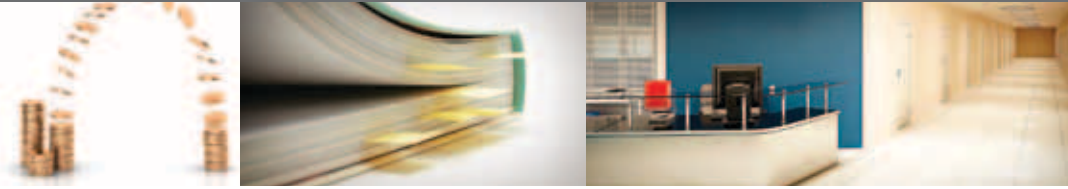


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INSOLVENCY &  
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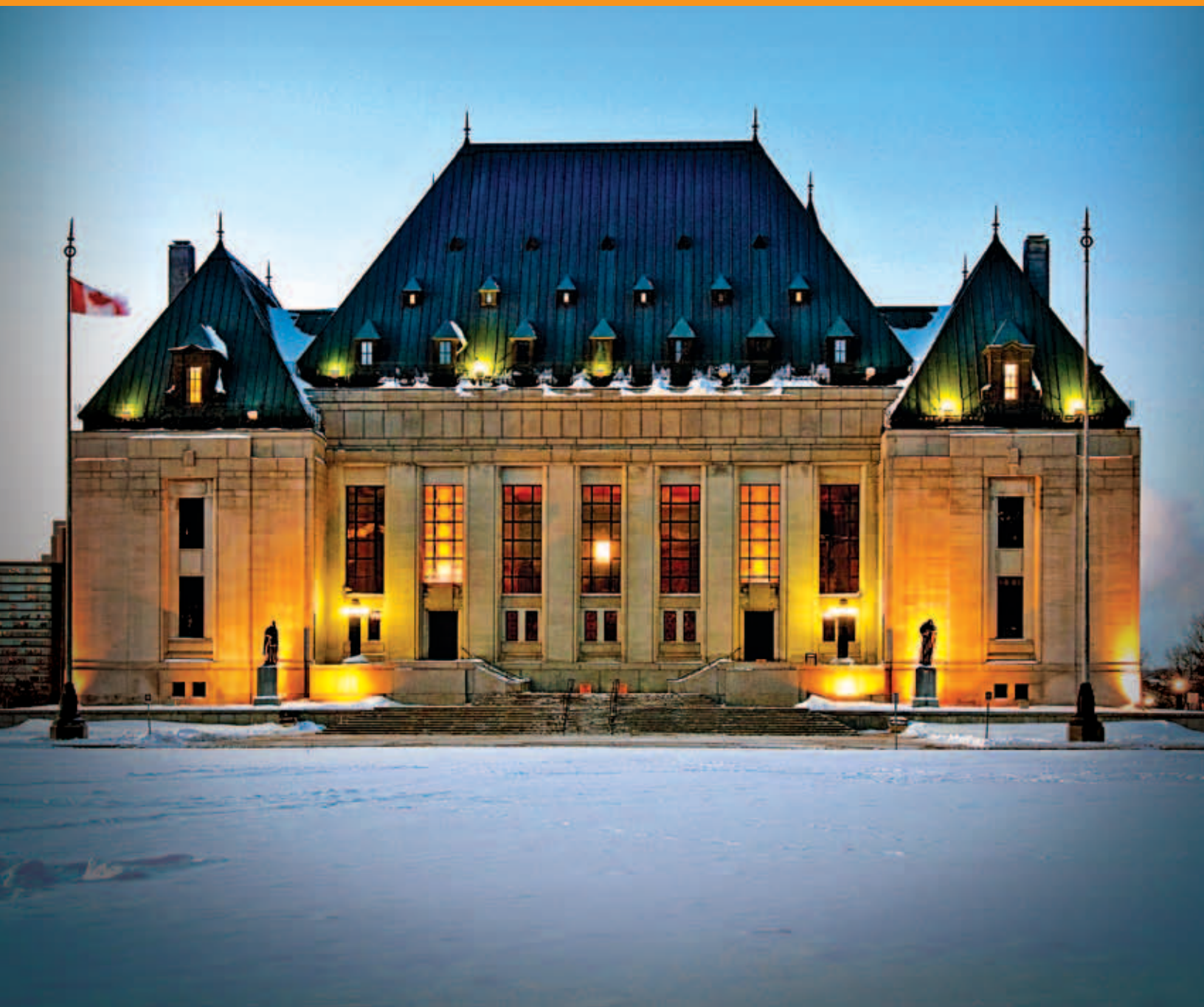
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# The Tax Man Is Defeated Once Again: SCC Confirms Crown's Status as an "Ordinary Creditor" for Unremitted GST Amounts in CCAA Reorganizations

by Simina Ionescu-Mocanu



**With *Century Services*, the Supreme Court has communicated a desire to maintain consistency in insolvency and restructuring proceedings and has discouraged statute shopping by treating creditors equally in both regimes.**

## Introduction

With recent amendments to insolvency and tax legislation, the Crown's priority position in a bankruptcy has become clear—the *Bankruptcy and Insolvency Act*<sup>1</sup> (“the BIA”) explicitly provides that statutory deemed trusts are ineffective in a bankruptcy unless they relate to amounts owing pursuant to the *Income Tax Act*<sup>2</sup> (“the ITA”), the *Canada Pension Plan*<sup>3</sup> (“the CPP”) and the *Employment Insurance Act*<sup>4</sup> (“the EIA”).

