Court File No: 09-CL-7950

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 NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION, NORTEL NETWORKS TECHNOLOGY CORPORATION, NORTEL COMMUNICATIONS INC., ARCHITEL SYSTEMS CORPORATION AND NORTHERN TELECOM CANADA LIMITED

BOOK OF AUTHORITIES OF THE MONITOR AND CANADIAN DEBTORS

(Motion for Plan Sanction and Canadian Escrow Release Order)

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2015 ONSC 2987
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2015 CarswellOnt 7072, 2015 ONSC 2987, 254 A.C.W.S. (3d) 522, 27 C.B.R. (6th) 175

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

Newbould J.

Heard: May 12-15, 20-22, 27-30, 2014; June 2, 5, 6, 16-20, 23-24, 2014; September 22-24, 2014
Judgment: May 12, 2015
Docket: 09-CL-7950

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Subject: Contracts; Estates and Trusts; Evidence; Insolvency; Intellectual Property; International; Property

TRIAL to determine allocation of proceeds of sale of assets of insolvent corporation in proceedings under *Companies' Creditors Arrangement Act*.

***Newbould J.*:**

Prologue

1 Until January 14, 2009, Nortel Networks Corporation ("NNC") was a publicly-traded Canadian company and the direct or indirect parent of more than 130 subsidiaries located in more than 100 countries, collectively known as the "Nortel Group" or "Nortel". It operated a global networking solutions and telecommunications business.

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2 On January 14, 2009 most of the Nortel entities filed for bankruptcy protection. In Canada, the Canadian incorporated entities (the "Canadian Debtors") filed under the *Companies' Creditors Arrangement Act* ("CCAA"). In the United States, most of the U.S. incorporated entities (the "U.S. Debtors") filed under chapter 11 of the *U.S. Bankruptcy Code*. In England, most of the entities incorporated in Europe, the Middle East and Africa (the "EMEA [1] Debtors") were granted administration orders under the *UK Insolvency Act, 1986.*

3 The initial intent of Nortel was to downsize and carry on those portions of its telecommunications business that it thought could be profitable. However that plan quickly evaporated and in June, 2009 Nortel decided to liquidate its assets. It sold its business lines for approximately $3.285 [2] billion of which approximately $2.85 billion is now available to be allocated. It then sold its residual intellectual property for $4.5 billion. These amounts totalling $7.3 billion are held in escrow (the "lockbox funds"). At issue in these proceedings is how to allocate the $7.3 billion among the Canadian Debtors, the U.S. Debtors and the EMEA Debtors.

4 The trial in this case was unique. It was a joint trial of the Ontario Superior Court of Justice (Commercial List) and the U.S. Bankruptcy Court for the District of Delaware [3] . It arose from the arrangements made by the parties as part of the process of selling assets, and from a Cross-border Insolvency Protocol (the "Protocol"). In short:

> (i) The parties agreed in an Interim Funding and Settlement Agreement before any of the Nortel assets were sold to put the proceeds of sale into escrow and then attempt to agree on a protocol for resolving how the proceeds were to be allocated. If no agreement was reached, the issues were to be tried by the Ontario and U.S. Courts pursuant to the Protocol.
>
> (ii) The parties could not agree on the allocation, nor could they agree on a protocol process. By orders of the Ontario and U.S. Courts, the allocation was directed to be determined in a joint trial pursuant to the Protocol. The EMEA Debtors were held to have attorned to the jurisdiction of these courts in the escrow agreements made with respect to the proceeds of the several sales that had occurred. [4]

5 The Protocol was approved early in the CCAA and chapter 15 proceedings by orders the Ontario and U.S. Courts. [5] This type of protocol has become standard in the last number of years to govern the administration of cross-border insolvency proceedings. The Protocol included it its purposes:

> 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

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(f) implement a framework of general principles to address basic administrative issues arising out of the cross-border nature of the Insolvency Proceedings.

6 The Protocol contained a number of provisions regarding the independence of the Canadian and U.S. Courts and the exclusive jurisdiction of each Court in the determination of matters arising in the Canadian and U.S. proceedings respectively. Included in the Protocol were the following provisions:

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...

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.

7 The Protocol provided in paragraph 12 for the harmonization and co-ordination of the administration of the two proceedings in Canada, including the holding of joint hearings of the two Courts and providing for discussions between the two judges. Included were the following:

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.

. . .

(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:

(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.

8 A joint hearing was held for this allocation dispute. The court rooms in Toronto and Wilmington were set up electronically so that lawyers and witnesses could and did appear in either courtroom and communicate with a lawyer, witness or the judge in the other courtroom through state of the art telecommunications services.

9 After the evidence was heard, written closing and reply briefs were filed by the parties and oral argument was made. It was agreed that at the conclusion of the case that each Court would release its decision at the same time. This judgment is being released at the same time as the opinion of Judge Gross in Wilmington.

10 Judge Gross in Wilmington and I have communicated with each other in accordance with the Protocol with a view to determining whether consistent rulings can be made by both Courts. We have come to the conclusion that a consistent ruling can and should be made by both Courts. We have come to this conclusion in the exercise of our independent

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and exclusive jurisdiction in each of our jurisdictions. These insolvency proceedings have now lasted over six years at unimaginable expense and they should if at all possible come to a final resolution. It is in all of the parties' interests for that to occur. Consistent decisions that we both agree with will facilitate such a resolution.

Nortel history and its matrix structure

11 NNC was the successor to a long line of technology companies headquartered in Canada dating back to the founding of Bell Telephone Company of Canada in 1883. Prior to being named Nortel, it was known as Northern Telecom. NNC's principal, direct operating subsidiary, also a Canadian company, was Nortel Networks Limited ("NNL"), which in turn was the direct or indirect parent of operating companies located around the world. [6]

12 From the mid-1980s, Nortel expanded substantially through the continued development of ground-breaking technology. The Nortel Group moved from developing and manufacturing traditional landline phone technology and equipment into digital, wireless and photonic technologies. At the same time, the Nortel Group expanded into Europe, Asia, Africa, the Middle East and Latin America.

13 At the time of its insolvency, Nortel had four main product groups (also known as Lines of Business):

• The "Carrier Networks" segment provided wireless networking solutions that enabled service providers and cable operators to supply mobile voice, data and multimedia communications to individuals and enterprises using mobile phone and other wireless devices. The Carrier Networks business also offered products providing local, toll, long distance and international gateway capabilities to telephone service providers as well as providing support to customers transitioning from one network to another.

• The "Enterprise Solutions" segment provided enterprise communications solutions addressing the headquarters, branch and home office needs of large and small businesses. The Enterprise Solutions segment's offerings included, among other things, Unified Communications, Ethernet routing and multiservice switching, IP and digital telephony (including phones), wireless LANs, security, IP and SIP contact centers, self-service solutions, messaging, conferencing and SIP-based multimedia solutions.

• The Metro Ethernet Networks ("MEN") segment provided carrier-grade Ethernet transport capabilities focused on meeting customers' needs for higher performance and lower cost emerging video-intensive applications. MEN included optical networking, carrier Ethernet switching products and multi-service switching products.

• The "Global Services" segment provided a broad range of services and solutions including network implementation services, network support services, network managed services (which related to the monitoring and management of customer networks and hosted solutions) and network application services.

14 The Nortel Group consists of more than 140 separate corporate entities located in 60 separate sovereign jurisdictions including Canada, the United States and the EMEA region, as well as the Caribbean and Latin America and Asia. NNC, the Nortel Group's ultimate parent holding company, was publicly listed and traded on both the Toronto Stock Exchange and the New York Stock Exchange.

15 One of NNC's direct subsidiaries is NNL, which was the Canadian operating company of the Nortel Group. NNL in turn owns 100% of the equity of each of NNI, which was the Nortel Group's operating company in the United States, NNUK, which was the Nortel Group's operating company in the United Kingdom, NN Ireland, which was the Nortel Group's operating company in Ireland, and 91.17% of the equity of NNSA, which was the Nortel Group's operating company in France.

16 The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to

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share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.

17 As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada, NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.

18 R&D was the primary driver of Nortel's value and profit. Together with NNL, the principal companies that performed R&D were NNI, NNUK, NNSA and NN Ireland. These were known as Integrated Entities or, in transfer pricing terms, Residual Profit Entities ("RPEs") due to their participation from 2001 in a residual profit pool in connection with Nortel's transfer pricing arrangements [7] . Other operating companies performed sales and distribution functions and were known as Limited Risk Distributors or Entities ("LREs").

19 R&D was performed at labs around the world. The advanced technology primary research which was intended to develop novel, cutting edge intellectual property technologies was performed mostly in NNL laboratories in Ottawa, which also did R&D for various lines of business. From 2000 to 2009 NNL accounted on average for just under half of all R&D expenditures, more in the latter years than the earlier years. NNI accounted for 38 to 42% and EMEA accounted for 16 to 20% in the earlier years and 11.7 % from 2005 to 2009. The R&D was shared throughout the Nortel Group as needed by the lines of business and customer needs in the various regions and countries.

20 Because R&D was the primary driver of Nortel's value and profit, the residual profits of Nortel, after payment of fixed rates of return to all Nortel companies for sales and distribution functions, were paid to the RPEs under a Master Research and Development Agreement ("MRDA") in accordance with a residual profit split method ("RPSM") based on each RPE's expenditure on R&D relative to the R&D expenditure of all RPEs.

21 Under the MRDA, NNL was the legal owner of the Nortel intellectual property and each RPE other than NNL was granted an exclusive license by NNL to make and sell Nortel products in its territory using or embodying Nortel intellectual property developed by Nortel companies anywhere in the world and a non-exclusive license to do so in territories that were not exclusive to an RPE. What the ownership rights of NNL were and what the license rights were that were granted in the MRDA are highly contested. Also contested is the role that the MRDA should play in this allocation proceeding.

Bankruptcy filings

22 Beginning around 2001, the burst of the dot-com bubble had a severe effect on the global economy and on the telecommunications industry in particular, including Nortel. Market forces led to a decline in Nortel's revenues and market share, and a decline in customer demand for Nortel's products. Subsequently, Nortel was faced with accounting issues which impacted Nortel's credit rating and its cost of financing and required Nortel to restate its financial statements for the fiscal years 2000 to 2005. The rating downgrades affected Nortel's access to capital markets and cost of financing for some years. The fortunes of Nortel improved for a few years but for various reasons, including the financial meltdown in the fall of 2008, Nortel saw its business decline in the two profitable lines of business that it was operating.

23 In light of the impact of the deteriorating market conditions and weakening customer commitments on Nortel's financial outlook, Nortel made the decision to commence formal bankruptcy and insolvency proceedings in Canada, the U.S. and England (respecting various EMEA entities) on January 14, 2009.

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24 On January 14, 2009 NNC, NNL, the wholly owned subsidiary of NNC which was its operating subsidiary and a number of other Canadian corporations filed for protection under the CCAA. On the same date, Nortel Network Inc. ("NNI"), the principal US subsidiary of NNL, and a number of other US corporations filed for protection under chapter 11 of the US Bankruptcy Code and Nortel Networks UK Limited ("NNUK"), the principal UK subsidiary of NNL, and certain of their subsidiaries (the "EMEA Debtors") save the French subsidiary Nortel Networks S.A. ("NNSA") were granted administration orders under the *UK Insolvency Act, 1986.* On the following day, a liquidator of NNSA was appointed in France pursuant to Article 27 of the European Union's Council Regulation (EC) No 1346/2000 on Insolvency Proceedings in the Republic of France.

25 Subsequent to the filing date, certain other Nortel subsidiaries have filed for creditor protection or bankruptcy proceedings in the local jurisdiction in which they are located. Certain solvent indirect subsidiaries of NNUK are not in administration, but are represented in these proceedings by the Joint Administrators with respect to the allocation issues.

Decision to liquidate

26 The initial intent on filing was to attempt to restructure the business and downsize it by focusing on Nortel's legacy CDMA (Code Division Multiple Access) wireless business and a potential business based on LTE (Long-Term Evolution) wireless technology with all other Nortel business lines being sold. However, Nortel's major customers did not support this plan and advised they were not prepared to provide new contracts to Nortel for this purpose. As well, it became clear that it would not be possible for Nortel to obtain the funding that would have been required to restructure around a CDMA business.

27 In June 2009, management and the Debtor Estates collectively determined that the best means to maximize value for its creditors was to sell Nortel's lines of business and other assets and to commence a liquidating insolvency. No party in these proceedings has suggested that it was a viable option to restructure along geographic lines or for a country-specific entity to independently continue in Nortel's business.

Interim Funding and Settlement Agreement ("IFSA")

28 From the petition date of January 14, 2009, NNL incurred significant expenses to preserve the value of the business, including R&D expenses, and it was experiencing negative cash flow. It had not received any transfer pricing payments from its subsidiaries under the MRDA as a result of the insolvency proceedings.

29 It was evident that there would be significant issues among the parties as to whom the proceeds of the sale of Nortel's assets should be paid. The parties appreciated that if determining the allocation of proceeds from Nortel's assets were a precondition to their sale, sales would be substantially delayed, and the value of the assets would depreciate, resulting in less money for all creditors. Avoiding a dispute during the sale processes about how to allocate the proceeds allowed the parties to obtain the highest monetary value for the assets being sold.

30 On June 9, 2009, the US Debtors (excluding NN CALA, which had not yet filed for bankruptcy), the Canadian Debtors and the EMEA Debtors (excluding NNSA, which later acceded to the agreement) entered into the Interim Funding and Settlement Agreement ("IFSA") to address both interim funding of NNL as well as principles under which collaborative sales of Nortel's businesses and assets could take place.

