the orderly and efficient administration of the Insolvency Proceedings to, among other things, maximize the efficiency of the Insolvency Proceedings, reduce the costs associated therewith and avoid duplication of effort;

c. honor the independence and integrity of the Courts and other courts and tribunals of the United States and Canada, respectively;

d. promote international cooperation and respect for comity among the Courts, the Debtors, the Creditors Committee, the Estate Representatives (which include the Chapter 11 Representatives and the Canadian Representatives as such terms are defined below) and other creditors and interested parties in the Insolvency Proceedings;

e. facilitate the fair, open and efficient administration of the Insolvency Proceedings for the benefit of all of the Debtors' creditors and other interested parties, wherever located; and

f. implement a framework of general principles to address basic administrative issues arising out of the cross-border nature of the Insolvency Proceedings.

As the Insolvency Proceedings progress, the Courts may also jointly determine that other cross-border matters that may arise in the Insolvency Proceedings should be dealt with under and in accordance with the principles of this Protocol. Subject to the provisions of this Protocol, including, without limitation, those included in paragraph 15 hereof, where an issue is to be addressed only to one Court, in rendering a determination in any cross-border matter, such Court may: (a) to the extent practical or advisable, consult with the other Court; and (b) in its sole discretion and bearing in mind the principles of comity, either (i) render a binding decision after such consultation; (ii) defer to the determination of the other Court by transferring the matter, in whole or in part to the other Court; or (iii) seek a joint hearing of both Courts.

C. Comity and Independence of the Courts

7. The approval and implementation of this Protocol shall not divest nor diminish the U.S. Court's and the Canadian Court's respective independent jurisdiction over the subject matter of the U.S. Proceedings and the Canadian Proceedings, respectively. By approving and implementing this Protocol, neither the U.S. Court, the Canadian Court, the Debtors nor any creditors or interested parties shall be deemed to have approved or engaged in any infringement on the sovereignty of the United States of America or Canada.

8. The U.S. Court shall have sole and exclusive jurisdiction and power over the conduct of the U.S. Proceedings and the hearing and determination of matters arising in the U.S. Proceedings. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct of the Canadian Proceedings and the hearing and determination of matters arising in the Canadian Proceedings.

9. In accordance with the principles of comity and independence recognized herein, nothing contained herein shall be construed to:

a. increase, decrease or otherwise modify the independence, sovereignty or jurisdiction of the U.S. Court, the Canadian Court or any other court or tribunal in the United States or Canada, including the ability of any such court or tribunal to provide appropriate relief on an ex parte or "limited notice" basis to the extent permitted under applicable law;

b. require the U.S. Court to take any action that is inconsistent with its obligations under the laws of the United States;

c. require the Canadian Court to take any action that is inconsistent with its obligations under the laws of Canada;

d. require the Debtors, the Creditors Committee, the Estate Representatives or the U.S. Trustee to take any action or refrain from taking any action that would result in a breach of any duty imposed on them by any applicable law;

e. authorize any action that requires the specific approval of one or both of the Courts under the Bankruptcy Code or the CCAA after appropriate notice and a hearing (except to the extent that such action is specifically described in this Protocol); or

f. preclude the Debtors, the Creditors Committee, the Monitor, the U.S. Trustee, any creditor or other interested party from asserting such party's substantive rights under the applicable laws of the United States, Canada or any other relevant jurisdiction including, without limitation, the rights of parties in interest to appeal from the decisions taken by one or both of the Courts.

10. The Debtors, the Creditors Committee, the Estate Representatives and their respective employees, members, agents and professionals shall respect and comply with the independent, non-delegable duties imposed upon them, if any, by the Bankruptcy Code, the CCAA, the Canadian Order and other applicable laws.

D. <u>Cooperation</u>

11. To assist in the efficient administration of the Insolvency Proceedings and in recognizing that the U.S. Debtors and Canadian Debtors may be creditors of the others'

estates, the Debtors and their respective Estate Representatives shall, where appropriate: (a) cooperate with each other in connection with actions taken in both the U.S. Court and the Canadian Court and (b) take any other appropriate steps to coordinate the administration of the Insolvency Proceedings for the benefit of the Debtors' respective estates.