GST/QST<sup>5</sup> claims are not afforded similar protection. In fact, the *Excise Tax Act*<sup>6</sup>, which creates a deemed trust over these amounts, also confirms that the trust is valid *unless otherwise provided by the BIA*. As a result, in a bankruptcy, the Crown is a mere unsecured creditor with respect to unremitted GST/QST, ranking subordinate in priority to the bankrupt's secured creditors.

The priority provisions of the BIA and the *Companies' Creditors Arrangement Act*<sup>7</sup> (as amended, the CCAA) are identical. However, the *Excise Tax Act* is silent on the trust's validity in CCAA proceedings. Because of this apparent drafting anomaly, it was commonly believed that the Crown had, at minimum, some room to argue that the deemed trust remained valid in a CCAA restructuring.<sup>8</sup> Nevertheless, the Crown's position in these types of proceedings remained unsettled.

## Impact of Century Services

Uncertainty was the status quo until December 16, 2010, when the Supreme Court of Canada (“the Supreme Court”) released its judgment in *Century Services Inc. v. Canada (Attorney General)*<sup>9</sup> (“*Century Services*”) and confirmed the Crown's unsecured position for unremitted GSA/QST amounts in CCAA restructurings.

*Century Services* dealt with an unsuccessful CCAA reorganization attempt by Ted LeRoy Trucking Ltd. (“LeRoy Trucking”). When LeRoy Trucking first filed for protection, it owed over \$300,000.00 to the Crown for unremitted GST. Once LeRoy Trucking concluded that reorganization was impossible, it sought leave to partially lift the CCAA stay of proceedings so that it could assign itself into bankruptcy. The Crown applied for a motion requesting that LeRoy Trucking immediately pay the outstanding GST.

A second important issue in the case then became whether the Chambers Judge could lift the stay of proceedings to allow LeRoy Trucking to file for bankruptcy protection, while, at the same time, staying the Crown's right to sue LeRoy Trucking for the unremitted GST.

The Chambers Judge used the broad discretion provided by section 11 of the CCAA to deny the Crown's motion and allow LeRoy Trucking's assignment in bankruptcy. On appeal, however, the Court of Appeal agreed with the Crown and held that once LeRoy Trucking's reorganization had failed, the Chambers Judge was bound by the *Excise Tax Act* to allow the Crown to demand payment of unremitted GST. In its view, the chambers judge had no discretion under the CCAA to continue the stay.

When LeRoy Trucking appealed, the Supreme Court reminded the parties that protection for statutory deemed trusts in insolvencies must

be expressly provided in legislation. As noted above, the CCAA provides protection for deemed trusts arising under specific legislation only (the ITA, the CPP and the EIA). Crown claims over GST are not protected. This, in the Supreme Court's view, suggested that Parliament had waived its priority over unremitted GST amounts in a restructuring.

As to the drafting inconsistency in the *Excise Tax Act*, the Supreme Court found that it created an “apparent” conflict only and found no evidence that Parliament intended to treat GST claims differently under the CCAA than under the BIA. The Supreme Court noted that

... a strange asymmetry would arise if the interpretation giving the [*Excise Tax Act*] priority over the CCAA urged by the Crown [was] adopted here: the Crown would retain priority over GST claims during CCAA proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one ...<sup>10</sup>

The Supreme Court further concluded that the Chambers Judge had authority under the CCAA to lift the stay to permit LeRoy Trucking to file for BIA protection. The transition from the CCAA to the BIA requires courts to lift the CCAA stay to allow the debtor to begin BIA proceedings. However, the stay should only be *partially* lifted—that is, it should not create a “gap” between the two statutes to allow parties to enforce remedies typically stayed in a bankruptcy after the conclusion of CCAA proceedings.<sup>11</sup>

## Conclusion

With *Century Services*, the Supreme Court has communicated a desire to maintain consistency in insolvency and restructuring proceedings and has discouraged statute shopping by treating creditors equally in both regimes. The decision is a clear illustration that, although the BIA and CCAA are two separate statutes, they work together as one scheme. Going forward into 2011, secured creditors can breathe a sigh of relief, knowing that their priority position relative to Crown claims for GST/QST in a CCAA restructuring will be maintained.

## Footnotes

<sup>1</sup> *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

<sup>2</sup> *Income Tax Act*, R.S.C. 1985, c. 1, 5th Suppl.

<sup>3</sup> *Canada Pension Plan*, R.S.C. 1985, c. C-8.

<sup>4</sup> *Employment Insurance Act*, R.S.C. 1996, c. 23.