31 The IFSA provided for a payment by NNI to NNL of $157 million in full settlement of any transfer pricing and other claims NNL might have had against NNI for the period from the petition date through September 30, 2009. The parties also agreed:

(a) to cooperate in the anticipated sales of the Nortel Group's assets;

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(b) that their execution of sale documentation or the closing of a sale transaction would not be conditioned upon reaching agreement either on allocation of the sale proceeds or on a binding procedure for determining the allocation question;

(c) that the sale proceeds would be deposited into escrow, and that there would be no distribution out of escrow without either the agreement of all of the selling debtors or the determination of any dispute relating thereto by the relevant dispute resolver;

(d) that in order to facilitate the lines of business sales, the U.S. and EMEA Debtors would enter into appropriate license termination agreements which would provide for the termination of the license rights granted by NNL under the MRDA; termination or relinquishment of a license would be deemed a sale with the licensed participants each being deemed a seller; and

(e) that the agreement would not have any impact on the allocation of proceeds to any Debtor from any asset sale and would not prejudice a party's rights to seek its entitlement to the proceeds from any sale.

32 The US and Canadian Courts entered orders approving the IFSA following a joint hearing on June 29, 2009.

33 On December 23, 2009 the Canadian and U.S. Debtors signed a Final Canadian Funding and Settlement Agreement (the "FCFSA") under which NNI agreed to pay NNL $190.8 million in full and final settlement of all claims that NNL might have against NNI. Further, NNL granted NNI an allowed $2 billion unsecured claim in NNL's CCAA proceedings ranking pari passu with other pre-petition unsecured claims against NNL, with such claim not being subject to offset or reduction. This claim had resulted from the tax authorities reviewing requests by the parties for approval of their transfer pricing arrangements. In 2009 NNL and NNI were advised that an agreement between the CRA and IRS sought a reallocation of income from NNL to NNI in the amount of U.S. $2 billion for the tax years ending 2001 to 2005. The tax authorities did not specify on what basis the $2 billion figure was calculated. The FCFSA, including the $2 billion admitted claim of NNI against NNL, was approved by the Canadian Court on January 21, 2010 and by the U.S. Court on the following day.

Asset sales

34 With the IFSA framework in place, the Debtor Estates embarked on a process that resulted in a series of sales of the various business lines, which occurred from mid-2009 through late 2010, with the last transaction closing in March 2011. The total proceeds were approximately $3.285 billion. There remains approximately $2.85 billion of that amount now available to be allocated.

35 In order to sell the lines of businesses separately, Nortel engaged in a "carve-out process" to identify the bundle of assets, rights and obligations that would have to be conveyed in each sale to enable the lines of business to function on a stand-alone basis.

36 An important aspect of the carve-out process was the identification of which IP rights, principally patent rights, needed to be conveyed. Each prospective purchaser of a business line wished to obtain as many patents as possible as part of each sale transaction and, conversely, the Nortel sellers wanted to ensure that the only patents transferred were those incorporated exclusively or principally in the business line in question so as to retain value within Nortel and not to jeopardize the ability to sell the other business lines that might require rights to the same patents.

37 Ultimately, those patents that were "predominantly used" in any given line of business were transferred to the purchaser of that line of business as part of the transaction. In the end, 2,700 patents were transferred as part of the business line sales.

38 For all other patents that were used in each line of business but not predominantly used, a non-exclusive license was granted to the purchaser for use of those patents in the operations of the particular business line being purchased.

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39 By the time that all of the business sales were completed in March 2011, Nortel had no remaining operating businesses. What it did retain was a residual patent portfolio consisting of approximately 7000 patents and patent applications. These were principally patents and patent applications that were not used in any of the lines of business and therefore were not subject to licenses to the business sale purchasers. In addition, the residual IP portfolio included patents used by multiple lines of businesses and licensed to the purchasers of those lines of businesses.

40 On April 4, 2011, after significant negotiations with two prospective purchasers, certain Nortel entities (including NNC, NNL, NNI and NNUK) entered into a stalking horse asset sale agreement with a wholly owned subsidiary of Google Inc. with a purchase price of $900 million.

41 An auction was held at the end of June 2011, and the residual patent portfolio was ultimately sold to Rockstar Bidco, LP, a single purpose entity backed by a consortium of major technology companies (Apple, Microsoft, Ericsson, Blackberry, Sony and EMC), for $4.5 billion.

Position of the parties

42 In this case the Monitor is acting under what is now referred to as a "super monitor" order of October 3, 2012 in which the Monitor was authorized to exercise any powers which may be exercised by a board of directors of any of the applicants, which includes NNC and NNL. This order occurred after NNC and NNL were left without any board of directors or management and it was necessary for the Monitor to be appointed to advance the interests of NNL and NNC in this CCAA proceeding. While I will refer to the Monitor, I do so in recognition that the Monitor is advancing the position of the Canadian Debtors in this litigation.

43 The intellectual property of Nortel represented by far the largest portion of the assets sold. The Rockstar sale of the residual IP generated $4.5 billion. The lines of business generated $3.285 billion of which approximately $2.85 billion is now available. Intellectual property was a substantial part of the assets of the business lines that were sold, although the experts differed as to its value.

44 The parties and their experts for the most part relied on their interpretation of the MRDA in support of their allocation positions for the proceeds from intellectual property for both the Rockstar sale and the lines of business sales. Two parties, the UKPC (the UK pension claimants, being the trustee of the UK pension plan, and the board of the UK Pension Protection Fund) and the Canadian Creditors Committee [8] contended that the MRDA should not govern the allocation and that a pro rata allocation based on a *pari passu* distribution to all creditors should be used to allocate the lockbox funds.

45 It is necessary therefore to consider the MRDA and whether it should govern the allocation.

The MRDA

46 The parties look to the rights of the various Nortel entities to intellectual property under the MRDA as a central issue in this proceeding. What these rights are is contested. Many of its terms have been excruciatingly parsed. I will first deal with the meaning of the MRDA as an operating agreement. I will then deal with the issue as to whether it applies, or was intended to apply, to the allocation of the Nortel assets after the world-wide insolvency of Nortel.

47 The MRDA and its predecessor Cost Sharing Agreements [9] ("CSA") were developed for and driven by transfer pricing concepts. Transfer pricing is the act of assigning a monetary value, or price, to movements of resources or economic contributions that occur within a multinational enterprise across different taxing jurisdictions. Against the risk that companies attempt to use transfer pricing to increase operating income (and therefore taxable income) in jurisdictions with low income tax rates and correspondingly to decrease operating income in high-tax jurisdictions, tax authorities around the world have instituted regulations governing intercompany transfer pricing. These regulations centre on the arm's length principle. The arm's length principle necessitates that intercompany transactions be priced in

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a manner consistent with the way in which similarly situated uncontrolled parties bargaining at arm's length would price the transactions i.e., within an arm's length range.

48 Dr. Eden, a transfer pricing expert who testified on behalf of the U.S. Debtors, well described in her report the way in which transfer pricing agreements are made in light of the fact that governments have developed a dense regulatory framework for transfer pricing due to worries about the potentially negative impacts that transfer pricing can have on government tax and customs duty revenues. The setting of transfer pricing policies for corporate income tax purposes of a multinational enterprise (MNE) is a highly regulated, data-driven and fact-intensive activity dominated by professionals. The establishment of an MNE's transfer pricing policy typically involves not only MNE group in-house staff, but also accountants, economists, lawyers, tax experts and other consultants. Moreover, an MNE's transfer pricing policy may involve the input of revenue authorities through an advance pricing agreement (APA) procedure.

49 All of this applied to Nortel and much evidence was given by tax people as to the process by which the MRDA was made and changed. Evidence was also given by some of them as to their view of the meaning of the agreement, the admissibility of which is contested.

(i) Governing law of the construction of the contract

50 The MRDA is by its terms to be construed in accordance with and governed by the law of Ontario. The same applied to the predecessor CSAs.

51 A number of authorities have been cited. A brief consideration of them is required in light of the various arguments made about the MRDA, particularly as it involves the principles of interpreting commercial contracts, what can be looked at when considering the factual matrix of the agreement and the use of recitals in an agreement in the interpretive process.

52 Winkler C.J.O. articulated the test for construing a commercial contract in *Salah v. Timothy's Coffees of the World Inc.* (2010), 74 B.L.R. (4th) 161 (Ont. C.A.) as follows:

> **16** The basic principles of commercial contractual interpretation may be summarized as follows. When interpreting a contract, the court aims to determine the intentions of the parties in accordance with the language used in the written document and presumes that the parties have intended what they have said. The court construes the contract as a whole, in a manner that gives meaning to all of its terms, and avoids an interpretation that would render one or more of its terms ineffective. In interpreting the contract, the court must have regard to the objective evidence of the "factual matrix" or context underlying the negotiation of the contract, but not the subjective evidence of the intention of the parties. The court should interpret the contract so as to accord with sound commercial principles and good business sense, and avoid commercial absurdity. If the court finds that the contract is ambiguous, it may then resort to extrinsic evidence to clear up the ambiguity.

53 In *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* (1998), 41 B.L.R. (2d) 42 (Ont. C.A.) Goudge J.A. stated the following regarding the interpretation of a commercial agreement at para. 27

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity. [*City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.)]. Rather, the document should be construed in accordance with sound commercial principles and good business sense; [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.)]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

54 I take the principles in *Kentucky Fried Chicken Canada* and in *Salah*, the latter adopted by Cronk J.A. in *Downey v. Ecore International Inc.*, 2012 ONCA 480 (Ont. C.A.) and by Juriansz J.A. in *Ariston Realty Corp. v. Elcarim Inc.*,

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2014 ONCA 737 (Ont. C.A.), as the applicable principles governing this case. See also *Unique Broadband Systems Inc., Re*, 2014 ONCA 538 (Ont. C.A.) at para. 88. [10]

55 The factual matrix of the contract is to be considered. What may be considered was expressed in *Kentucky Fried Chicken* as follows:

> **25** ...While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In the famous passage in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-96 (H.L.) Lord Wilberforce said this:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> **26** The scope of the surrounding circumstances to be considered will vary from case to case but generally will encompass those factors which assist the court "... to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract." *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901.

56 More recently, Rothstein J. in *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 (S.C.C.) referred to the use of surrounding circumstances and cautioned as to the extent they can be considered:

> **57** While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement (*Hayes Forest Services*, at para. 14; and Hall, at p. 30). The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract (Hall, at pp. 15 and 30-32). While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement (*Glaswegian Enterprises Inc. v. B.C. Tel Mobility Cellular Inc*. (1997), 101 B.C.A.C. 62).
>
> **58** The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to case. It does, however, have its limits. It should consist only of objective evidence of the background facts at the time of the execution of the contract (*King*, at paras. 66 and 70), that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting. Subject to these requirements and the parol evidence rule discussed below, this includes, in the words of Lord Hoffmann, "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man" (*Investors Compensation Scheme*, at p. 114). Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

57 It is clear that the factual matrix that can be considered may not include evidence of the subjective intent of a party or what a party believed a contract to mean. See *Sattva*, *supra*, at para. 59. It may also not include evidence of negotiations or create an ambiguity where none exists in an agreement. See also *Primo Poloniato Grandchildren's Trust (Trustee of) v. Browne* (2012), 115 O.R. (3d) 287 (Ont. C.A.) in which Feldman J.A. stated:

> **71** While the scope of the factual matrix is broad, it excludes evidence of negotiations, except perhaps in the most general terms, and evidence of a contracting party's subjective intentions: Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2d ed. (Markham: LexisNexis, 2012), at p. 27. As the cases above suggest, the factual matrix

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includes only objective facts known to the parties at or before the date of the agreement, and what is common to both parties: Hall, p. 30. Hall goes on to state that while the factual matrix can "be used to clarify the parties' intentions as expressed in a written agreement, it cannot be used to contradict that intention, create an ambiguity which otherwise does not exist in the written document, or have the effect of making a new agreement": p. 31 (footnotes omitted). Ultimately, the words of the agreement are paramount.

58 The recitals in the MRDA are the subject of debate in this case. A clear statement of how recitals may be used in the interpretation of an agreement can be found in *Elliott Estate, Re*, [1962] O.J. No. 164 (Ont. C.A.); aff'd [1963] S.C.R. 305 (S.C.C.). In that case, Kelly J.A. stated that a recital could be used only if there is an ambiguity in the operative parts of the agreement and the recital is clear. He stated:

11 I turn therefore to consider to what extent the recital may be used to overcome the patent deficiencies of clauses 6 and 7 and in fact of the whole operative parts of the agreement. In the first instance it must be borne in mind that a recital is not a necessary part of a document and its use in the interpretation of the document as a whole is strictly limited.

> The reciting Part of a Deed is not at all a necessary Part either in Law or Equity. It may be made use of to explain a Doubt of the Intention and Meaning of the Parties but it hath no Effect or Operation. But when it comes to limit the estate, there the Deed is to have its Effect according to what Limitations are therein set forth.

Per Holt, C.J., *Bath and Mountague's Case* (1693) 3 Cas. in Ch. 55 at 101; 22 E.R. 963 at 991. An oft quoted statement of the extent to which reference may be had to recitals is contained in the judgment of Lord Esher, M.R. in *Ex Parte Dawes. In Re Moon*, (1886) 17 Q.B.D. 275 at p. 286:

> Now there are three rules applicable to the construction of such an instrument. If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. If the recitals are ambiguous, and the operative part is clear, the operative part must prevail. If both the recitals and the operative part are clear, but they are inconsistent with each other, the operative part is to be preferred.

It is to be noted that the qualifying condition for the use of a recital in the interpretation of the operative parts is that there must be ambiguity in the operative parts; in such a case the preferred meaning to be given to the operative words should be that consistent with the intention expressed in the recital, provided that the words of the operative part are by themselves capable of such an interpretation. *MacKenzie v. Duke of Devonshire*, (1896) App. Cas. 400; *Ex Parte Dawes. In Re Moon, Supra*; *In re Sugden's Truts, Sugden v. Walker*, (1917) 2 Ch. 92. It is essential, however, that the construction to be placed upon the operative part in the light of the recital be a construction which the words themselves of the operative part are capable of bearing. Where, however, the operative parts of a document, due to the lack of appropriate words, are incapable of a construction which will fulfil the intention expressed in recitals, the recital may not be used for the purpose of reading into the operative clause a meaning which it is incapable of conveying when considered by itself.