12. To harmonize and coordinate the administration of the Insolvency Proceedings, the U.S. Court and the Canadian Court each may coordinate activities and consider whether it is appropriate to defer to the judgment of the other Court. In furtherance of the foregoing:

a. The U.S. Court and the Canadian Court may communicate with one another, with or without counsel present, with respect to any procedural matter relating to the Insolvency Proceedings.

b. Where the issue of the proper jurisdiction of either Court to determine an issue is raised by an interested party in either of the Insolvency Proceedings with respect to a motion or application filed in either Court, the Court before which such motion or application was initially filed may contact the other Court to determine an appropriate process by which the issue of jurisdiction will be determined; which process shall be subject to submissions by the Debtors, the Creditors Committee, the Monitor, the Bondholders Committee (collectively the "Core Parties"), the U.S. Trustee and any interested party prior to a determination on the issue of jurisdiction being made by either Court.

c. The Courts may, but are not obligated to, coordinate activities in the Insolvency Proceedings such that the subject matter of any particular action, suit, request, application, contested matter or other proceeding is determined in a single Court.

d. The U.S. Court and the Canadian Court may conduct joint hearings (each a "Joint Hearing") with respect to any cross-border matter or the interpretation or implementation of this Protocol where both the U.S. Court and the Canadian Court consider such a Joint Hearing to be necessary or advisable, or as otherwise provided herein, to, among other things, facilitate or coordinate proper and efficient conduct of the Insolvency Proceedings or the resolution of any particular issue in the Insolvency Proceedings. With respect to any Joint Hearing, unless otherwise ordered, the following procedures will be followed:

(i) A telephone or video link shall be established so that both the U.S. Court and the Canadian Court shall be able to simultaneously hear and/or view the proceedings in the other Court.

(ii) Submissions or applications by any party that are or become the subject of a Joint Hearing (collectively, "Pleadings") shall be made or filed initially only to the Court in which such party is appearing and seeking relief. Promptly after the scheduling of any Joint Hearing, the party submitting such Pleadings to one Court shall file courtesy copies with the other Court. In any event, Pleadings seeking relief from both Courts shall be filed in advance of the Joint Hearing with both Courts.

(iii) Any party intending to rely on any written evidentiary materials in support of a submission to the U.S. Court or the Canadian Court in connection with any Joint Hearing (collectively, "Evidentiary Materials") shall file or otherwise submit such materials to both Courts in advance of the Joint Hearing. To the fullest extent possible, the Evidentiary Materials filed in each Court shall be identical and shall be consistent with the procedural and evidentiary rules and requirements of each Court.

(iv) If a party has not previously appeared in or attorned or does not wish to attorn to the jurisdiction of a Court, it shall be entitled to file Pleadings or Evidentiary Materials in connection with the Joint Hearing without, by the mere act of such filings, being deemed to have appeared in or attorned to the jurisdiction of such Court in which such material is filed, so long as such party does not request any affirmative relief from such Court.

(v) The Judge of the U.S. Court and the Justice of the Canadian Court who will preside over the Joint Hearing shall be entitled to communicate with each other in advance of any Joint Hearing, with or without counsel being present, (1) to establish guidelines for the orderly submission of Pleadings, Evidentiary Materials and other papers and for the rendering of decisions by the Courts; and (2) to address any related procedural, administrative or preliminary matters.

(vi) The Judge of the U.S. Court and the Justice of the Canadian Court, shall be entitled to communicate with each other during or after any joint hearing, with or without counsel present, for the purposes of (1) determining whether consistent rulings can be made by both Courts; (2) coordinating the terms upon of the Courts' respective rulings; and (3) addressing any other procedural or administrative matters.

13. Notwithstanding the terms of the paragraph 12 above, this Protocol recognizes that the U.S. Court and the Canadian Court are independent courts. Accordingly, although the Courts will seek to cooperate and coordinate with each other in good faith, each of the Courts shall be entitled at all times to exercise its independent jurisdiction and authority with respect to: (a) the conduct of the parties appearing in matters presented to such Court; and (b) matters presented to such Court, including, without limitation, the right to determine if matters are properly before such Court.

14. Where one Court has jurisdiction over a matter which requires the application of the law of the jurisdiction of the other Court, such Court may, without limitation, hear expert evidence of such law or, subject to paragraph 15 herein, seek the written advice and direction of the other Court which advice may in the discretion of the receiving Court, be made available to parties in interest.