<sup>5</sup> Quebec Sales Tax.

<sup>6</sup> *Excise Tax Act*, R.S.C. 1985, c. E-15.

<sup>7</sup> *Companies' Creditors Arrangements Act*, R.S.C. 1985, c. C-36.

<sup>8</sup> See, for instance, the Ontario Court of Appeal decision of *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737 (C.A.), which held that the GST deemed trust created by the *Excise Tax Act* trumped provisions in the CCAA that nullified the trust. This decision was not followed uniformly by other provincial courts in Canada (e.g., *Komunik Corp. (Arrangement relatif à)*, 2009 QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII)).

<sup>9</sup> *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 (*Century*).

<sup>10</sup> *Century*, *ibid.* at para. 47, citing *Gauntlet Energy Corp., Re* (2003), 30 Alta. L.R. (4th) 192, at para. 21.

<sup>11</sup> *Century*, *ibid.* at para. 80.

# Set-Off Rights in Oil & Gas Insolvencies: the SemCAMS Saga Continues

by Simina Ionescu-Mocanu

## Introduction

The law of set-off allows a party who has mutual dealings with another to literally “set off” (or offset) amounts that it owes the other party against whatever amounts the other party owes to it. The right of set-off applies notwithstanding the onset of insolvency and restructuring proceedings.

In typical insolvencies, most creditors recover only a portion of the amounts owed to them by the insolvent debtor. Set-off is particularly beneficial in this context because creditors do not have to take a discounted value for their debts while paying the obligations that they owe to the debtor in full.

In our June 2010 issue of *On Record: Energy*, we provided a summary of two Alberta Court of Appeal decisions arising out of the SemCAMS ULC Companies’ Creditors Arrangement Act<sup>1</sup> (“the CCAA”) proceedings: *Nexen Marketing v. SemCAMS ULC*<sup>2</sup> [“Nexen”] and *Trilogy Energy LP v. SemCAMS ULC*<sup>3</sup> [“Trilogy”]. In both decisions, the Alberta Court of Appeal (“the Court of Appeal”) restricted the availability of set-off to very limited circumstances.

In December of 2010, the Court of Appeal released another judgment in the SemCAMS ULC restructuring, this time denying leave to Celtic Exploration Ltd. (“Celtic”) in *SemCanada Crude Co., Re*<sup>4</sup> [“Celtic”]. Similar to *Trilogy* and *Nexen*, *Celtic* confirms that courts in Alberta have chosen to adopt a narrow approach to set-off in insolvency proceedings.





## Facts in *Celtic*

SemCAMS ULC (“SemCAMS”) was the operator and the joint owner of natural gas processing plants and gas gathering systems and pipelines in Alberta, including the facilities at the Kaybob South Amalgamated Plant (“the KA Plant”).

The KA Plant operated pursuant to a construction, ownership and operation agreement among the joint owners of the plant and SemCAMS as operator (“the CO&O Agreement”). Parties could have their natural gas processed at the KA Plant in two ways: (i) as joint owners under the CO&O Agreement, or (ii) as third party users under gas handling and processing agreements (each, “a Gas Processing Agreement”).

Joint owners and third party users made monthly payments to SemCAMS, as operator, based on the plant’s projected use. At the end of a calendar year, a “thirteenth month adjustment” reconciled projected throughput to actual throughput.

Celtic was a natural gas producer that originally processed its gas at the KA Plant as a third party user under a Gas Processing Agreement. In 2006, Celtic and SemCAMS terminated this agreement and entered into the Inlet Gas Purchase Agreement (“the IGPA”). Under the IGPA, Celtic sold its raw natural gas to SemCAMS and transferred title to the gas at the KA Plant. SemCAMS then processed the gas using its capacity and priority rights as a *joint owner* in the KA Plant.

On July 22, 2008, the Alberta Court of Queen’s Bench granted SemCAMS creditor protection under the CCAA. A series of communications between Celtic’s and SemCAMS’ management ensued, which left SemCAMS with the impression that the IGPA had been suspended as of the date of the initial CCAA filing. Celtic eventually denied this fact.

Celtic continued to deliver raw natural gas to the KA Plant after July 22, 2008. However, since SemCAMS believed that the IGPA had been suspended, it thought it was accepting Celtic’s gas in its capacity as operator pursuant to standard third party terms under Gas Processing Agreements and not as a joint owner pursuant to the IGPA. SemCAMS invoiced Celtic monthly for standard gathering and processing fees that it charged as operator to third party users.

When SemCAMS commenced CCAA proceedings, it owed Celtic approximately \$32 million, including approximately \$1.4 million pursuant to the thirteenth month adjustment under the IGPA.

On October 9, 2009, Celtic purported to set off the \$1.4 million thirteenth month adjustment against amounts that Celtic owed to SemCAMS as operator for post-filing gas processing at the KA Plant.

SemCAMS applied for an order declaring that the IGPA was suspended effective July 22, 2008 and a declaration that Celtic was not entitled to set-off.