59 It was held in *PUC Distribution Inc. v. Brascan Energy Marketing Inc.*, 2008 ONCA 176 (Ont. C.A.), that an elevation of a recital to a mutual promise or operative provision was an error.

60 *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at para. 57, in which Iacobucci J. in discussing the meaning of an agreement referred to the recitals, was referred to in argument. Iacobucci J. did not discuss the principles to be used in considering recitals. *Sistem Mühendislik Ïnsaat Sanayi Ve Ticaret Anonim Sirketi v. Krygyz Republic*, 2012 ONSC 4983 (Ont. S.C.J. [Commercial List]), has also been referred to in argument, a decision in which I did not refer to the principles to be used in considering recitals in interpreting contracts. I consider the decision in *Sistem* to be consistent with the principles enunciated by Kelly J.A. in *Elliott Estate*. I do not see either *Eli Lilly* or *Sistem* establishing any different criteria for the use of recitals from *Elliott Estate*.

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61 I turn now to the interpretation of the MRDA and the rights accorded in it keeping these interpretive principles in mind.

(ii) Position of the parties

62 The essential differences in allocation positions advanced by the parties flow from the different manner in which each characterizes the terms of the MRDA, the interests held by the parties in Nortel's IP, and the applicability of terms of the MRDA to the value ascribed to various assets.

63 The Monitor, supported by the CCC, contends that under the MRDA, NNL owned the IP and the interests of NNI and the other participants to the MRDA were restricted to certain exclusive and non-exclusive license rights granted to them by NNL pursuant to the terms of the MRDA. The Monitor says that the license rights were not unlimited, as they did not cover all rights in the IP in question, but rather covered only a subset (albeit a substantial subset) of the IP rights, on certain terms, all of which have valuation implications. In particular, the Monitor says that the license rights granted to NNI and the other licensed participants were not all rights to the IP but were subject to "field of use" restrictions that gave the licensees the right to use the IP to make, use or sell "Products" as defined in the MRDA, which meant products, software or services that were made or sold by, or for, any of the licensees. This meant that the Products must have been created or marketed by or for the Nortel Group. No product that was part of a third party's business rather than the business of Nortel could fall within the definition of Products. While the license gave the licensees the right to sublicense, this could not permit the licensees to sublicense what they did not have.

64 The Monitor's position, supported by the CCC, is that what was sold in the Rockstar sale of IP was the ownership of residual patents and patent applications owned by NNL. The purchasers would not have bought the residual IP to make Nortel products, and that as the license rights held by NNI and the other licensees would not have permitted them to sublicense to the Rockstar consortium the right to use the IP for the Rockstar consortium's own purposes, the proceeds of the Rockstar sale belong to NNL.

65 The position of NNI, supported by the other U.S. interests, asserts that each of NNI and the other licensees held all of the rights and all of the value in the IP in their respective exclusive territories as defined in the MRDA. The U.S. Debtors assert that the license rights NNI held were not subject to any field of use or scope restriction or limitation, resulting in an assertion that all of the economic value in the IP in the exclusive territory belonged to the licensee. They contend that the legal title held in the IP under the MRDA was a purely "bare" legal title with no monetary value. They also rely on a right to sue for damages in the U.S. for infringement of NN Technology by others.

66 The position of the EMEA debtors is that each of the parties to the MRDA jointly owned all of the IP in proportion to their financial contributions to research and development, and that all share in the sale proceeds attributable to IP in those same proportions. The joint ownership is said to arise independent of, but recognized in, the MRDA.

(iii) Analysis

(a) The meaning of the exclusive license

67 The agreement is headed MASTER R&D AGREEMENT. It was entered into on December 22, 2004 with an effective date of January 1, 2001 and states that it confirms and formalizes the operating arrangements of the participants as and from that date. It provided that NNL was the legal owner of the NN Technology (the IP), and it contained grants of licenses from NNL to the other participants, referred to as the Licensed Participants. Each Licensed Participant was given an exclusive license for its territory and a non-exclusive license for those parts of the world other than Canada and where the Licensed Participants had their exclusive territory. The exclusive territory for NNI was the U.S. and Puerto Rico, for NNUK was the United Kingdom, for NNSA was France and for Nortel Ireland was the Republic of Ireland.

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68 At its core, so far as the ownership and licensing of the IP is concerned are articles 4(a) and 5(a) and (b). The original language remained in substance but was amended from time to time. These articles as amended are as follows:

Article 4 — Legal Title to NN Technology

(a) Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired, or developed pursuant to the terms of this Agreement, shall be vested in NNL. In consideration therefor, NNL agrees to enter into an Exclusive License and a Non-Exclusive License with each of the Licensed Participants as set forth in Article 5.

Article 5 — Grant of Exclusive Licenses by NNL

(a) To the extent of its legal right to do so, and subject to the rights of relevant third parties, NNL hereby:

(i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License"); and

(ii) grants to each Licensed Participant, as of January 1, 2009 (the "Non-Exclusive License Effective Date"), a non-exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Non-Exclusive Territory, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Non-Exclusive License").

69 To support their differing interpretations of these provisions, the parties augment to some extent their arguments by reference to other provisions in the MRDA. It will be necessary to deal with these. As can be seen from article 5(i), NNL "continues to grant", a reflection of the fact that prior to the MRDA, the parties were governed by Cost Sharing Agreements (CSAs) [11] . Recitals to the MRDA make this clear:

WHEREAS legal title to all NN Technology is held in the name of NNL;

WHEREAS each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under NT Technology for a Specified Territory pursuant to the Amended Research and Development Cost Sharing Agreement entered into on January 1, 1992, and it is the intent of NNL and the Licensed Participants that the Licensed Participants continue, as of the effective date of this Agreement, to hold and enjoy such rights;

70 In considering the various interpretations of the MRDA put forward by the parties, it is helpful to compare those provisions with the earlier CSA provisions. Under the CSA, the parties split the costs of R&D by a certain formula. That agreement did not purport to split profits in any way. However, the tax authorities made it clear that they no longer would permit a cost sharing arrangement at Nortel and instead wanted an arrangement whereby profits would be shared among the participants by a residual profit split method (RPSM) that allocated profits according to the amount each participant spent on R&D. Relevant recitals in the MRDA that were not contained in the previous CSA are:

WHEREAS each Participant bears the full entrepreneurial risks and benefits for the Nortel Networks business;

WHEREAS each Participant has performed, in the past, and intends to continue to perform R&D Activity with respect to the Nortel Products;

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WHEREAS each Participant desires to avoid the duplication of R&D Activity;

WHEREAS each Participant believes that it is appropriate that each Participant should benefit from its contribution to R&D activity commensurate with the value of its contribution to that R&D activity in the context of the manner in which the Nortel Networks business is conducted and that the residual profit split methodology (RPSM) is the best arm's length measure, in the circumstances of NNL and the Participants, of such contributions with reference to such benefits;

WHEREAS this Agreement reflects the Participants' intent and agreement since January 1, 2001 to enter a license arrangement with the Licensed Participants, and the Participants have operated from January 1, 2001 in accordance with the terms set forth herein;

WHEREAS Participants acknowledge that as a result of a collective review by the Canadian Customs and Revenue Agency, the US Internal Revenue Service, and the UK Inland Revenue regarding the application of the RPSM, the calculation of the RPSM as set forth in Amended Schedule A may be amended which amendments would require the consent of the Participants;

71 These recitals and the RPSM method contained in the MRDA were driven by transfer pricing considerations. The language, for example, that each Participant (NNL and the Licensed Participants) bears the full entrepreneurial risks and benefits for the Nortel Networks business was not in the prior CSA and was part of the rationalization adopted to support a RPSM.

72 The MRDA provided in article 2 that each Participant would perform R&D at a level consistent with past practices and share the results of its R&D with the other participants. Article 3 provided payment for the R&D as follows:

Article 3 — R&D Activity Payments

(a) For and as a consequence of the performance of R&D Activity, each Participant shall be entitled to receive a payment in an amount equal to the allocation determined under the RPSM (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.

(b) Each Participant hereby accepts and agrees to make the payment determined under the RPSM in Amended Schedule A [12] Participant's share of the R&D Allocation. as representing such

(c) The R&D Allocation will be computed pursuant Amended Schedule A which sets forth the basis of the RPSM as originally proposed to the Revenue Authorities. The Participants understand that the RPSM is the subject of review, discussions and negotiations with the Revenue Authorities. The Participants agree to amend this Agreement and to adjust the RPSM to the extent necessary to reflect any negotiated determination with the Revenue Authorities as to the final R&D Allocation.

73 The U.S. Debtors and EMEA take the position that the legal title that is vested in NNL under article 4 of the MRDA is bare legal title given to NNL for administrative convenience to enable it to administer all NN Technology and that the licensed participants own the equitable and beneficial interest in the NN Technology. It draws on the recital that provides:

WHEREAS each Licensed Participant held and enjoyed equitable and beneficial ownership of certain exclusive rights under NT Technology [13] for a Specified Territory pursuant to the Amended Research and Development Cost Sharing Agreement entered into on January 1, 1992, and it is the intent of NNL and the Licensed Participants that the Licensed Participants continue, as of the effective date of this Agreement, to hold and enjoy such rights;

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74 I do not see this recital as clearly stating that a Licensed Participant has equitable and beneficial ownership of the NT Technology. It states that a Licensed Participant held equitable and beneficial ownership of "certain exclusive rights under NT Technology" and would continue to have such rights. The recital does not say what the "certain exclusive rights" were and it is just as consistent with those rights being license rights rather than ownership rights in the technology. As well, having equitable and beneficial ownership of certain exclusive rights "*under* NT Technology" would seem to be something different from having equitable and beneficial ownership of certain exclusive rights "of" or "in" the NT Technology.

75 In the CSA referred to in the recital, the language used is as follows:

> **ARTICLE 4 LEGAL TITLE TO NT TECHNOLOGY**
>
> The Parties hereto acknowledge that, except as otherwise specifically agreed, legal title to all NT Technology whether now in existence or developed pursuant to the terms of this Cost Sharing Agreement, except patents owned by Participant [Northern Telecom Inc., now NNI] on January 1, 1980, shall be vested in Northern Telecom [now NNL]. With respect to patentable inventions and copyrightable property encompassed by NT Technology, Northern Telecom shall have the exclusive right but not the obligation to file and prosecute applications in its name for patent or copyright protection in every country of the world. Participant shall execute or cause to be executed such documents reasonably requested by Northern Telecom as may be necessary or desirable to give effect to the foregoing. (Underlining added).

76 The exception in this provision for patents owned by Northern Telecom Inc., now NNI, suggests that the legal title vested in Northern Telecom (now NNL) was ownership rather than bare legal title. Otherwise there would have been no purpose in excluding the patents owned by Northern Telecom Inc. It would not have been necessary.

77 In article 6 of the CSA, dealing with confidential information, it is stated:

> Participant acknowledges that Northern Telecom is the legal owner of the NT Technology developed pursuant to this Cost Sharing Agreement and that the NT Technology is proprietary and constitutes a trade secret. Participant shall hold the NT Technology in confidence and only make use of or disclose it as permitted by this Cost Sharing Agreement.

78 This provision refers to Northern Telecom being the "legal owner". This is consistent with the language of article 4 of the CSA. If, as stated in the recital to the MRDA, it was the intent of NNL and the Licensed Participants that the Licensed Participants would continue under the MRDA to hold and enjoy such rights as they held under the CSA, those rights would not include legal ownership of the NN Technology.

79 NNI also relies on language in Schedule A of the MRDA to assert its beneficial ownership of the NN Technology. It provides in part:

> **Calculation of Arm's Length R&D Allocation to each Participant**
>
> The purpose of this section is to provide a brief summary of Nortel's transfer pricing policy and to provide clarity as to how each Participant is to be compensated under this Agreement.
>
> The current transfer pricing methodology is the residual profit split method ("RPSM") which was adopted by the Participants at the request of the tax authorities as the most appropriate method for determining the arm's length compensation to each of the Participants for the R&D Activity to be provided pursuant to the Master R&D Agreement. The RPSM acknowledges the fact that the key profit driver in the Nortel business is the development and maintenance of rapidly depreciating intellectual property ("IP").

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> Accordingly, the R&D Allocation provided to Participants under the RPSM reflects the fact that the Participants bear the full entrepreneurial risk of the Nortel business such as the risks attendant with the substantial and continuous development and ownership of the NN Technology. Mathematically, the RPSM accords the Participants all the upside risk in the Nortel business as well as the downside risk. (Underlining added).

80 Schedule A is part of the MRDA. I do not, however, read it as granting rights. The rights are granted in the operative provisions of the MRDA. Schedule A states at the outset that its purpose is to give a brief summary of Nortel's transfer pricing policy and to provide clarity as to how each participant is to be compensated. Schedule A provides in some detail how the residual profit is to be calculated and split amongst the Participants. Stating that Participants bear risks such as risks attendant with the development and ownership of the NN Technology does not state that ownership of the technology is being granted. What the Licensed Participants were granted in the MRDA were license rights.

81 Various dictionary definitions were resorted to in arguing what the meaning of "legal title" to the NN Technology was that was vested in NNL under article 4 of the MRDA. In the end, I do not think it necessary to get into that debate. NNL had ownership of NN Technology to the extent that NN Technology was not licensed to the Licensed Participants. Rights in inventions were assigned by the inventors to NNL and NNL applied for the patents and was named as owner of them. It was NNL who granted licenses to the Licensed Participants. NNUK, for example, did not provide a license to NNI for IP developed by NNUK. It was NNL that did so. Although NNL had the exclusive right to the NN Technology in Canada under the MRDA, the MRDA did not grant any license to NNL. That was recognition that it was NNL that owned the NN Technology.

82 A licensee does not enjoy property rights. Its rights are contractual. A licence is merely a permission to do that which would otherwise amount to trespass. See *Kraft Canada Inc. v. Euro Excellence Inc.*, [2007] 3 S.C.R. 20 (S.C.C.) at para. 27. A licensee's rights are not necessarily equivalent to those of the patentee; rather, they are limited to, and qualified by, the express terms of the license. See *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at para. 49. It is the determination of what those license rights were that were granted to the Licensed Participants in the MRDA that is important because it is those license rights that were given up by Licensed Participants to permit the business line sales and the sale of the residual IP to Rockstar.