15. Notwithstanding anything to the contrary herein contained, to the extent any motion is filed or relief is sought (collectively, "Requested Relief") in either Court relating to: (i) the proposed sale of assets for gross proceeds in excess of U.S. $30 million and where at least one U.S. Debtor and one Canadian Debtor are parties to the related sale agreement or that involves assets owned by at least one U.S. Debtor and one Canadian Debtor; (ii) any motion to allocate sale proceeds which are in the aggregate more than U.S. $30 million and where at least one U.S. Debtor and one Canadian Debtor are parties to the related sale agreement or that involves assets owned by at least one U.S. Debtor and one Canadian Debtor; (iii) matters relating to the advanced pricing agreement involving both the United States and Canadian taxing authorities; (iv) matters regarding transfer pricing methodology relating to an obligation for the transfer of goods and services between one or more U.S. Debtors and one or more Canadian

Debtors; (v) any matter relating to alleged fraudulent conveyance or preference claims in excess of U.S. $30 million and which may have a material impact on both one or more U.S. Debtors and one or more Canadian Debtors; (vi) matters relating to any proposal or approval of a disclosure statement, information circular, plan of reorganization or plan of compromise and arrangements in either the U.S. Proceedings or the Canadian Proceedings; (vii) any motion to appoint a Trustee or Examiner in the U.S. Proceedings, any motion to convert the U.S. Proceedings to a Chapter 7 proceeding, any motion to appoint a Receiver in the Canadian Proceedings, or any motion to convert the Canadian Proceedings to a bankruptcy or proposal proceeding under the Bankruptcy and Insolvency Act (Canada); (viii) any motion to substantively consolidate the Debtors' estates; (ix) matters impacting the material tax attributes of the U.S. Debtors, including the net operating losses of the U.S. Debtors in any prior fiscal year; (x) any motion to amend the terms of any of the Debtors' registered pension plans the effect of which would increase the liability of any Debtor thereunder; (xi) any motion to assume, ratify, reject, repudiate, modify or assign executory contracts having a material impact on the assets, operations, obligations, rights, property or business of both the U.S. and Canadian estates and accounting for annual gross revenue in excess of U.S. $30 million ("Material Contracts"); (xii) any motion seeking relief from the automatic stay in the U.S. Proceedings and/or the stay of proceedings in the Canadian Proceedings (1) involving any Material Contract or (2) to pursue actions having a material impact on the assets, operations, obligations, rights, property or business of at least one U.S. Debtor and one Canadian Debtor and involving damages in excess of U.S. $30 million; (xiii) any motion seeking to create or extend any program, plan, proposal or scheme relating to or authorizing payments to employees where the consideration relates to non-ordinary course incentive performance, retention, severance, termination or such like payments; and (xiv) any motion regarding any program, plan proposal, scheme or similar course of action related to the wind-down of one or more of the Debtors' businesses;

Then the following procedures shall be followed:

a. unless otherwise consented to by the Core Parties, any and all documents, other than any Monitor's report related to the Requested Relief, shall be filed (as applicable) and served on the Core Parties on not less than seven days notice prior to the proposed hearing date for such Requested Relief in the Court of the forum country where the party seeking the Requested Relief intends the Requested Relief to be heard; *provided, however*, that to the extent the Requested Relief is necessary to avoid irreparable harm to the Debtors and/or the Debtors' bankruptcy estates, as may be determined by the Court of the forum country where the Requested Relief is being sought or such Court otherwise determines, such documents related to the Requested Relief shall be served on the Core Parties on such reasonable notice as such Court may determine;

b. upon notice of such Requested Relief being provided to the Core Parties, each of the Core Parties will have not less than two business days from receipt of such notice (or such shorter period as the Court of the forum country where the Requested Relief is being sought shall determine, as set forth in paragraph 15(a) herein) to request, in writing, that the filing party seek a Joint Hearing for the Requested Relief;

c. if the filing party agrees to seek a Joint Hearing, the Requested Relief shall be heard at a Joint Hearing conducted by the Courts in accordance with the procedures set forth in paragraph 12 herein; and

d. if the filing party does not agree to seek a Joint Hearing, the party seeking to have the Requested Relief heard at a Joint Hearing may file a notice of Joint Hearing dispute in both the Court of the forum country and the Court of the non-forum country and serve notice thereof on the remaining Core Parties, whereupon the respective Courts of the forum country and the non-forum country may consult with one another in accordance with paragraphs 6 and 12 hereof, in order to determine whether a Joint Hearing is necessary or may otherwise consult with the Core Parties prior to any party proceeding with the underlying Requested Relief in the original proposed forum country.