## IGPA Suspended and Set-Off Denied

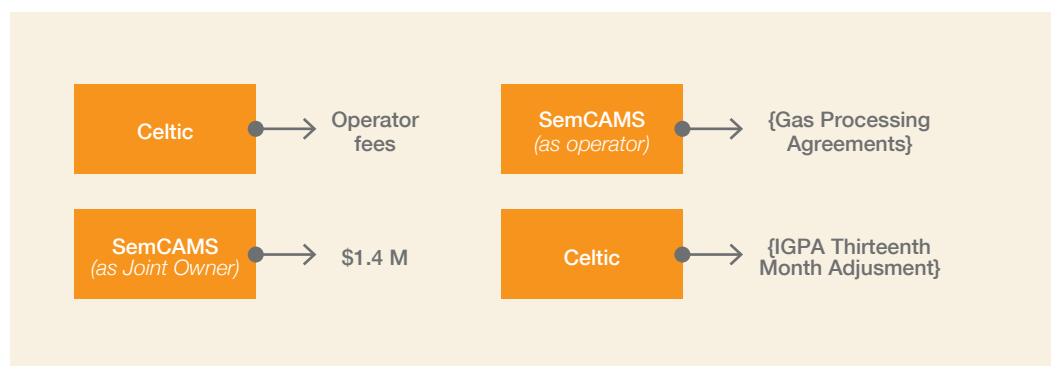
At the Court of Queen's Bench level it was held that the IGPA was suspended effective July 22, 2008 and that Celtic could not set off amounts that it owed to SemCAMS after the suspension date against SemCAMS' pre-filing indebtedness under the IGPA.<sup>5</sup> Celtic applied for leave to appeal.

## Celtic Applies for Leave to Appeal

### (a) Determining Jurisdiction and Examining the IGPA's Suspension

The first issue that Celtic raised in its application for leave to appeal was whether the lower court, the Court of Queen's Bench, had jurisdiction to declare that the parties had agreed to suspend the IGPA. Celtic argued that there were many disputed facts at issue and that the lower court should not have declared that the IGPA was suspended without a full trial.

The Court of Appeal agreed with the lower court's analysis and held that section 11 of the CCAA gave it broad jurisdiction to make "any order" it considered "appropriate in the circumstances" (subject to the restrictions set out in the CCAA).<sup>6</sup> The issue of whether Celtic and SemCAMS reached an agreement to suspend the IGPA went to the integrity of the CCAA process. A full trial was also unnecessary because the lower court relied on objective evidence (written correspondence between the parties setting out their intentions), which showed that both Celtic and SemCAMS agreed to suspend the IGPA.



### (b) Set-Off in Light of Trilogy

Celtic had initially submitted that the IGPA entitled it to set off its post-filing obligations against SemCAMS' indebtedness under the thirteenth month adjustment. Since the Court of Appeal had already agreed with the lower court's decision that the IGPA was suspended, it had no basis upon which to find contractual set-off in favour of Celtic.

Celtic then suggested that even if contractual set-off was prohibited, it was still entitled to equitable set-off because the parties' identity remained the same and the obligations in question arose out of substantially the same relationship. The Court of Appeal however, once again agreed with the Court of Queen's Bench and explained that the suspension of the IGPA on July 22, 2008 meant that SemCAMS stopped purchasing and processing Celtic's natural gas as a joint owner. After that date, SemCAMS processed the gas in its capacity as operator of the KA Plant.

Applying the test set out in *Telford v. Holt*,<sup>7</sup> the Court of Appeal held that Celtic had not met the burden of establishing a close connection between the parties' cross-claims and had not established that it would not be manifestly unjust to disallow equitable set-off. It further noted that Celtic involved virtually identical circumstances to *Trilogy*. Similar to the creditor in *Trilogy*, Celtic sought to set off amounts that SemCAMS owed in its capacity as a joint owner against its indebtedness to SemCAMS as operator.<sup>8</sup> As a result, "allowing equitable set-off to Celtic in these proceedings after denying it to Trilogy and other producers in similar circumstances would raise further issues of inequity."<sup>9</sup>

## Moving Forward: Best Practice in Light of SemCAMS

Celtic confirms our initial conclusions concerning set-off rights in Alberta following *Trilogy* and *Nexen*. The Court of Appeal continues to narrow the application of equitable set-off to limited circumstances, especially in insolvency cases. Similar to *Trilogy*, Celtic should serve as a warning to participants and increase awareness to the capacity in which their contracting counterparties are acting, as such capacity may impact their ability to utilize not only set-off rights which are typically available contractually or at law, but also at equity.

To maintain contractual rights to set-off, participants may want to consider using provisions which specifically allow set-off even when counterparties are acting as operators or trustees. Joint owners delivering gas to parties who conduct business in more than one capacity should request their counterparties to confirm whether they are accepting the gas as operators or in another capacity. Non-operators may also wish to take additional security to protect their exposure.<sup>10</sup>

### Footnotes

<sup>1</sup> *Nexen Marketing v. SemCAMS ULC* (2009), 457 A.R. 336 (C.A.) [Nexen].