83 The grant of the exclusive license in the MRDA in article 5(i) is:

> ...NNL hereby:
>
> (i) continues to grant to each Licensed Participant an exclusive, royalty-free license, including the right to sublicense, which except as hereinafter provided shall be in perpetuity, rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith (Exclusive License") (Underlining added);

84 The license is not a license of NN Technology, but rather a license "to make... and sell Products using or embodying NN Technology". Thus the MRDA definition of "Products" is of central importance and the Monitor says that "Products" is defined to mean products, software or services that were made or sold by, or for, NNL and the Licensed Participants. The Monitor contends that products not made for NNL or the Licensed Participants, such as products that would be made by the Rockstar consortium members or their licensees are not covered by the license.

85 The definition of "Products" at Article 1(g) of the MRDA is:

> "Products" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time by, or for, any of the Participants, and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing,

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> and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing. (Underlining added).

86 The U.S. Debtors parse the language of the license grant and contend that the Licensed Participants obtained all of the rights to the NN Technology. They break down the grant of the exclusive license into four clauses as follows:

> NNL hereby:
>
> continues to grant to each Licensed Participant an exclusive, royalty-free license, including
>
> the right to sublicense, which except as hereinafter provided shall be in perpetuity,
>
> rights to make, have made, use, lease, license, offer to sell, and sell Products using or embodying NN Technology in and for the Exclusive Territory designated for that Licensed Participant, and
>
> all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License").

87 The U.S. Debtors stated in their opening brief that the opening grant of an exclusive, royalty-free license in the first clause is not limited by the word "including". They say the word "including" does not create a limitation, that the word "including" follows the words "exclusive, royalty-free license" and thus the words that follow cannot, and do not purport to, limit the broad exclusive licenses granted to the licensed participants under the MRDA. In effect they argue that the opening words before the word "including" created a complete grant of a license without reserve.

88 I cannot accept that argument. The words "continues to grant an exclusive, royalty-free license", on their own, do not say what the license is, or what it is for, or for how long. Given that a licensee's rights are limited to, and qualified by, the express terms of the license (*Eli Lilly & Co.* at para. 49), a license grant of uncertain scope, such as proposed by the U.S. Debtors, would have no meaning. Moreover, the words "in and for the Exclusive Territory designated for that Licensed Participant" appear after "including". On the U.S. Debtors' reading of the license, the territorial limitation would only apply to the license to make Products, and would not apply to a broad exclusive license that they say is already created before one gets to the word "including". It would also mean that the words "in perpetuity" which follow the reference to a sublicense would not apply to the broad exclusive license, which is inconsistent with what the U.S. Debtors say is the case.

89 There would be no commercial purpose in the MRDA granting a broad unrestrictive license and then providing more specific grants in the license that are restricted. For example, the third clause restricts the licensee to selling Products, which contains terms of limitation.

90 The U.S. Debtors also contend that the third clause permits NNI or any other Licensed Participant to make or have made for it Products using NN Technology and that the sublicense rights contained in the second clause are not so limited to Products using NN Technology. I cannot accept that contention. A sublicense could not sublicense more than the licensee had under its license and the second clause could not purport to do so. This argument of the U.S. Debtors relies on its argument that the first clause was a broad unrestrictive grant of a license, which argument I cannot accept.

91 The U.S. Debtors contend that the fourth clause is a free-standing or "catch-all" license grant of all rights to patents etc. unconnected to the license to make, use or sell Products. The language of this provision is:

> all rights to patents, industrial designs (or equivalent) and copyrights, and applications therefor, and technical know-how, as necessary or appropriate in connection therewith ("Exclusive License");

92 The U.S. Debtors say that the concluding words "in connection therewith" refer to the preceding words "technical know-how". The contention of the U.S. Debtors is that this last clause is like the first clause, being a separate grant not limited by the right to make, use or sell Products. The Monitor says that these all of these words in the clause relate to

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the license to make, use or sell Products and that the words "in connection therewith" do not relate only to the reference to technical know-how.

93 I must say that I find it difficult to accept that the concluding words "in connection therewith" modify only the words "technical know-how". There would be no need for a comma after the words technical know-how". Those words, even if only applicable to the last clause, could apply equally to "industrial designs (or equivalent)" and "applications therefor".

94 I do not find persuasive at all the attempt of the U.S. Debtors to parse the language of the grant of license as they have done. On their reading, there are several different grants of license. Yet at the end of the paragraph are the words "Exclusive License" in parenthesis. There is only one license and the words should be read together harmoniously.

95 The U.S. Debtors make the point that what they refer to as the last clause in the license grant would be superfluous on the reading of the Monitor. That is because the definition of Products and NN Technology includes patents and the other things contained in that last clause. The U.S. Debtors say that because in interpreting a contract one should strive to give meaning to all of its terms, the last clause should be read as providing rights different from the rights to make, use or sell Products. While this argument on its face has a certain attractiveness, I do not think it right in this case.

96 The grant of license rights in article 5 is one grant. It does not in the paragraph expressly spell out the definition of Product or NN Technology. The draftsman may have thought it prudent to include the final clause. The words "in connection therewith" must be given some meaning and I do not accept the meaning given to them by the U.S. Debtors. I read the words as relating to the grant of a license to make, use and sell Products employing NN Technology, which in my view was the intent of the entire license granted in clause 5(i).

97 The Monitor refers to a statement of Lord Hoffman, no stranger to contract interpretation and a legal giant of his day, in *Beaufort Developments (NI) Ltd. v. Gilbert-Ash (NI) Ltd.* (1998), [1999] 1 A.C. 266 (Ireland H.L.), at 274 that arguments of redundancy should be treated with caution. He stated:

> I think, my Lords, that the argument from redundancy is seldom an entirely secure one. The fact is that even in legal documents (or, some might say, especially in legal documents) people often use superfluous words. Sometimes the draftsmanship is clumsy; more often the cause is a lawyer's desire to be certain that every conceivable point has been covered. One has only to read the covenants in a traditional lease to realise that draftsmen lack inhibition about using too many words.

98 In *Long v. Delta Catalytic Industrial Services Inc.*, [1998] 6 W.W.R. 792 (Alta. Q.B.), Fruman J. (as she then was) said much the same thing:

> Some might argue that this interpretation makes the provision redundant...That may well be the case, but it won't be the first time that a repetitive provision has been inserted into an agreement.

99 Redundancy could also be laid at the feet of the U.S. Debtors in their interpretation of the license grant. If their reading is correct, all of the second, third and fourth clauses would be redundant as the first clause was an unrestricted grant of a license. I think in this case redundancy arguments are just that, arguments that do not deal with the commercial purpose of the agreement.

100 An addendum to the MRDA dated December 14, 2007 with effect from January 1, 2006 was made to adopt changes to the terms of the MRDA that had been reflected in the financial statements of the Participants. The first two recitals of this addendum stated:

> Whereas each Participant holds and enjoys equitable and beneficial ownership of NN Technology as defined in the Prior Agreement,
>
> Whereas this Addendum continues each Participant's rights and obligations in the NN Technology,

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101 The reason for this addendum was stated in the third recital

> Whereas given changes in the Nortel business, NNL and certain other Participants are seeking governmental approval of modifications to the RPSM.

102 This was the first of two addenda that changed the way of calculating the residual profit split each year from an amortized 30% spend of each Participant each year on R&D to a five year rolling average spend by each Participant on R&D. The operative parts of this addendum did not change the operative terms of the prior MRDA relating to the licence rights granted to the participants. I do not read the first two recitals that "each Participant holds and enjoys equitable and beneficial ownership of NN Technology as defined in the Prior Agreement" and the addendum "continues each Participant's rights ... in the NN Technology" as changing anything with respect to those rights in the prior MRDA. It is how the prior MRDA defines the rights of the participants that is important.

103 Confidentiality provisions are contained in the MRDA. The Monitor contends that because under article 6(a) the licensed participants owe a duty of confidentiality to NNL regarding the NN Technology but NNL does not owe such a duty to the Licensed Participants is an indication of the ownership by NNL of the NN Technology. The U.S. Debtors contend that because exceptions to the duty of confidentiality in article 6(d) give the right to the Licensed Participants to communicate to suppliers, customers and third persons licensing rights to use the NN Technology that they must have been given the authority to license to such third parties.

104 I think too much is made by each side of these confidentiality provisions. There is something perhaps in each side's argument, but I would not read article 6 as expanding on or limiting the ownership or license rights of the NN Technology. That was not its purpose. Regarding article 6(d)(iii), it begs the question as to whom the rights were given to license to third parties, and in light of the evidence of sub-licensing prior to the MRDA, to which I will refer in dealing with surrounding circumstances or the factual matrix, it is clear that NNL was a party to all such sub-licensing and NNI alone never sub-licensed.

105 The U.S. debtors contend that what was intended by IPCo comfortably falls within the definition of a Product and that therefore what was sold to Rockstar embodied rights that NNI had. They contend:

> IPCo was a licensing service business that the Participants proposed to be developed and indeed were actively developing, and which indisputably embodied the entirety of the Patent Portfolio sold to Rockstar, fits comfortably within the plain meaning of a "service" and thus the definition of "Products".

106 I do not agree. IPCo was considered for a time after the insolvency filings in January 2009. It could not be considered to have been part of the operating arrangements of Nortel while it carried on its business or intended to be governed by the MRDA. IPCo was not intended to be a "licensing service" business. The evidence of Sharon Hamilton, which I accept, is that the proposed business of IPCo was to use threatened or actual litigation against technology companies making their own products which arguably used or embodied NN Technology, in an attempt to encourage them to take and pay for a license to NN Technology. That was not a business contemplated in any meaningful way at any time that the MRDA or its predecessor was negotiated or signed.

107 The economic analysis prepared by Horst Frisch in 2002 as part of its work in devising the RPSM for the MRDA referred to Nortel customers choosing Nortel products and services because Nortel is committed to using its R&D resources in providing full pro-active service and support to its customers. A functional analysis for the years 2000 to 2004 sent by Nortel to the tax authorities in 2004 said the same thing. It also stated:

> Nortel's networking solutions generally bring together diverse networking products from its various product families, and related services, to create either a customized or "off the shelf" solution for customers. Nortel's business consists of the design, development, manufacture, assembly, marketing, sale, licensing, servicing and support of these networking solutions.

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108 The definition of Products in the MRDA is:

> "**Products**" shall mean all products, software and services designed, developed, manufactured or marketed, or proposed to be designed, developed, manufactured or marketed, at any time by, or for, any of the Participants, and all components, parts, sub-assemblies, features, software associated with or incorporated in any of the foregoing, and all improvements, upgrades, updates, enhancements or other derivatives associated with or incorporated in any of the foregoing.

109 Taken this definition, the license to NNI and the other participants was to "make, use..., license...sell" Products using or embodying NN Technology by, or for, the Participants. The Monitor contends that giving someone else (i.e. not any of the Participants) the right to use or embody NN Technology in their own products are not "services" within the Products definition in the MRDA. The Monitor contends that on the U.S. Debtors' reading of the word "services" in the MRDA, NNI could have provided a "service" to competitors of Nortel by permitting them to use in the U.S. the entirety of Nortel's patent pool to make their own products to compete with Nortel. The plain reading of the MRDA and common sense are contrary to this interpretation.

110 I agree with the Monitor's interpretation of the MRDA. At the time the MRDA was being considered, Nortel was not in a business of licensing its services to others for the business of others. It was providing a service to its customers to support the technology being acquired by its customers. The MRDA must be read in that context. What was contemplated for a relatively short period of time after the world wide insolvency of the Nortel Group was simply not in the cards prior to that time.

(b) The right to sue for infringement

111 The U.S. Debtors contend that the right to sue is central to their rights as exclusive licensee in the U.S. The right to sue is contained under Article 4 which is headed Legal Title to NN Technology. The right is not contained in the exclusive or non-exclusive licenses under article 5. I cannot read this right to sue as being part of the licenses granted to the licensed participants in article 5. Articles 4 (a) and (e) are relevant, and provide:

> (a) Except as otherwise specifically agreed, legal title to any and all NN Technology whether now in existence or hereafter acquired, or developed pursuant to the terms of this Agreement, shall be vested in NNL. In consideration therefor, NNL agrees to enter into an Exclusive License and a Non-Exclusive License with each of the Licensed Participants as set forth in Article 5.
>
> (e) Licensed Participants have the right to assert actions and recover damages or other remedies in their respective Territories for infringement or misappropriation of NN Technology by others.

112 This right was not contained in the prior CSA. It first appeared in the MRDA.

113 This right in sub-article 4 (e) does not state that the Licensed Participants have the exclusive right to bring action in their territories. The exclusive rights which the Licensed Participants have are contained in the exclusive license rights in article 5. There is no provision in the MRDA that precluded NNL from suing for patent infringement in a territory in which Licensed Participants had exclusive license rights. Indeed, the limited practice in the U.S. before the MRDA was signed was that both NNL and NNI were named as plaintiffs in infringement actions. To the extent those actions can be considered to be part of the factual matrix, it explains why the right to sue granted to NNI was not an exclusive right.

114 The right to sue for damages given to the Licensed Participants in their exclusive territories would obviously require a Licensed Participant to establish that it had been damaged. If the suit involved a breach of rights which the Licensed Participant had under its license, damages could presumably be proven. However, if the suit involved a breach of rights which the Licensed Participant did not have under its license, damages could not be proven.

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115 If a Licensed Participant were the only plaintiff, which does not appear to have ever been the case, presumably it would be open to a defendant to contend that the Licensed Participant had not suffered any damages as what was being done by the defendant was not something that the Licensed Participants could have done under its license. That defence would not likely be run if both NNL and the Licensed Participant such as NNI were plaintiffs.

116 The Licensed Participants were not given any right to sue for damages for patent infringement in non-exclusive territories. This right was held by NNL.