E. Recognition of Stays of Proceedings

16. The Canadian Court hereby recognizes the validity of the stay of proceedings and actions against the U.S. Debtors and their property under section 362 of the

Bankruptcy Code (the "U.S. Stay"). In implementing the terms of this paragraph, the Canadian Court may consult with the U.S. Court regarding: (i) the interpretation, extent, scope and applicability of the U.S. Stay and any orders of the U.S. Court modifying or granting relief from the U.S. Stay; and (ii) the enforcement of the U.S. Stay in Canada.

17. The U.S. Court hereby recognizes the validity of the stay of proceedings and actions against the Canadian Debtors and their property under the Canadian Order (the "Canadian Stay"). In implementing the terms of this paragraph, the U.S. Court may consult with the Canadian Court regarding: (i) the interpretation, extent, scope and applicability of the Canadian Stay and any orders of the Canadian Court modifying or granting relief from the Canadian Stay; and (ii) the enforcement of the Canadian Stay in the United States.

18. Nothing contained herein shall affect or limit the Debtors' or other parties' rights to assert the applicability or nonapplicability of the U.S. Stay or the Canadian Stay to any particular proceeding, property, asset, activity or other matter, wherever pending or located. Subject to paragraph 15, herein, motions brought respecting the application of the stay of proceedings with respect to assets or operations of the Canadian Debtors shall be heard and determined by the Canadian Court. Subject to paragraph 15 herein, motions brought respecting the application of the stay of proceedings with respect to assets or operations of the U.S. Debtors shall be heard and determined by the U.S. Court.

F. Rights to Appear and Be Heard

19. The Debtors, the Core Parties, and any other committee that may be appointed by the U.S. Trustee, and the professionals and advisors for each of the foregoing, shall have the right and standing: (i) to appear and to be heard in either the U.S. Court or Canadian Court in the U.S. Proceedings or Canadian Proceedings, respectively, to the same extent as creditors and other interested parties domiciled in the forum country, subject to any local rules or

regulations generally applicable to all parties appearing in the forum; and (ii) to file notices of appearance or other papers with the clerk of the U.S. Court or the Canadian Court in respect of the U.S. Proceedings or Canadian Proceedings, respectively; provided, however, that any appearance or filing may subject a creditor or interested party to the jurisdiction of the Court in which the appearance or filing occurs; provided further, that an appearance by the Creditors Committee in the Canadian Proceedings shall not form a basis for personal jurisdiction in Canada over the members of the Creditors Committee. Notwithstanding the foregoing, and in accordance with the policies set forth above, including, inter alia, paragraph 12 above; (i) the Canadian Court shall have jurisdiction over the Chapter 11 Representatives (as defined below) solely with respect to the particular matters as to which the Chapter 11 Representatives appear before the Canadian Court; and (ii) the U.S. Court shall have jurisdiction over the Canadian Representatives (as defined below) solely with respect to the particular matters as to which the Canadian Representatives appear before the U.S. Court.

20. In connection with any matter in the Canadian Proceedings in which the Creditors Committee seeks to become involved and which would otherwise require the Creditors Committee to execute a confidentiality agreement, the Creditors Committee, its individual members and professionals shall not be required to execute confidentiality agreements but instead the Creditors Committee and its members shall be bound by the confidentiality provisions contained in the Creditors Committee bylaws, and the Creditors Committee's professionals shall be bound by the terms of the confidentiality agreement with the Debtors dated February 2, 2009.

G. Claims Protocol

21. The Debtors anticipate that it will be necessary to implement a specific claims protocol to address, among other things and without limitation, the timing, process,

jurisdiction and applicable governing law to be applied to the resolution of intercompany claims filed by the Debtors' creditors in the Canadian Proceedings and the U.S. Proceedings. In such event, and in recognition of the inherent complexities of the inter-company claims that may be asserted in the Insolvency Proceedings, the Debtors shall use commercially reasonable efforts to negotiate a specific claims protocol, in form and substance satisfactory to the Debtors, the Monitor, and the Creditors Committee, which protocol shall be submitted to the Canadian Court and the U.S. Court for approval. In the event that the Debtors fail to reach agreement among such parties, the Debtors shall file a motion in both the Canadian Court and the U.S. Court seeking approval of such claims protocol as the Debtors shall determine to be in the best interest of the Debtors and their creditors.