<sup>2</sup> *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

<sup>3</sup> *Trilogy Energy LP v. SemCAMS ULC* (2009), 460 A.R. 269 (C.A.), refusing leave to appeal *SemCanada Crude Co., Re*, 2009 ABQB 397.

<sup>4</sup> *SemCanada Crude Co., Re.*, 2010 ABCA 403 [Celtic].

<sup>5</sup> *SemCanada Crude Company (Re)*, 2010 ABQB 531.

<sup>6</sup> The Court further held that the issue of whether the IGPA was suspended arose directly as a result of the CCAA proceedings and had a strong impact on other creditors' claims.

<sup>7</sup> *Telford v. Holt*, [1987] 2 S.C.R. 193.

<sup>8</sup> *Celtic*, *supra* note 4 at para. 39.

<sup>9</sup> *Ibid.* at para. 121.

<sup>10</sup> In *Nexen*, *supra* note 1, the Alberta Court of Appeal confirmed that mere membership in the same corporate group could not establish a sufficient connection to create a right of equitable set-off. To avoid this risk, parties should obtain security for all contracts entered into with a group of companies, even when there is no direct risk of credit exposure.



# Debt Restructuring Using a Plan of Arrangement

by Emily T. Joyce, Student-at-Law

## Introduction

Until recently, *Canada Business Corporations Act*<sup>1</sup> (the “CBCA”) plans of arrangement were reserved for restructuring equity. Since section 192(3) of the CBCA authorizes corporations that are “not insolvent” to make an application under the statute, it was generally believed that insolvent corporations were implicitly excluded from the CBCA’s ambit. As a result, CBCA plans of arrangement were rarely used to restructure debt and were never used if the restructuring company was insolvent.<sup>2</sup> Parties carried out these restructurings almost exclusively under the *Companies’ Creditors Arrangement Act*<sup>3</sup> (“the CCAA”).

## Industry Canada’s Policy Statement

Industry Canada published a policy statement last year (“the Statement”) which endorsed the view that the CBCA’s arrangement provisions are meant to be facilitative and should not be construed narrowly.<sup>4</sup> The Statement notes that plans of arrangement carried out under section 192 of the CBCA can be used to affect a wide range of transactions, including “spin-offs” and combinations of business enterprises, continuances of corporations to and from other jurisdictions and “going-private” transactions.

The impetus for Industry Canada’s publication came from recent Canadian decisions suggesting a more receptive approach to CBCA arrangements, approving them for many different types of transactions with a variety of objectives, including compromising debt.

## What Is Needed to Meet the Solvency Test?

Courts have approved arrangements and allowed applicant corporations to satisfy the section 192(3) solvency requirement on two grounds.<sup>5</sup> First, in restructurings involving a group of applicant corporations, courts have held that section 192(3) can be satisfied as long as one of the applicant corporations is solvent. This is the case even if one of the principal corporate entities involved in the overall transaction is not solvent or if the solvent applicant corporation was established just to take part in the plan.<sup>6</sup> Second, plans of arrangement involving insolvent corporations have proceeded where the applicant was insolvent at the interim hearing date, but became solvent by the date of the final hearing.

Both these possibilities are explicitly recognized in the Statement, which addresses potential concerns and should be reviewed by anyone considering a debt restructuring under the CBCA. In some cases, proceeding under

Unlike the *CBCA*, which gives courts significant discretion in making interim orders, the *ABCA* does not appear to empower courts to issue a stay of proceedings against creditors.

traditional insolvency legislation may be more appropriate, especially if the purpose of the restructuring is to carry out transactions that principally involve compromising debt.

### Proceeding with a *CBCA* Plan of Arrangement

In brief terms, the *CBCA* arrangement application process is as follows:

#### (a) Proposed Plan & Drafting of Information Circular (Stakeholder Negotiations / Director's Notice)

To initiate the application, the applicant's debtors and creditors prepare and draft a proposed information circular, which outlines the terms of the plan and other necessary information about the restructuring process. The Director—the *CBCA* appointed regulator—must review the circular before filing.

#### (b) Application for Interim Order

Parties then officially commence the *CBCA* process by applying to the court for an "interim order", which will set out the arrangement's procedural requirements, including service requirements, creditor meetings (and classes of creditors) for the purpose of voting on the plan, and outlines a date for the plan's final approval. Although the interim order application may be made *ex parte* (without notice), courts will hear objections and have the ability to vary or even set aside the order on application by the Director. The Director may make submissions at this hearing (and at the final order hearing, discussed below). As a result, it is customary for the applicant to provide notice of the interim order application and the relevant application material to the Director at least five business days before the court application.

The principles governing the classification of creditors under the *CBCA* are substantially similar to those employed in *CCAA* restructurings, which are preliminarily concerned with grouping creditors with a commonality of legal interests.