(iv) Surrounding circumstances or the factual matrix

117 What may be looked at in constructing an agreement is objective evidence of the background facts at the time of the execution of the contract. It may not include evidence of the subjective intent of a party or what a party believed a contract to mean. Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

118 There is an issue regarding the timing of the evidence that may be looked at. The exclusive licence to the Licensed Participants was contained in the 1985 CSA between Northern Telecom Limited [now NNL] and Northern Telecom Inc. [now NNI] signed in December 1984 and continued with no substantive changes in the 1992 CSA and in the MRDA and its later addenda. I would not, however, limit the time of the surrounding circumstances to the time that the CSAs were signed. The MRDA was made on December 22, 2004 effective January 1, 2001. Thereafter, while there were a number of changes to the MRDA in various addenda, no changes of substance were made to the operative provisions regarding the rights of the participants in NN Technology. I think the surrounding circumstances to the time of the signing of the MRDA in December 2004 can be looked at. Although there were some modifications to the MRDA after that, none involved any substantive change to the rights of NNL or to the exclusive licenses given to the Licensed Participants.

119 There was a great deal of evidence led by the U.S. and EMEA interests as to the subjective views of the witnesses, mostly tax personnel, regarding the rights of the parties under the CSA or MRDA or what the witnesses understood the language to mean, or in one case as to the witness's understanding of what others understood the documents to mean. Apart from the latter being inadmissible hearsay, all of this evidence was not admissible as it amounted to subjective views as to the meaning of an agreement. Nor was it admissible under the factual matrix rule permitting objective surrounding circumstances at the time of the execution of the agreement to be considered, and I do not consider it [14] . For example, what Mr. Henderson thought about the rights under the CSA license, that he copied from an earlier version of the CSA, or what others thought the MRDA meant or what they thought the intent of it was is not to be taken into account. See *Sattva*, *supra*, at para. 59.

120 I think it right to point out that not all of the evidence was one way. For example, the evidence of Angela De Wilton, the director of Intellectual Property in the Nortel IP law group and the director of IP strategy, was that Nortel was the owner of the patents and not just for administrative reasons. This evidence, elicited on cross-examination, also suffers from it being her subjective view of the rights of the parties under the MRDA. There were other witnesses who said much the same thing, such as Mr. Binning, the Executive Vice-President and CFO of NNC and NNL from November, 2007 to March, 2010 who said on his cross-examination that he understood that NNL owned the IP. This evidence suffers from the same problem of being a subjective view of the rights of the parties. The point is that that not all witnesses agreed with the subjective views of other witnesses.

121 There was also some evidence led of a prior draft of the MRDA and the views of an outside tax lawyer at Oslers who acted for NNL as to the particular draft language. This evidence is also inadmissible as being a prior draft and as constituting that particular lawyer's subjective views as to what the MRDA should contain.

122 A great deal of evidence, including evidence of statements made to tax authorities, had to do with economic theories of transfer pricing. As the transfer pricing principles changed from a cost sharing approach to a residual profit

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sharing approach, the economic theories and statements to tax authorities changed. One thing that did not change from the CSA approach to the RPSM approach was the language of the license grant from NNL to the other participants. It is that language that must be considered.

(a) 1996 APA

123 The 1992 CSA between Northern Telecom Limited (now NNL) and Northern Telecom Inc. (now NNI) was made with effect from January 1, 1992 but was not drafted until 1996 after the negotiations with the CCRA in Canada and the IRS is the U.S. in the advance pricing agreement process, so as to reflect the terms of the APA made with each of those tax authorities.

124 The U.S. Debtors say that the APA makes clear that NNI was entitled to all of the benefits of the NN Technology in the U.S., including all sub-licensing rights. I think they draw too long a bow. The APA between Northern Telecom and the CCRA was an agreement which by its terms was to "establish a cost sharing methodology which will result in the allocation of expenses to NNI by [NNL] for R&D done by [NNL] and its subsidiaries...which will constitute reasonable amounts in the circumstances for the purposes of section 69 of the Income Tax Act". The concern of the tax authorities was that the costs of R&D be properly allocated between NNL and NNI. The purpose of the APA was not to agree how the income of NNL and NNI was to be shared or allocated, but how to apply R&D expenditures to whatever the income was for each of NNL and NNI.

125 Article 1.1 of the APA stated that the allocation of R&D expenses was to be determined in accordance with the cost sharing methodology described in appendix A. Appendix A is headed Cost Sharing Methodology. It contains detailed formulae to determine how R&D is to be allocated. At the outset, it has a section headed Understandings. The first understanding is that all benefit derived from R&D expenses is recognized either in the selling of a finished product to an unrelated customer or from the licensing of the technology resulting from the R&D expense (the "Benefit") within a defined geographical market by a Cost Sharing Participant ("CSP"). It goes on to state that "[NNL], as a CSP, "is entitled to all Benefits in all geographical markets except for the part(s) thereof granted to another CSP" and "NNI is also a CSP and its geographical market is the united States of America and the Commonwealth of Puerto Rico".

126 This statement that NNL is entitled to all Benefits in all geographical markets except for the part(s) thereof granted to another CSP is somewhat unclear. It could refer to all Benefits except for parts thereof granted to another CSP, or to all geographical markets except for those parts granted to another CSP. The former would seem to make sense because there would be no purpose in stating that NNL was entitled to all benefits in all geographical markets except those granted to another CSP as the following sentence states that the geographical market of NNI is the U.S. and Puerto Rico. If as I read it the understanding was that NNL was entitled to all benefits except for those granted to a CSP, the document begs the question as to what benefits were granted to NNI, which is the issue in this case.

127 It is understandable, as Mr. Henderson testified, that the parties needed to wait until the APA was settled with the tax authorities before the 1992 CSA was settled as the APA stated that it was to apply to the taxation years 1992 to 1999. That does not mean, however, that the parties needed to know how revenue was to be allocated by the APA. The purpose of the APA was to obtain an agreement from the revenue authorities how to allocate R&D costs, not revenues. This is borne out by Mr. Henderson's admissions on cross-examination that the 1992 CSA just adopted the license language of the 1985 CSA and that all operative provisions were the same.

(b) Sub-licences

128 Both sides refer to the evidence of sub-licensing as refuting the case of the other. In this I think they are incorrect. Not a great deal is clear from this evidence.

129 The reply closing argument of the U.S. Debtors contains a list of "Sublicenses Involving NNI". None were made only by NNI. Many were made by NNL and NNI and others were made by NNL on behalf of itself and its subsidiaries.

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130 The sublicenses made by NNL and NNI recited that NNL has granted to NNI "certain rights to license said patents" in the U.S. In the body of the agreement it provides that NNL and NNI "to the extent of their legal right to do so" grants a license to the licensee for the countries and jurisdictions in which Nortel now or in the future holds the Nortel patent. What rights had been licensed to NNI is not stated in the sublicense. Some sublicenses provided that the royalties were payable to NNI, with NNI having the right to direct some or all of the payments to NNL. Others, being a majority of them, provided for the royalties to be payable to NNL with NNL having the right to direct some or all of the payments to NNI. In the case of cross-license agreements, the royalties were payable to NNL and there was no provision for NNL to direct some or all of the payments to NNI.

131 In agreements made by Nortel, defined as NNL on behalf of itself and its subsidiaries, regarding U.S. patents, it was stated that Nortel was the owner of the patents and that Nortel granted world-wide license rights for the patents. Other agreements involving other patents made by Nortel, also defined as NNL on behalf of itself and its subsidiaries, recited that Nortel was the owner of the patents. The effect of the language in this form of agreement is that the patents are owned by Nortel on behalf itself and its subsidiaries, which supports the position of EMEA that all patents were jointly owned by the MREs.

132 The U.S. Debtors point to some evidence of certain Nortel tax personnel to explain the forms of sublicensing agreements used by Nortel. One is an e-mail exchange in 2002 involving two different views from two different tax persons, in which subjective views as to what the license in the CSAs from NNL to the other participants meant and what the theory of the sublicensing agreements was. The other is an e-mail in 2000 from someone professing not to be an expert in tax and passing on his understanding of what the tax people's view was. Apart from the latter being hearsay and inadmissible, this e-mail evidence contains subjective views of the extent of the license in the CSAs from Nortel to the other participants in the CSAs and is inadmissible.

133 Nortel's IP team prepared a presentation after the sale of the business lines in connection with the stalking horse bid process for the residual intellectual property. The presentation reviewed the history of Nortel's portfolio including its past licensing activities. It stated that Nortel previously had a small licensing group which was not a core focus of the company. There were virtually no assertions against major players, customers or partners and they focused on smaller companies with limited ability to fight back. They had earned approximately $37 million per year in royalty income. The licensing operations ceased in 2007 for budgetary reasons but in 2008 Nortel made a decision to restart the licensing organization. Mr. Binning, the Executive Vice-President and CFO of NNC and NNL from November 2007 to March 10, 2010 said that during that time Nortel was not in the license business. I take it from this evidence that for a business as large as the Nortel business, it would appear that sublicensing was an insignificant business for Nortel prior to its bankruptcy.

134 If one follows the money from the sublicenses, the evidence is that the royalties were split on the basis of the MRDA participant's contributions to R&D. The royalties were incorporated into the RPSM calculations even although they were not mentioned in Schedule A to the MRDA. Why this was done was not made clear by Mr. Stephens who gave the evidence of this happening. With one exception, we were not pointed to any evidence as to what was done with any royalties received prior to 2006, which is perhaps a more germane period as being prior to the signing of the MRDA. In 2004 a settlement of $35 million with Foundary Networks, Inc. was split on the basis of the RPSM.

135 In sum, there were no sublicenses when the license was granted by NNL to NNI at the time of the 1985 CSA. There were a number after that which do not indicate any clear pattern of what sublicense rights either NNL or the other participants were recognized to have. Sublicensing was a very insignificant part of the Nortel business prior to its insolvency.

(c) Representations to tax authorities

136 I have already discussed the 1996 APA process.

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137 In connection with the switch from a CSA approach to a RPSM approach, Horst Frisch, a leading firm of transfer pricing economists, was retained to advise Nortel. Horst Frisch prepared a report dated March 14, 2002 titled Economic Analysis of Nortel Networks' Intercompany Transactions and this report was given to the tax authorities.

138 The U.S. interests point to a statement at page 10 of the report that stated from an economic standpoint, each participant could be considered to "own" the NT Technology. The paragraph in question made clear that what was being discussed was the situation under the CSA that existed up to the end of 1999. It stated:

> Prior to 2000 Nortel shared it global R&D expenses pursuant to its R&D cost sharing arrangement ("R&D CSA"), which dates back to the mid-1970's (with several amendments). Under the arrangement, each cost sharing participant ("CSP") had the right to use the intangible property developed pursuant to the R&D cost sharing arrangement (i.e., the NT Technology") in its respective market. From an economic standpoint, each R&D cost sharing participant could be considered to "own" the NT technology as it related to its specific region.

139 What is meant by "from an economic standpoint" each participant could be considered to "own" the NT technology as it related to its specific region is not clear. The OECD Guidelines and transfer pricing regulations in the U.S. and Canada all define intangible property to include licenses or rights to use assets. The statement of Horst Frisch that each participant had the right to use the IP and from an economic standpoint could be considered to "own" the NT technology could well have referred to owning the license rights held by each participant rather than referring to the underlying NT technology. The U.S. Debtors in their opening brief acknowledged case law to the effect that the rights an exclusive licensee holds are referred to as beneficial ownership.

140 Horst Frisch was clearly not talking about legal rights, nor were they discussing particular language in the CSA. Even had they purported to give their views as to what legal rights the parties had under the CSA or the MRDA, which they were not, those views would not have been admissible. Horst Frisch was discussing economic theory.

141 A few pages further in the report, when Horst Frisch were discussing what would occur under the RPSM method of allocating profits under the MRDA, they stated that the economic theory underlying the CSA was not applicable to the RPSM of allocating profits. The report stated:

> As noted above, under the prior R&D CSA the CSP which ultimately made the sale to a third party in its exclusive territory was deemed to have economic ownership of the NT Technology since the third party sale attracted an R&D allocation under the CSA.
>
> In the absence of the R&D CSA, with the two exceptions noted above, each old CSP will incur R&D expense which should entitle it to share in Nortel's global profits or losses. We have not attempted to attach these R&D expenses to the manufacturing or the distribution operation of the old CSPs since there will no longer be a formula by which global R&D expenses are shared (i.e., a third party sale will not attract an R&D allocation so it is not reasonable to assume that only the selling entity will continue to own the valuable intangibles). The amount of R&D performed is not necessarily correlated with third party sales or manufacturing activity. Rather, each entity will perform and pay for its own R&D expenses, and has the ability to sell Nortel products worldwide and share in global profits or losses.

142 What Horst Frisch were saying was that the economic theory of the participant in a third party sale in its territory "owning" the intangibles would not apply to such a sale under the MRDA. Perhaps implicitly they were saying that the economic "ownership" of the intangibles would be owned by all of the participants in accordance with their R&D spend under the MRDA, although this is not expressly stated. If so, from an economic point of view, it would be more consistent with the position of EMEA rather than the U.S. or Canadian interests. [15]

143 After the APAs were applied for in 2002, the tax authorities visited various Nortel sites. They then posed a number of questions. In September 2003 Nortel send a 45 page response to these questions. One of the questions was to update the authorities on any developments since the APA submission was made and whether any changes to the proposed

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transfer pricing methodology were anticipated. One of the responses of Nortel had to do with restructuring charges. The U.S. interests point to a statement that the residual entities are the owners of the intangible property. The context is important to see what was being said. Included was the following:

> In 2000 and later years, the telecommunications industry experienced a decline in demand unlike any other substantial industry in modem history. For that reason, there does not appear to be any precedent for analyzing the above issues. Accordingly, a reliance on basic economic principles was deemed necessary.
>
> In an arm's length situation, it was determined that the residual entities would agree to reimburse the distribution entities for a portion of their restructuring charges rather than have those entities become insolvent and forced into receivership. Generally, the underlying economic rationale for this argument is this: the residual entities, as the owners of the intangible property, as well as the manufacturers of the tangible goods, would recognize that its distribution network is critically necessary for their long-term survival. Should members of the distribution network become insolvent/cease operations, the residual entities' ability to offer their products for sale may be severely impacted. Therefore, it is in their best economic interests to ensure that a strong global distribution network exists.