H. Retention and Compensation of Estate Representative and Professionals

22. The Monitor, its officers, directors, employees, counsel and agents, wherever located, (collectively the "Monitor Parties") and any other estate representatives appointed in the Canadian Proceedings (collectively, the "Canadian Representatives") shall (subject to paragraph 19) be subject to the sole and exclusive jurisdiction of the Canadian Court with respect to all matters, including: (a) the Canadian Representatives' tenure in office; (b) the retention and compensation of the Canadian Representatives; (c) the Canadian Representatives' liability, if any, to any person or entity, including the Canadian Debtors and any third parties, in connection with the Insolvency Proceedings; and (d) the hearing and determination of any other matters relating to the Canadian Representatives arising in the Canadian Proceedings under the CCAA or other applicable Canadian law. The Canadian Representatives shall not be required to seek approval of their retention in the U.S. Court for services rendered to the Debtors. Additionally, the Canadian Representatives: (a) shall be compensated for their services to the Canadian Debtors solely in accordance with the CCAA, the Canadian Order and other applicable

Canadian law or orders of the Canadian Court; and (b) shall not be required to seek approval of their compensation in the U.S Court.

23. The Monitor Parties shall be entitled to the same protections and immunities in the United States as those granted to them under the CCAA and the Canadian Order. In particular, except as otherwise provided in any subsequent order entered in the Canadian Proceedings, the Monitor Parties shall incur no liability or obligations as a result of the Canadian Order, the appointment of the Monitor, the carrying out of its duties or the provisions of the CCAA and the Canadian Order by the Monitor Parties, except any such liability arising from actions of the Monitor Parties constituting gross negligence or willful misconduct.

24. Any estate representative appointed in the U.S. Proceedings, including without limitation any examiners or trustees appointed in accordance with section 1104 of the Bankruptcy Code (collectively, the "Chapter 11 Representatives") shall (subject to paragraph 19) be subject to the sole and exclusive jurisdiction of the U.S. Court with respect to all matters, including: (a) the Chapter 11 Representatives' tenure in office; (b) the retention and compensation of the Chapter 11 Representatives; (c) the Chapter 11 Representatives' liability, if any, to any person or entity, including the U.S. Debtors and any third parties, in connection with the Insolvency Proceedings; and (d) the hearing and determination of any other matters relating to the Chapter 11 Representatives arising in the U.S. Proceedings under the Bankruptcy Code or other applicable laws of the United States. The Chapter 11 Representatives shall not be required to seek approval of their retention in the Canadian Court and (a) shall be compensated for their services to the U.S. Debtors solely in accordance with the Bankruptcy Code and other applicable laws of the United States or orders of the U.S. Court; and (b) shall not be required to seek

approval of their compensation for services performed for the U.S. Debtors in the Canadian Court.

25. Any professionals (i) retained by and being compensated solely by, or (ii) being compensated solely by, the Canadian Debtors including in each case, without limitation, counsel and financial advisors (collectively, the "Canadian Professionals"), shall be subject to the sole and exclusive jurisdiction of the Canadian Court. Such Canadian Professionals: (a) shall be subject to the procedures and standards for retention and compensation applicable in the Canadian Court under the CCAA, the Canadian Order and any other applicable Canadian law or orders of the Canadian Court with respect to services performed on behalf of the Canadian Debtors; and (b) shall not be required to seek approval of their retention or compensation in the U.S. Court.

26. Any professionals (i) retained by, or (ii) being compensated by, the U.S. Debtors including in each case, without limitation, counsel and financial advisors (collectively, the "U.S. Professionals") shall be subject to the sole and exclusive jurisdiction of the U.S. Court. Such U.S. Professionals: (a) shall be subject to the procedures and standards for retention and compensation applicable in the U.S. Court under the Bankruptcy Code and any other applicable laws of the United States or orders of the U.S. Court; and (b) shall not be required to seek approval of their retention or compensation in the Canadian Court.

27. Subject to paragraph 19 herein, any professional retained by the Creditors Committee, including in each case, without limitation, counsel and financial advisors (collectively, the "Committee Professionals") shall be subject to the sole and exclusive jurisdiction of the U.S. Court. Such Committee Professionals: (a) shall be subject to the procedures and standards for retention and compensation applicable in the U.S. Court under the

Bankruptcy Code and any other applicable laws of the United States or orders of the U.S. Court; and (b) shall not be required to seek approval of their retention or compensation in the Canadian Court or any other court.