#### (c) Stakeholder Meetings and Vote

Although the *CBCA* does not contain a specific voting threshold for the approval of a plan, case law indicates that a plan will be approved if at least two-thirds in value of creditors who vote in each class support the plan. However, given the absence of a statutorily established threshold, the courts maintain a broad discretion to approve plans even if the two-thirds threshold is not met.

#### (d) Final Order for Plan Approval

A few days after the creditor vote, the applicant will schedule another application for a final approval order. The criteria which the court must apply when requested to approve a plan of arrangement under the *CBCA* are well-established. The plan will be approved if the court is satisfied that (i) all statutory requirements have been fulfilled, (ii) the arrangement is put forward in good faith, and (iii) the arrangement is fair and reasonable.<sup>7</sup> Additionally, the court will also consider whether the arrangement strikes a fair balance having regard to the interest of the corporation and the circumstances of the case. Although a positive vote by creditors and stakeholders is an important consideration in this regard, the vote is not determinative of whether the arrangement will be approved.

The Statement also sets out several procedural safeguards to mitigate any concerns, such as providing disclosure to known security holders, appropriate voting requirements and obtaining independent opinion reports.

If the court grants the final order, the transaction outlined in the plan of arrangement will close and be finalized almost immediately after the order is filed or as set out on the information circular timetable. Indeed, this entire process can take as little as 30 days from filing to the final hearing.

For some, the *CBCA* process can be efficient and very flexible. Section 192(4) of the *CBCA*—which gives courts a general discretion on an initial application under section 192(4) to "make any interim or final order it thinks fit"—provides courts with wide enough discretion to issue a stay of proceedings against creditor actions. However, the additional hurdles imposed by the solvency test and the court's wider discretion in the process bring forth added uncertainties and consequent risk of delay.

### Using the *ABCA* for Debt Restructuring?

Certain other corporate statutes do not impose a solvency limitation on arrangements. For example, the Alberta Business Corporations Act ("the *ABCA*")<sup>8</sup> has no such limitation on arrangements. However, because the *ABCA* contains no provisions for interim relief, it is unlikely courts would be amenable to allowing the arrangement provisions of the *ABCA* to be used for debt restructurings involving insolvent companies. Unlike the *CBCA*, which gives courts significant discretion in making interim orders, the *ABCA* does not appear to empower courts to issue a stay of proceedings against creditors. The more limited power of a court under an *ABCA* arrangement application militates against the possibility that an application involving a potentially insolvent corporation would succeed. Recent commentary also supports the view that section 193 of the *ABCA* permits only a solvent company to make fundamental changes to its corporate structure.<sup>9</sup>

#### Footnotes

<sup>1</sup> *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.

<sup>2</sup> Peter Rubin & Bill Kaplan, Q.C., "Arrangement Provisions of the Canada Business Corporations Act" *Commercial Insolvency Reporter* (December 2010) 21.

<sup>3</sup> *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

<sup>4</sup> Industry Canada, "Policy of the Director Concerning Arrangements under Section 192 of the *Canada Business Corporations Act*" (January 4, 2010). This policy sets out the position of the Director appointed under the *Canada Business Corporations Act* (the "Act") as to the permissible use of and appropriate procedural safeguards and substantive requirements applicable to arrangements under section 192 of the Act.

<sup>5</sup> See, for e.g.: *In the Matter of a Proposed Arrangement Involving Ainsworth Lumber Co. Ltd., Ainsworth GP Ltd. and Ainsworth Engineered Canada Limited Partnership*, June 20, 2008, No. S-084425 (BCSC); *In the Matter of a Proposed Plan of Arrangement of Tembec Arrangement Inc., Tembec Industries Inc. and Tembec Enterprises Inc.*, January 24, 2008, No. 08-CL-7367 (ONSC); *Masonite International Inc. (Re)*, [2009] O.J. No. 3264 (SC); *Trizec Corp. (Re)*, [1994] A.J. No. 577 (QB) [Trizec]; *Amoco Acquisition Co. v. Dome Petroleum Co.*, [1988] A.J. No. 330 (CA).

<sup>6</sup> *St. Lawrence & Hudson Railway Co.*, [1998] O.J. No. 3934 (SCJ) [St. Lawrence].

<sup>7</sup> See, for e.g. *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69 at para. 137 *Stelco Inc. (Re)*, [2007] O.J. No. 4234 (SCJ) at para. 2; *Trizec*, *supra* note 5 at para. 13; *St. Lawrence*, *ibid* at paras. 12-14.

<sup>8</sup> *Business Corporations Act*, R.S.A. 2000, c. B-9.

<sup>9</sup> Kelly Bourassa and Matthew Simpson, "Stay Under the Business Corporations Act (Alberta)" (2011) *National Insolvency Review* at 8. Please note, however, that many arrangements have used a combination of the *CCAA* and *ABCA* provisions in order to create two combined reorganization plans.