144 This is a discussion of economic theory. It cannot be construed as a discussion of legal principles or the meaning of the MRDA. The reference to being owners of the intangible property could well be a reference to license rights rather than the underlying intangibles, as license rights are intangible property.

145 Dr. Timothy Reichert, a transfer pricing expert called by the Monitor, made the following statement about economic ownership as considered in transfer pricing, a statement not contradicted by any witness:

> A central concept in transfer pricing is that of "economic ownership" (referred to, alternatively, as "beneficial ownership," and simply "ownership"). Economic ownership is not a reference to ownership in a legal sense, but rather refers to a party's right to benefit from an income stream attributable to a defined undertaking or activity.

146 This statement cannot be disregarded. An economic right to an income stream attributable to a defined undertaking or activity requires one to know what is the defined undertaking or activity. The economic statements made to the taxing authorities did not purport to define the precise limits to the license granted by NNL to the participants under either the CSA or the MRDA. As seen, the statements made to the taxing authorities did not at all make clear what rights were being referred to and in particular, whether the "economic or beneficial ownership" was in the underlying NN Technology or in the license rights to that technology. They cannot be taken as statements that under the MRDA the licensees legally owned the NN Technology.

147 To the contrary, Mr. Weisz, the Leader of International Tax at NNI who was involved in Nortel's transfer pricing policies, and who was asked by Mr. Dolittle, the VP of Tax for Nortel to become involved in the APA process that had stalled, told the IRS during that process that it was NNL that was the legal owner of the IP.

148 It must also be recognized that the APA process with the tax authorities was to arrive at an agreement with them regarding the Nortel operating business. It was an operating business with profits and losses that the tax authorities were interested in. This was the case both for the APA processes for both the CSA and MRDA. There were no discussions with the tax authorities as to what would happen on the insolvency of the entire business of Nortel. The discussion of the economic theory of economic or beneficial ownership must be considered in that light. They were not discussing such a theory in so far as it might apply to the situation of a cessation of business as occurred with Nortel.

149 The issue in this case has to do with the breadth of the licenses granted to the Licensed Participants and whether that included the right to sublicense the residual patent portfolio that was eventually sold to Rockstar. However at the time of the APA processes, sublicensing was a miniscule part of the business of Nortel and not surprisingly I have been pointed to no presentation to the tax authorities that discussed this issue. It was not on the Nortel radar.

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150 The MRDA was provided to the tax authorities. They also had the prior CSA. The U.S. interests do not say that NNI rights were obtained other than in the CSA and then the MRDA. The tax authorities had these agreements and were able to read them, and were in as good a position as anyone to form their own view of what the agreements did or did not do. It cannot be suggested that the tax authorities did not understand transfer pricing. It was their business to know it.

151 There is evidence relied on by the EMEA debtors to support their position that the proceeds of the sale of the residual IP should be allocated in accordance with the relative expenditure on R&D by NNL and the licensed participants. After the APS application was filed by Nortel with the tax authorities in 2002, planning for a June 19, 2002 joint meeting with the three tax authorities took place in earnest, including the preparation of answers to questions Nortel anticipated might be raised by the tax authorities. In preparation for the meeting, Nortel engaged advisors from Deloitte & Touche LLP, KPMG LLP, Horst Frisch, and Sutherland Asbill & Brennan LLP to assist. Mr. O'Connor of Deloitte's prepared the following answer to an anticipated question regarding the sale of any IPCo, an answer that was circulated and agreed before the meeting:

> [Q:] How does Nortel propose to account for any future sale of intellectual property developed prior to or during the term of the APA? Which entities are considered the legal owner of IP and which are considered the economic owners?
>
> [A:] Proceeds from the sale of IP will be allocated to residual profit split participants on the basis of their economic ownership of the IP — that is, on the basis of their share of total R&D capital stock in the year of sale.

152 The document was taken to the joint meeting. There is no evidence one way or the other as to whether the question was asked. While the question does not deal with what would happen if all of the Nortel IP was sold on a world-wide insolvency of Nortel, it is evidence that at the time of the APA process, Nortel was prepared to say that any sale of IP would be split in accordance with the RPSM in the year of the sale.

(d) Avoiding permanent establishment status in the U.S.

153 The U.S. interests contend that it was important to NNI not to be considered a U.S. resident for U.S. tax purposes and thus not have "permanent establishment" in the U.S. It is contended that it was this concern that drove separate legal entities to be set up for each country and for the license to be exclusive to the Participants for their territory so that the Participants would be the only ones dealing with customers in that territory.

154 Taken that as the situation, I do not see that it gets very far. There is no question that the exclusive license gave NNI the exclusive right to sell Nortel products in the U.S. The important issue in this case is what rights NNI had to sub-license and whether it was restricted to Nortel "Products" as defined in the MRDA. Sub-licensing was a miniscule part of the business of Nortel and there is no evidence at all that sublicensing issues drove the setting up of companies in different jurisdictions.

(e) Patent litigation

155 I have previously referred to the patent litigation that had taken place prior to the MRDA. Both NNL and NNI were plaintiffs in the actions in the U.S. Why that was so does not really matter. It explains why the right given to licensed participants to sue in their territories for damages for patent infringement was not an exclusive right.

156 As to what was done with the proceeds of patent litigation, there was a settlement in October, 2004 of an action commenced by NNL and NNI against Foundary Networks, Inc. $35 million was paid for past infringement and for future royalties under a license agreement. The entire payment was treated as royalty income and allocated to NNL and the Licensed Participants in accordance with the RPSM in the MRDA.

(f) Conclusion of factual matrix evidence

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157 I do not consider the surrounding circumstance or factual matrix evidence to provide much clear assistance in construing the meaning of the terms in the MRDA. Even if it did, I would be required to be guided by the dictates of *Sattva* that while the surrounding circumstances will be considered in interpreting a contract and the goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract, they must never be allowed to overwhelm the words of the contract and the interpretation of a contract must always be grounded in the text. While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.

(v) Commercial reasonableness

158 The U.S. interests and EMEA say that the Monitor's interpretation of the MRDA is commercially unreasonable. They contend that no party at arm's length would agree to spend large amounts to develop patents but only one party would be entitled to all of the proceeds from the sale of those patents.

159 It must be remembered that the MRDA and its predecessor CSA were drafted to come to terms with the tax authorities. The parties to the negotiations were Nortel on the one hand and the tax authorities on the other. The resulting CSA and then MRDA were operating agreements premised on cost sharing under the CSA and profit or loss sharing under the MRDA. The tax authorities were interested in the tax that each Nortel entity would pay each year. The tax authorities dealt in only limited periods of time. The 1992 CSA was settled with the tax authorities only in 1996, yet in 1999 they made it clear they wanted Nortel to abandon the CSA agreement and instead change to a RPS method of transfer pricing.

160 Nortel and the tax authorities were not negotiating on what would happen if Nortel stopped operating or in the event of a world-wide insolvency of Nortel. More particularly, they were not negotiating on how the proceeds of the sale of the entire Nortel world-wide patent portfolio would be allocated amongst the various Nortel companies in the event of the insolvency of Nortel. That was not discussed. This is not surprising because, as Dr. Eden testified, transfer pricing rules were developed only in connection with ongoing entities for purposes of determining their corporate tax.

161 The issue of commercial reasonableness must be considered in the context of who was involved in the preparation of the MRDA. It was not the technology people. Mr. Brian McFadden, the Chief Technology Officer of Nortel at the time the MRDA was drafted and signed, was not consulted about its terms and never heard of the MRDA while at Nortel. Ms. Angela de Wilton, the Nortel Director of Intellectual Property had no recollection of ever seeing the MRDA. In order to make the argument that it would have been commercially unreasonable for a Nortel company to agree to do R&D leading to patents and not be paid for the patents on the sale of the business, one would think that the people responsible for the R&D would have at least known of the agreement and its terms. The fact that they did not indicates that a trade-off of R&D for future receipts on a sale of the business was not on the radar screen at all so far as the operating people were concerned. The language of the MRDA was all tax driven.

162 So far as what was on the radar of the tax people at Nortel at the time the terms of the MRDA were settled, in so far as the quid pro quo for doing R&D was concerned, the MRDA expressly provided in Article 2(c) that any compensation for R&D was to be based solely on the RPSM allocation. It stated:

> (c) All costs incurred directly or indirectly by each Participant for R&D Activity shall be borne exclusively by it. Any reimbursement for costs including any other compensation shall be provided to such Participant for its R&D Activity solely as provided in Article 3 below.

163 Article 3 that the annual sharing of profits or losses under the residual profit split method was what was to be received for each participants R&D that year. It stated:

> **Article 3 — R&D Activity Payments**

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(a) For and as a consequence of the performance of R&D Activity, each Participant shall be entitled to receive a payment in an amount equal to the allocation determined under the RPSM (the "R&D Allocation") as the measure of the benefit to which it is entitled commensurate with its performance of, and contribution to, R&D Activity.

164 In the context of what the parties were dealing with in the MRDA, I do not see how it can be said that it was commercially unreasonable for them to agree that in return for doing R&D each year, they would share only in the profits or losses in accordance with the RPSM allocation. That is all they had in mind. While Nortel had suffered losses by 2004 when the MRDA was signed, there is no evidence that Nortel expected to have only losses in the future. To the contrary, the operating people at Nortel expected that Nortel would return to profitability.

165 Mr. Henderson testified that a bankruptcy or insolvency of Nortel was not in their minds at the time the RPSM in the MRDA was created. The fact that they did not consider or provide what was to happen to the proceeds if all of the IP was sold after a world-wide insolvency does not make the agreement commercially unreasonable. The time for considering whether an agreement properly interpreted is commercially reasonable or unreasonable is surely the time when it was agreed, not in hindsight.

166 The U.S. Debtors called Dr. Catherine Tucker, a transfer pricing expert, whose evidence was to the effect that under the Monitor's interpretation of the MRDA, the Licensed Participants would lack appropriate incentives to undertake expensive and speculative R&D for the next potential generation of products. I do not think her evidence helpful. It is really an inadmissible subjective view as to how the MRDA license should be interpreted.

167 There is no basis for Professor Tucker's assumption that the MRDA was intended to create incentives for the Licensed Participants to make forward-looking innovations. The fact that Mr. McFadden, the Chief Technology Officer of Nortel at the time of the MRDA, was not consulted about the MRDA and knew nothing about it belies any such assumption. Professor Tucker's assumption also ignores the way in which R&D was carried out at Nortel.

168 The majority of Nortel R&D was directed by the various Business Lines, which had to prepare annual R&D plans for approval. The remaining R&D, the advanced technology research (the "leap from one S-curve to the next" that Professor Tucker describes), was coordinated by the Chief Technology Officer. The evidence of Mr. McFadden was that all advanced technology programs were based in Ottawa and were operated by NNL. While product development R&D groups within each of Nortel's lines of business reported directly to the heads of their business units, the advanced technology programs personnel within each line of business reported directly to the CTO's office at NNL. The R&D was not the bailiwick of any Licensed Participant.

(vi) Conclusions on the meaning of the MRDA

169 I interpret the MRDA, and find, that under it, and while Nortel operated as a going concern business, NNL had all ownership interests of the NN Technology subject to grants, being (i) the grant to each Licensed Participant of a non-exclusive right to assert actions and recover damages in their territory under article 4(e) and (ii) the grant of exclusive and non-exclusive licenses to the Licensed Participants under article 5(a).

170 The licenses under article 5(a) were not licenses of all rights to the NN Technology but were subject to field of use restrictions that gave the Licensed Participants the right to use the NN Technology to make, use or sell Products as defined in the MRDA, which meant products, software or services that were made or sold by, or for, any of the Licensed Participants. The Products must have been created or marketed by or for the Nortel Group. No product that was part of a third party's business rather than the business of Nortel fell within the definition of Products. The business considered by IPCo was not covered by the licenses. The Licensed Participants' rights to sublicense were subject to these restrictions.

Applicability of the MRDA to the allocation issues

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171 Nortel Networks UK Pension Trust Limited and the Board of the UK Pension Protection Fund (the "UKPC") contend that the MRDA was never intended to provide an answer to the question of how to allocate among the bankrupt estates the proceeds of the sale of the Nortel Group's assets following the world-wide insolvency of Nortel.

172 I agree. The MRDA was an operating agreement and was not intended to, nor did it, deal with the disposal of all of Nortel's assets in a situation in which no revenue was being earned and no profit or losses were occurring. The MRDA provided in its opening line that it was an agreement "confirming and formalizing the operating arrangements" of the parties.

173 There is a provision in schedule A to the MRDA added in the third addendum effective January 1, 2006 but signed by the parties late in late December 2008 or early January 2009 that indicates that sales of property were not intended to be dealt with under the MRDA. That schedule A provided that in dealing with the calculations of the Nortel earnings/losses to be used in the RPSM calculation, there was to be deducted "gain/loss on the sale of business". A gain or loss would normally be taken into account on the particular company's statement of profit and loss and the Participants decided they did not want any such gain or loss to influence the calculation of profits or losses for the purposes of calculating the allocation of profits or losses in the RPSM calculation. Mr. Orlando testified that the sale of a business was seen to be a non-operating activity. This provision is an indication that the MRDA was not intended to deal with the sale of any assets, let alone the world-wide assets of the Nortel Group.

174 The MRDA and its predecessor Cost Sharing Agreements ("CSAs") were developed for and driven by transfer pricing concepts. They were drafted to come to terms with the tax authorities. The MRDA expressly provided in a recital that the calculation of the RPSM might have to be adjusted as a result of its review by the tax authorities. The MRDA was drafted by tax lawyers and tax advisors. The primary external counsel involved, and lead drafter of the MRDA, Giovanna Sparagna, testified that the MRDA is "primarily focused on transfer pricing," which is "part of tax law," and it is "primarily [a] tax law document[]." The MRDA was signed on behalf of NNL by John Doolittle, Nortel's Vice-President of Tax. All parties acknowledge that the MRDA was a tax-driven document designed to implement Nortel's transfer pricing policies.