I. Notice

28. Notice of any motion, application or other Pleading or paper (collectively the "Court Documents") filed in one or both of the Insolvency Proceedings involving or relating to matters addressed by this Protocol and notice of any related hearings or other proceedings shall be given by appropriate means (including, where circumstances warrant, by courier, telecopier or other electronic forms of communication) to the following: (a) all creditors and interested parties, in accordance with the practice of the jurisdiction where the papers are filed or the proceedings are to occur; and (b) to the extent not otherwise entitled to receive notice under clause (a) of this sentence, counsel to the Debtors; the U.S. Trustee; the Monitor; the Creditors Committee; the Bondholders Committee and any other statutory committees appointed in the Insolvency Proceedings and such other parties as may be designated by either of the Courts from time to time. Notice in accordance with this paragraph shall be given by the party otherwise responsible for effecting notice in the jurisdiction where the underlying papers are filed or the proceedings are to occur. In addition to the foregoing, upon request, the U.S. Debtors or the Canadian Debtors shall provide the U.S. Court or the Canadian Court, as the case may be, with copies of any orders, decisions, opinions or similar papers issued by the other Court in the Insolvency Proceedings.

29. When any cross-border issues or matters addressed by this Protocol are to be addressed before a Court, notices shall be provided in the manner and to the parties referred to in paragraph 28 above.

J. **<u>Effectiveness; Modification</u>**

30. This Protocol shall become effective only upon its approval by both the U.S. Court and the Canadian Court.

31. This Protocol may not be supplemented, modified, terminated, or replaced in any manner except upon the approval of both the U.S. Court and the Canadian Court after notice and a hearing. Notice of any legal proceeding to supplement, modify, terminate or replace this Protocol shall be given in accordance with the notice provisions set forth above.

K. **<u>Procedure for Resolving Disputes Under this Protocol</u>**

32. Disputes relating to the terms, intent or application of this Protocol may be addressed by interested parties to the U.S. Court, the Canadian Court or both Courts upon notice in accordance with the notice provisions outlined in paragraph 28 above. In rendering a determination in any such dispute, the Court to which the issue is addressed: (a) shall consult with the other Court; and (b) may, in its sole and exclusive discretion, either: (i) render a binding decision after such consultation; (ii) defer to the determination of the other Court by transferring the matter, in whole or in part, to such other Court; or (iii) seek a Joint Hearing of both Courts in accordance with paragraph 12 above. Notwithstanding the foregoing, in making a determination under this paragraph, each Court shall give due consideration to the independence, comity and inherent jurisdiction of the other Court established under existing law.

33. In implementing the terms of this Protocol, the U.S. Court and the Canadian Court may, in their sole, respective discretion, provide advice or guidance to each other with respect to legal issues in accordance with the following procedures:

a. the U.S. Court or the Canadian Court, as applicable, may determine that such advice or guidance is appropriate under the circumstances;

b. the Court issuing such advice or guidance shall provide it to the non-issuing Court in writing;

c. copies of such written advice or guidance shall be served by the applicable Court in accordance with paragraph 28 hereof;

d. the Courts may jointly decide to invite the Debtors, the Creditors Committee, the Estate Representatives, the U.S. Trustee and any other affected or interested party to make submissions to the appropriate Court in response to or in connection with any written advice or guidance received from the other Court; and

e. for clarity, the provisions of this paragraph shall not be construed to restrict the ability of either Court to confer as provided in paragraph 12 above whenever it deems it appropriate to do so.

L. Preservation of Rights

34. Except as specifically provided herein, neither the terms of this Protocol nor any actions taken under the terms of this Protocol shall: (a) prejudice or affect the powers, rights, claims and defenses of the Debtors and their estates, the Creditors Committee, the Estate Representatives, the U.S. Trustee or any of the Debtors' creditors under applicable law, including, without limitation, the Bankruptcy Code the CCAA, and the orders of the Courts; or (b) preclude or prejudice the rights of any person to assert or pursue such person's substantive rights against any other person under the applicable laws of Canada or the United States.

IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION

Court File No: 09-CL-7950

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

FIFTH AMENDED AND RESTATED INITIAL ORDER

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Lawyers for the Applicants

DOCSTOR: 2112105\1A

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 SILVER STREAMS HOMES INC.; SILVER STREAMS HOMES (PUCCINI) INC., 2148993 ONTARIO INC., 2148990 ONTARIO INC., 2147681 ONTARIO INC. AND 2147650 ONTARIO INC.

Court File No. CV-13-10362-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BRIEF OF AUTHORITIES OF
TARION WARRANTY CORPORATION
(Motion to Approve Settlement Agreement)
(Returnable June 25, 2015)

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