# Including Partnerships in CCAA Proceedings

by Simina Ionescu-Mocanu

## Introduction

Prior to *Forest & Marine Financial Corp., Re.*<sup>1</sup> [*Forest & Marine*], restructurings pursuant to the *Companies' Creditors Arrangement Act*<sup>2</sup> (as amended, the "CCAA") were typically limited to debtor "companies"—that is, "corporations" or other "legal persons" incorporated under a provincial or federal statute and, as of September 2009, income trusts. As a result, the general consensus was that the CCAA did not apply to partnerships because they were not "companies" under the statute. In *Forest & Marine*, the British Columbia Court of Appeal ("the Court of Appeal") applied the CCAA stay of proceedings to a partnership even though the partnership itself was not named in the CCAA initial order.

The decision also deals with the appropriateness of the CCAA process in liquidation-based restructurings. In *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*<sup>3</sup> [*Cliffs Over Maple Bay*], the same court had suggested that using the CCAA to effect a sale, wind up or liquidation of a debtor's business violated the CCAA's fundamental purpose of enabling a business to survive as a going concern. *Forest & Marine* broadened the application of the statute once again to cases where the debtor had yet

to develop a clear restructuring plan. The case appears to reaffirm the flexibility of the CCAA process and the fact that a court's decision to approve a stay or plan ultimately depends on the degree to which the restructuring benefits the debtor's largest group of stakeholders.

## Facts

Forest & Marine Financial Limited Partnership ("the Partnership") was part of a group of related investors and corporations ("the Group"), which were in the business of providing financial and investment services. The Partnership was the Group's main operating entity and owned its operating assets. Its main liabilities consisted of debt owing to Asset Engineering LP ("AE")—a secured creditor that held a general security agreement over the Partnership's loans and accounts receivable and a second mortgage on one of its buildings. The other members of the Group guaranteed the Partnership's indebtedness and granted collateral security in support of their guarantees. The Partnership defaulted. AE demanded full payment of the Partnership's indebtedness and applied for the appointment of an interim receiver over the Group. In turn, the Group sought CCAA protection.

The British Columbia Supreme Court ("the Supreme Court") granted an initial order in favour of the Partnership and dismissed AE's receivership application. Less than 40 days later, the Supreme Court extended the stay of proceedings to July 31, 2009 and granted CCAA protection to the entire Group pursuant to the Supreme Court's inherent jurisdiction. AE appealed to the Court of Appeal.

## Including the Partnership in the Stay

The first issue on appeal was whether the Partnership could use the CCAA to obtain creditor protection, as the statute, on its face, applied to debtor "companies" only.<sup>4</sup> The Court of Appeal upheld the lower court decision and held that although the CCAA did not technically apply to limited partnerships, the Partnership or the limited partners did not have to be included in the CCAA order to effect a stay of proceedings in relation to these parties.<sup>5</sup>

In doing so, the Court of Appeal noted that a partnership is not a legal entity *per se*, but rather "the relationship which subsists between



persons carrying on business”.<sup>6</sup> Because a limited partnership is not a recognized legal entity, in most structures, the general partner controls the limited partnership’s property and its business relationship with its creditors (not the limited partnership itself).<sup>7</sup> This meant that the Court of Appeal could prevent proceedings against the business and assets of the Partnership and its limited partners by simply ordering a stay in relation to the Partnership’s general partner—an entity that fit the definition of a “company” under the CCAA.

However, there was one more procedural difficulty that the Partnership had to face. Similar to the rules in Alberta, the provincial rules of civil procedure in British Columbia allowed a partnership to be sued in its own name. In the Court of Appeal’s view, this allowed the possibility of multiple proceedings, which would create an “obvious and apparent conflict” with the CCAA order. To forestall this procedural problem and obtain control over its own process, the Court of Appeal used its inherent discretion to grant the stay to the entire Group, including the Partnership.<sup>8</sup>

## Should the Court Have Granted a Stay in the First Place?

The second issue in this case was whether the stay was appropriate in light of the Court of Appeal’s prior comments in *Cliffs Over Maple Bay*. In that case, the debtor company (a real estate developer) applied for CCAA protection but had no intention to propose a plan of arrangement or continue its business after its proposal was complete. A stay was refused because the Court of Appeal did not believe that the restructuring could result in anything other than the distribution of proceeds from the debtor’s liquidation to its secured creditors in what appeared to be a simple order of priorities.

The Court of Appeal found *Forest & Marine* to be quite different from *Cliffs Over Maple Bay*.<sup>9</sup> Here, the Partnership was at the centre of a complicated corporate group and carried on an active financing business that it hoped to save notwithstanding the current economic downturn. CCAA protection was appropriate even though the Partnership did not know whether the restructuring would ultimately result in refinancing or involve a reorganization and compromise. Its process qualified as a valid CCAA plan because it contemplated the possibility of a creditor compromise. If the Group were put into liquidation, many of the Partnership’s customers in the coastal marine and forest industries would be negatively affected. AE’s position, on the other hand, was well secured and the Partnership projected making further payments to reduce its total indebtedness. Granting a stay in this case would further the CCAA’s fundamental purpose—preserving the parties’ status quo, thus enabling the debtor to prepare a plan and remain in business for the benefit of all stakeholders.<sup>10</sup>

## Conclusions & Food for Thought

*Forest & Marine* illustrates a more practical approach to the CCAA process, broadening its ambit to include new participants. The decision also implies that courts will stay proceedings under the CCAA even if its participants have yet to determine whether the restructuring will ultimately involve refinancing or reorganization. *Forest & Marine* confirms that the main concern in these cases continues to be the degree to which the restructuring benefits the largest group of stakeholders.