175 Following the insolvency proceedings on January 14, 2009, no transfer pricing payments were made under the MRDA. The two special cash payments made by NNI to NNL were made under different agreements, being the IFSA dated June 9, 2009 and the FCFSA dated December 23, 2009.

176 Dr. Eden, who testified on behalf of the U.S. Debtors, testified that transfer pricing was only for ongoing businesses. She also testified that she saw the MRDA as a transfer pricing document and that the RPSM method contained in it was only used for corporate income tax purposes. She and other transfer pricing experts such as Dr. Richard Cooper, Dr. Steven Felgran and Dr. Timothy Reichert testified to the effect that transfer pricing does not address entitlement to the proceeds of the sale of assets on insolvency.

177 I accept that the MRDA was a transfer pricing document created for tax purposes. The licenses were a part of it. The licenses granted under it were never dealt with separately from the MRDA. Their only purpose was to support the intended tax treatment resulting from the MRDA.

178 It can perhaps be argued that under article 9 of the MRDA the rights of NNL under article 4 and of the Licensed Participants under article 5 continued on the expiry or termination of the agreement, indicating a purpose other than tax that survives the insolvency of the Nortel enterprise. I would not construe those provisions that way.

179 The relevant provisions of article 9 of the MRDA provide:

Article 9 — Duration and Continuing Rights and Obligations

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(a) This Agreement shall be effective from January 1, 2001 until December 31, 2004, provided however that this Agreement will automatically renew for additional and unlimited one-year terms until terminated by the mutual written consent of all Participants.

(b) Upon the expiry or termination of this Agreement as provided herein, each Licensed Participant shall be deemed to have acquired a fully paid up license permitting it to continue to exercise the rights granted to it herein, and, in particular, the rights granted to it in Article 5 as though this Agreement had continued.

(c) The provisions of Article 4 (Legal Title to NN Technology) with respect to NN Technology acquired or developed pursuant to this Agreement from the Effective Date of this Agreement up to and including its expiry or termination date, Article 6 (relating to confidentiality) and Article 7 (relating to liability) shall survive notwithstanding the expiry of this Agreement, or any termination of this Agreement for any cause whatsoever.

180 Under article 9, the MRDA automatically renewed after 2004 unless terminated by mutual consent of all parties to it. If terminated, the Licensed Participants were to be deemed to have acquired a fully paid up license "permitting it to continue to exercise the rights granted to it herein... as though this Agreement had continued". This provision by its terms contemplated the business of the Licensed Participants continuing to operate. It did not contemplate a situation in which all of the Licensed Participants liquidated their assets and went out of business.

181 The CSAs contained a similar provision regarding the rights of the Licensed Participants on termination to a fully paid up license. At the end of 1999, the tax authorities did not want to renew the APAs and they encouraged Nortel to adopt a RPSM. In December, 2001, Nortel's CSAs for R&D were terminated effective January 1, 2001. In spite of the termination of these agreements, Nortel continued to operate and it was only on December 22, 2004 after negotiations with the tax authorities that the MRDA was executed with an effective date of January 1, 2001. The MRDA stated that it confirmed and formalized the operating arrangements of the Participants as and from that date. That is, the license rights under the CSAs continued to be used in accordance with the terms of the CSAs, and Nortel's tax advisors told that to the tax authorities on April 26, 2004. This was contemporaneous with the MRDA being settled.

182 One can see from this that the purpose of continuing rights under article 9 of the MRDA after a termination was to permit the Participants to continue operating, during which a new agreement would have to be negotiated. Nortel was a multi-national enterprise that had to live with tax authorities where it operated and could not live without a transfer pricing agreement of some kind. As previously discussed, there was no thought at the time of the MRDA being settled that Nortel was not going to return to profitability.

183 Article 11(a) of the MRDA provided that any Participant that was not a party to an APA with the tax authorities could elect to withdraw from the MRDA. Article 11(c)(iv) of the MRDA provided that it was a defaulting event if one of the Participants became insolvent, in which case the Participant automatically was terminated from participation in the agreement. A fourth addendum was made to the MRDA effective December 31, 2008 and signed in early January 2009. It was headed *Standstill Provision* and provided that in the event of an occurrence of an event described at Section (sic) 11(c)(iv), i.e. if a Participant became insolvent, (i) no Participant effected by such insolvency shall be automatically terminated from participating in the agreement, (ii) no Participant shall elect to withdraw from the agreement under Article 11(a), and (iii) NNL would have the right in its sole discretion to terminate participation in the MRDA of any Participant affected by such event, i.e. of a defaulting Participant by reason of its insolvency.

184 This provision did not contain provisions expressed to apply in the event of a world-wide insolvency of all of the Nortel companies. It contained provisions of a standstill nature dealing with a situation in which one Participant became insolvent. It was obviously designed to prevent a Participant from declaring insolvency and then trying to take positions contrary to other Participants and to prevent the other Participants in such an event trying to take positions contrary to other Participants. I do not read this provision as an indication that in the event of a world-wide insolvency of all of the

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Nortel companies with no operations, the agreement was to continue to govern the affairs of a non-operating enterprise. Had that been the parties' intention, they could have said so in the addendum. They did not.

185 I conclude that the circumstances surrounding the creation of the MRDA lead to no other result but that the construct of legal title to the NN Technology being in NNL in return for NNL granting exclusive licenses to the Licensed Participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while Nortel operated as a going concern business. The agreement in its application was intended to apply only to Nortel while it operated and not to deal with rights after Nortel and its subsidiaries stopped operating its businesses.

EMEA position on ownership of the Nortel IP

186 The EMEA Debtors' position is different from the position of the Canadian and U.S. Debtors. They say that the Participants, or RPEs, have joint ownership of all Nortel IP under common law principles by reason of the IP belonging to the RPEs that employed the inventors. They say that the MRDA recognizes that joint ownership and that the joint ownership should be the basis for allocating the proceeds of the sale of the Nortel residual IP.

187 The basic premise of the EMEA Debtors' argument is that the Participants or RPEs were joint owners of all Nortel IP by reason of law. They argue that under Canadian law, the inventor is the first owner of an invention and is the legal title holder entitled to apply for any related patent. However, where the inventor is employed to invent, as the Nortel Group's researchers were, then the employer by operation of law beneficially owns any resulting IP. While the employee inventor who is listed on the patent application holds legal title, the employer is the beneficial owner. Given the integrated nature of Nortel and its R&D created in multiple jurisdictions, the EMEA Debtors argue that each participant beneficially owned not the IP created in its jurisdiction, but rather a share of the indivisible pool of the Nortel Group's IP.

188 Canadian and U.K. law appears to support the principle that where an employee creates an invention as part of his or her employment, the employer is the beneficial owner of the patent. [16] U.S. law is otherwise. Under U.S. law, unless there is agreement to the contrary, it is the inventor and not the employer who is the owner of his or her invention until he or she assigns it [17] .

189 All Nortel employees, whether employed by NNL or a subsidiary, were required to assign directly or indirectly to NNL any intellectual property which they generated during the course of their employment. At least 98% of the patents and patent applications sold to Rockstar had been assigned by the inventors to NNL.

190 The EMEA Debtors say that while the inventors assigned their rights to NNL, the subsidiaries that employed the inventors did not. Thus they say that NNUK, the employer of inventors in the U.K., continued to have beneficial ownership of the patents for inventions created by its employees. I do not accept that. NNUK was required under article 4 (b) of the MRDA to execute such documents as NNL reasonably required to give effect to article 4 (a), which provided for legal title to NN Technology to be vested in NNL. In light of that obligation, NNUK is in no position now to say that the assignment of the IP from its employees to NNL was ineffective.

191 This argument of the EMEA Debtors would not apply to NNI in the U.S. as under U.S. law NNI did not have any such common law rights to IP developed by its employees who assigned their rights to NNL. Nor would it apply to patents invented by employees of NNL who assigned their rights to NNL. The EMEA Debtors' argument, if accepted, would mean that NNUK would only have rights to the IP developed by its employees and would have no joint ownership interest in the IP developed by employees of NNL, NNI, NNSA or Nortel.

192 I cannot accept the joint ownership theory of the Nortel IP or use that theory as a basis for allocating the proceeds of sale of the Nortel IP assets.

Appropriate method to allocate the proceeds of sale

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193 While the Monitor on behalf of the Canadian Debtors and the U.S. Debtors take diametrically different views as to their rights under the MRDA, they each look to the MRDA and the rights they say were given to them as the basis of their allocation positions. I have not accepted their position that they obtained rights under the MRDA that determine their right to the proceeds of the sale of Nortel's assets.

194 Nor have I accepted the position of the EMEA Debtors that the RPEs have joint ownership of all Nortel IP under common law principles recognized in the MRDA and that such joint ownership should be the basis for allocating the proceeds of the sale of the Nortel residual IP.

195 Without the MRDA to govern the allocation, and without the joint ownership theory of the EMEA Debtors, the issue becomes one of deciding what metric should be used to allocate the proceeds of sale.

196 In so far as the IP is concerned, while the patents were registered in the name of NNL, I would not for that reason hold that NNL is entitled to the proceeds of the IP sales. The patents and application rights to apply for patents were held in the name of IP for administrative purposes. It was best practices in a multi-national enterprise to have all patents assigned to one company, in this case to NNL, as explained by Ms. Anderson and Ms. De Walton, and made management of the portfolio much easier. While these witnesses expressed subjective views that it was NNL who owned the patents, these views are not determinative, as acknowledged in the Monitor's reply brief at paras 65-66.

197 This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name.

198 Canadian law permits recovery for unjust enrichment whenever a plaintiff can establish three elements: an enrichment of or benefit to the defendant, a corresponding deprivation of the plaintiff, and the absence of a juristic reason for the enrichment: *Kerr v. Baranow*, 2011 SCC 10 (S.C.C.) at para. 32.

199 U.S. law provides that unjust enrichment occurs where a party obtains a benefit which, under the circumstances and in light of the relationship between the parties, it would be inequitable to retain: *Counihan v. Allstate Insurance Co.*, 194 F.3d 357 (U.S. C.A. 2nd Cir. 1999), 361. It requires the retention of a benefit to the loss of another or the retention of money or property of another against the fundamental principles of justice or equity and good conscience. It is not available if there is a contract that governs the relationship between the parties that gives rise to the claim: *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872 (U.S. Del. Ch. 2009), 891.

200 On either test, I find that NNL would be unjustly enriched by being entitled to all of the proceeds of the sale of Nortel IP at the expense of the other RPEs who contributed to the creation of that IP just because the patents were registered in NNL's name. It would be inequitable. There would be no juristic reason for the enrichment as the MRDA as I have interpreted it does not deal with the allocation rights of the parties in this world-wide insolvency of Nortel.

201 It would also unjustly enrich NNI if it were to be allocated the amount from the IP sales that it claims based principally on its revenues, which is the basis of the claim by the U.S. Debtors. NNI was able to sell Nortel products based on the R&D and resulting IP performed by other RPEs.

202 This is an unprecedented case involving insolvencies of many corporations and bankrupt estates in different jurisdictions. The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions. They were created by all of the RPEs located in different jurisdictions. Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services. R&D took place in various labs around the world in a collaborative fashion. R&D was organized around

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a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not.

203 Nortel's matrix structure also allowed Nortel to draw on employees from different functional disciplines worldwide (*e.g.* sales, R&D, operations, finance, general and administrative, etc.), regardless of region or country according to need. Individuals could be part of a team with horizontal responsibility without removing them from their respective position vertically (or departmentally) within the Nortel group. [18]

204 In these circumstances, what principles should be applied to determine the allocation of the proceeds of the asset sales? In my view, doing what is just in the unique circumstances of this case should govern the allocation.

205 A court has wide powers in a CCAA proceeding to do what is just in the circumstances. Section 11(1) provides that a court may make any order it considers appropriate in the circumstances. Although this section was provided by an amendment that came into force after Nortel filed under the CCAA, and therefore by the amendment the new section does not apply to Nortel, it has been held that the provision merely reflects past jurisdiction. In *Century Services*, Deschamps J. stated:

> **65** I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).
>
> **67** The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.
>
> **68** In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence. (underlining added)

206 This Court has a broad inherent jurisdiction to make orders as required to fill in gaps or lacunae not covered by specific provisions in the CCAA. As a superior court of general jurisdiction, the Superior Court of Justice has all of the powers that are necessary to do justice between the parties. Except where provided specifically to the contrary, the Court's jurisdiction is unlimited and unrestricted in substantive law in civil matters. See *80 Wellesley St. East Ltd. v. Fundy Bay Builders Ltd.*, [1972] 2 O.R. 280 (Ont. C.A.) at para. 9. See also *TCR Holding Corp. v. Ontario*, 2010 ONCA 233 (Ont. C.A.) at para. 26, *Beach v. Moffatt* (2005), 75 O.R. (3d) 383 (Ont. C.A.) at para. 8, *M. (J.) v. Bradley* (2004), 71 O.R. (3d) 171 (Ont. C.A.) at para. 43 and *McVan General Contracting Ltd. v. Arthur* (2002), 61 O.R. (3d) 240 (Ont. C.A.) at para. 56.

207 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.) at paras. 57-61, it was recognized by the Supreme Court and stated by Justice Deschamps that the CCAA is skeletal in nature and does not contain a comprehensive code that lays out all that is permitted, that the incremental exercise of judicial discretion with respect to the CCAA has been adapted and has evolved to meet contemporary business and social needs and that when large companies encounter difficulty and reorganizations become increasingly complex, CCAA courts have been called upon to innovate accordingly.

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208 In this case, insolvency practitioners, academics, international bodies, and others have watched as Nortel's early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation. [19] The costs have well exceeded $1 billion. A global solution in this unprecedented situation is required and perforce, as this situation has not been faced before, it will by its nature involve innovation. Our courts have such jurisdiction.