Some have also noted that the question of whether a debtor may sell its assets during CCAA proceedings without a formal restructuring plan may have been answered by recent legislative amendments.<sup>11</sup> Newly enacted section 36(1) of the CCAA states that a debtor cannot sell its assets

outside of the ordinary course of business without court approval. This provision lists certain factors that courts must consider when deciding whether to approve these sales. The debtor’s completion of a plan is not a listed factor. However, more recent decisions considering section 36(1) have held that courts may approve sales even if not all the criteria are present and for reasons other than those listed in the provision. Conversely, courts may refuse to approve sales for reasons not mentioned in section 36(1).<sup>12</sup>

Regardless of whether liquidating under the CCAA is appropriate, creditors must keep in mind that discretion and flexibility are founding principles in these types of restructurings. In some cases, stakeholders may benefit more from the leverage granted to them in a sale approval application than during the plan voting process, particularly if they hold a smaller claim and cannot effect a veto.

At the same time, in instances where the debtor does not intend to introduce a plan of arrangement or where it is highly unlikely that creditors would vote in favour of any plan, debtors ought to expect increased scrutiny from the courts in light of decisions such as *Cliffs Over Maple Bay*.<sup>13</sup> In some cases, debtors ought to consider if it is more efficient to cooperate with creditors via a receivership and sale rather than resorting to the CCAA to effect a liquidation.

### Footnotes

- <sup>1</sup> *Forest & Marine Financial Corp., Re* (2009), 54 C.B.R. (5th) 201 (B.C. C.A.) [*Forest & Marine*].
- <sup>2</sup> *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36.
- <sup>3</sup> *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.* (2008), 296 D.L.R. (4th) 577 (B.C. C.A.).
- <sup>4</sup> *Forest & Marine*, *supra* note 1 at para. 9.
- <sup>5</sup> *Forest & Marine*, *ibid.* at para. 20.
- <sup>6</sup> *Forest & Marine*, *ibid.* at para. 15, citing section 2 of the British Columbia Partnership Act, R.S.B.C. 1996, c. 348.
- <sup>7</sup> *Forest & Marine*, *ibid.* at para. 18, citing *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]); and *Kucor Construction & Developments & Associates v. Canada Life Assurance Co.* (1998), 41 O.R. (3d) 577 (C.A.).
- <sup>8</sup> *Ibid.* at para. 21. The Court noted that it was not granting a “freestanding remedy” under the CCAA or exercising its discretion to supplement perceived shortcomings in its application. Rather the Court used a “... purely procedural step to forestall a purely procedural problem.”
- <sup>9</sup> *Forest & Marine*, *ibid.* at para. 26.
- <sup>10</sup> *Ibid.*
- <sup>11</sup> Rogers, L. “Latest Developments in CCAA Sales”, *The Six Minute Debtor-Creditor and Insolvency Lawyer 2009*, The Law Society of Upper Canada (October, 2009).
- <sup>12</sup> *Re White Birch Paper Holding Co.*, 2010 QCCS 4915; leave to appeal refused 2010 QCCA 1950, citing *Re Canwest Publishing Inc./Publications Canwest Inc.* (2010), 68 C.B.R. (5th) 233 (Ont. S.C.J. [Commercial List]); and *Re Nortel Networks Corp.* (2009), 56 C.B.R. (5th) 224 (Ont. S.C.J. [Commercial List]).
- <sup>13</sup> For a similar finding, see Madam Justice Kent’s recent decision in *Octagon Properties Group Ltd., Re* 2009 ABQB 500, heard just two months after *Forest & Marine*.

# Women Build 2011

BD&P is pleased to be presenting sponsor of a new initiative of Habitat for Humanity Calgary — that of Women Build 2011. The Women Build program is an international movement that helps bring women together for a common purpose: to change the lives of families in their communities. Women of all ages and backgrounds are encouraged to volunteer in a non-traditional capacity — that of construction! It allows participants to learn new skills while contributing at the same time to the provision of safe, comfortable homes in which families can grow and prosper.

The Women Build Program was focused during the week of May 2nd to 7th with the building of a 5-plex in Cochrane which will ultimately house 5 families. BD&P hosted a unique kick-off party on April 19, 2011 complete with a station for bedazzling hammers and a feature drink, “the Drill Bit-ini” designed to launch the All Women Build Program in Calgary. A group of BD&P female lawyers and clients will be onsite in Cochrane to take part in the all women build on Saturday, May 7. It promises to be an exciting day! A number of our female lawyers and staff were involved in an all women build in November 2010 and couldn’t say enough about the positive experience they had working side by side with their colleagues in furtherance of the dream of a young family previously residing in less than ideal circumstances.

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