209 It is a fundamental tenet of insolvency law that all debts shall be paid *pari passu* and all unsecured creditors receive equal treatment. See *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2005), 74 O.R. (3d) 652 (Ont. C.A.) at para. 25, per Blair J.A., *Indalex Ltd., Re* (2009), 55 C.B.R. (5th) 64 (Ont. S.C.J. [Commercial List]), at para. 16 per Morawetz J. and my comments in *Nortel Networks Corp., Re* (2014), 121 O.R. (3d) 228 (Ont. S.C.J. [Commercial List]) at para.12. A pro rata allocation in this case goes partway towards such a result.

210 According to the various protocols, the task in this proceeding is to determine the amount that is to be allocated to each of the Canadian, U.S. and EMEA Debtors' Estates. I do not read the protocols or the IFSA as precluding a pro rata allocation. While payment to the Selling Debtors is to be made from the $7.3 billion in the lockbox funds, neither the protocols nor the IFSA determine how the allocation is to be made.

211 Directing a pro rata allocation will constitute an allocation as required. Once the lockbox funds have been allocated, it will be up to each Nortel Estate acting under the supervision of its presiding court to administer claims in accordance with its applicable law. A pro rata allocation can be achieved by directing an allocation of the lockbox funds to each Debtor Estate based on the percentage that the claims against that Estate bear to the total claims against all of the Debtor Estates.

212 It is argued that a pro rata allocation would constitute an impermissible substantive consolidation of the Estates, or as put by the U.S. Debtors, an impermissible "global substantive consolidation". I do not agree. A pro rata allocation in this case would not constitute a substantive consolidation and, even if it did, it would in my view be permissible within established case law.

213 In a liquidation or reorganization of a corporate group, the doctrine of substantive consolidation has emerged in order to provide a mechanism whereby the court may treat the separate legal entities belonging to the corporate group as one. In particular, substantive consolidation allows for the combination of the assets and liabilities of two or more members of the group, extinguishes inter-company debt and creates a single fund from which all claims against the consolidated debtors are satisfied. In effect, under substantive consolidation, claims of creditors against separate debtors instantly become claims against a single entity.

214 A pro rata allocation in this case would not constitute a substantive consolidation, either actual or deemed, for a number of reasons. First, and most importantly, the lockbox funds are largely due to the sale of IP and no one Debtor Estate has any right to these funds. It cannot be said that these funds in whole or in part belonged to any one Estate or that they constituted separate assets of two or more Estates that would be combined. Put another way, there would be no "wealth transfer" as advocated by the bondholders. The IFSA, made on behalf of 38 Nortel debtor entities in Canada, the U.S. and EMEA, recognized that the funds would be put into a single fund undifferentiated as to the Debtor Estates and then allocated to them on some basis to be agreed or determined in this litigation. Second, the various entities in the various Estates are not being treated as one entity and the creditors of each entity will not become creditors of a single entity. Each entity remains separate and with its own creditors and its own cash on hand and will be administered separately. The inter-company claims are not eliminated.

215 Even if it could be said that a pro rata allocation involved substantive consolidation, which it cannot, I do not see case law precluding it in the unique circumstances of this case international case. Even in domestic cases, CCAA plans involving substantive consolidation are not unknown.

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216 In Canada, neither the CCAA nor the BIA contains express provisions authorizing substantive consolidation. Similarly, the U.S. Bankruptcy Code does not explicitly permit substantive consolidation. However, courts in both jurisdictions have rendered consolidating orders on the basis of their equitable jurisdiction. See *See* M. MacNaughton and M. Azoumanidis, *Substantive Consolidation in the Insolvency of Corporate Groups: A Comparative Analysis, Annual Review of Insolvency Law, 2007*, J. Sarra, ed. (Carswell: 2008). [20]

217 In *Rescue! The Companies' Creditors Arrangement Act*, by Dr. Janis Sarra, Carswell 2007, the grounds for permitting substantive consolidation were described as follows at page 242:

> The court will allow a consolidated plan of arrangement or compromise to be filed for two or more related companies in appropriate circumstances. For example, in *PSINet Ltd.* the Court allowed consolidation of proceedings for four companies that were intertwined and essentially operated as one business. The Court found the filing of a consolidated plan avoided complex issues regarding the allocation of the proceeds realized from the sale of the assets, and that although consolidation by its nature would benefit some creditors and prejudice others, the prejudice had been ameliorated by concessions made by the parent corporation, which was also the major creditor. Other cases of consolidated proceedings such as Philip Services Canadian Airlines, Air Canada and Stelco, all proceeded without issues in respect of consolidation.
>
> Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

218 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), Justice Farley held that a consolidated plan was appropriate, noting that there was significant intertwining of the debtor companies, including multiple instances of inter-company debt, cross-default provisions and guarantees and the existence and operation of a centralized cash-management system. All of these features were present in Nortel.

219 In *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]), Justice Farley noted that a plan of arrangement based on substantive consolidation avoided the "complex and likely litigious issues" that could result from the allocation of the proceeds of the sale of substantially all of the debtor companies' assets. He also noted that the consolidated plan reflected the intertwined nature of the debtors and their operation. In that case, Farley J. stated that the overall effect of a consolidation was required:

> In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C.S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect.

220 In *Northland Properties Ltd., Re* [1988 CarswellBC 531 (B.C. S.C.)], a case involving a proposed plan for several companies that operated as a single entity, Justice Trainor considered the tests for permitting a substantive consolidation. He looked to U.S. law for guidance and began his analysis by adopting the balancing test articulated in *Baker & Getty Financial Services Inc., Re*, 78 B.R. 139 (U.S. Bankr. N.D. Ohio 1987):

> The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether "the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition".

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221 Trainor J. then went on to list seven factors which had been developed to assist in the balancing of interests. Those factors were:

1. difficulty in segregating assets;

2. presence of consolidated financial statements;

3. profitability of consolidation at a single location;

4. commingling of assets and business functions;

5. unity of interests in ownership;

6. existence of intercorporate loan guarantees; and

7. transfer of assets without observance of corporate formalities.

222 In considering these factors, it is clear beyond peradventure that Nortel has had significant difficulty in determining the ownership of its principle assets, namely the $7.3 billion representing the proceeds of the sales of the lines of business and the residual patent portfolio. This amount constitutes over 80% of the total assets of all of the Nortel entities [21] . This issue has taken several years of litigation and untoward costs in the parties attempting to establish an entitlement to it. As the MRDA does not govern how the sales proceeds are to be allocated, there is no one right way to separate them. It cannot be said that there is no question which entity is entitled to the sale proceeds or in what amount. It is clear that these assets are in the language of Dr. Janis Serra "so intertwined that it is difficult to separate them for purposes of dealing with different entities".

223 Moreover, the evidence in this case is clear and uncontested that Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP through integrated R&D activates that were global in scope.

224 When consolidation occurs, some creditors may be prejudiced if they would have had a greater recovery of so many cents on the dollar against their debtor if there had been no consolidation. Conversely, other creditors may be benefitted by consolidation if they would have had a lesser recovery against their debtor if there had been no consolidation. In this case, even if a pro rata allocation amounted to a consolidation, the issue would be moot because it cannot be said that without consolidation one class of creditors, including the bondholders, would necessarily have had a greater recovery than with consolidation. The reason for this is that there has been no recognized measurable right in any one of the selling Debtor Estates to all or a fixed portion of the proceeds of sale.

225 The bondholders who hold bonds with covenants of both NNL and NNI contend that they would be unduly prejudiced by a pro rata allocation of the lockbox funds as they are entitled to look to both NNL and NNI for payment of their claims and if one of these companies did not have sufficient funds to pay the bonds in full, they could look to the other. I agree that they are entitled to claim against both companies and this will be recognized in the pro rata allocation that will be ordered.

226 The bondholders have the legal right to be paid in full on their bonds. But so do all of the other creditors. Like the pensioners and other creditors, the bondholders are not secured. Because of a shortfall in funds, all of these creditors cannot be paid in full. The issue is how the pain is to be shared.

227 The total cash on hand in the U.S. Debtors' and Canadian Debtors' Estates as of June 2014 was a little over 25% of the face amount of the outstanding bonds. Without an allocation from the lockbox funds of a sufficient amount to

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enable NNL and NNI to pay the bonds in full, the bondholders could not be paid in full. The bondholders, however, have no covenants in their bonds requiring the lockbox funds to be allocated in any manner, and specifically, no right to have lockbox funds allocated to NNL or NNI. Nor do NNL or NNI have any such rights. The lockbox funds are not the property of any one of NNL or NNI or any other RPE.

228 The bondholders are like other creditors in this regard. The other creditors of the Canadian Debtors could likewise argue that they will be prejudiced if the argument of the Monitor that all of the IP proceeds should be paid to NNL as the owner of the IP is not accepted. But the prejudice to be considered is not this kind of prejudice, but prejudice to legal rights. Neither the bondholders nor the other creditors of the Canadian Debtors have any legal right to have the lockbox funds allocated in a way that will benefit them.

229 The bondholders with covenants of NNL and NNI contend that their expectations will be disregarded by a pro rata allocation and that it will harm the bond markets if they are not somehow paid in full. I think this argument is overblown in this case and in any event not supported by any evidence of their expectations.

230 The evidence of Peter Currie, the CFO of NNC and NNL from 2005-2007, which is not contested, was that until the early to mid-2000s, Nortel's public debt was issued by NNL without guarantee from any other Nortel entity. In 2006, while Nortel's credit rating was still adversely affected by various factors, NNL issued notes having an aggregate principal amount of US$2 billion, which notes were conditionally guaranteed by NNI. NNI was a conditional guarantor in large part because at that time it carried certain hard assets on its balance sheet and because Nortel could obtain slightly better debt terms given that NNI was domiciled in the same place as the ultimate lenders, that is, the United States.

231 Thus it is quite clear from the evidence that when Nortel went to the bond market in 2006 and 2007 to raise funds, Nortel believed that it required the covenant of NNI in order to get the financing on terms and at a cost that Nortel wanted. However, prior to the Nortel insolvency in January, 2009, the market place did not differentiate in any material way the bonds that were guaranteed by NNI and the bonds not carrying a NNI guarantee.

232 From June, 2006 to December, 2008, Moody's and DBRS issued nine credit ratings for Nortel that did not distinguish between Nortel bonds guaranteed by NNI and those that were not. The UCC's expert witness Robert Kilimnik [22] agreed on his deposition that if a guarantee is a risk differentiator from DBRS's point of view, and there were a series of bonds with a guarantee and a series of bonds without a guarantee, he would expect them to be rated differently. This is an indication that the market did not differentiate between the NNC bonds guaranteed by NNI from those that were not guaranteed.

233 Another indication is the evidence of the Nortel bond spreads compared to U.S. government bonds contained in Ex. 58. The chart demonstrates that that Nortel bonds that carried an NNI guarantee traded at higher or equal spreads to Nortel bonds that did not carry an NNI guarantee. Mr. Kilimnik, an experienced bond trader, said on his deposition testimony was that bonds with a lower spread are considered less risky in the marketplace and that if guarantees were recognized by creditors as reducing the risk of issuances by the same company, he would have expected to see that expectation reflected in spread comparisons.

234 Mr. Paviter Binning, the Executive Vice-President and CFO of NNC from 2007 to March 2010 and an impressive witness to be sure, agreed with that conclusion of Mr. Kilimnik and testified that the data implied that the market was giving no value to the guarantees. He also testified that in his experience, investors generally looked to the overall quality of the company and that the guarantees were neither here nor there. He agreed that part of the reason why the guarantees may have had no meaning for the market was that the bonds were sub-investment grade in the first place. His evidence, which I accept, means that after the bonds were issued, the guarantees by NNI did not have a material effect on the marketplace.

235 John McConnell, a professor of business (finance) at Purdue University, delivered a report and testified on behalf the unsecured creditor's committee of NNI in response to a report of Leif M. Clark and Jay L. Westbrook, the latter

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of whom did not testify at the trial. Professor McConnell's report contained data from the date that the Nortel Group filed for protection on January 14, 2009 to January 2014 which indicated that the bonds not guaranteed by NNI traded at prices below the bonds guaranteed by NNI.

236 I do not see this data as relevant. Counsel for the bondholders in his opening asserted that the expectations of bondholders that are relevant are the expectations pre-petition and not post-petition.

237 If the expectations of those who purchased bonds post-petition were relevant, there was no evidence at all from such purchasers. Professor McConnell spoke to no bondholder and on cross-examination admitted that he had no way of knowing what factors went into the purchase and/or sale of any of the Nortel bonds by any of the current bondholders in the market post-filing. No bondholder testified or gave any evidence of expectations in acquiring bonds.

238 The evidence of Professor McConnell is based entirely on the fact that after the insolvency filings, bonds without a NNI guarantee traded at a lower price than those with a NNI guarantee. There are two points that can be made. The first is that his conclusion is an inference drawn from the trading price of the bonds after the insolvency as to what motivated those purchasers of the bonds after the insolvency. Second, there was no analysis of Professor McConnell that would lead to the conclusion that his inference of bondholder purchaser expectations could apply to purchasers of bonds prior to the onset of insolvency. He said he could not do such an analysis because before insolvency the bonds had different attributes which would not permit him to draw inferences as to the effect of guarantees. Be that as it may, I would not accept the inference drawn by Professor McConnell regarding the effect of the guarantees on a purchaser of bonds. I prefer the evidence of Mr. Binning to which I have referred. [23]

239 Moreover, the evidence is clear that bonds trade on a much different basis after insolvency. Mr. Binning testified that prior to the threat of insolvency, the bonds traded on a yield to maturity basis, meaning that bondholders take all of the payments that would be expected to be made if the bond is held to maturity, and then calculate a percentage yield based upon the price paid for the bonds. Once insolvency or financial distress is anticipated, Mr. Binning testified that bonds trade in the hands of distressed investors who trade not on a yield to maturity basis but in a classic arbitrage market based upon price and expectations of future price and what they think they can make on the bonds during insolvency. He advised the board of Nortel on September 30, 2008, three and a half months before the Nortel filing, that RBC had advised that approximately 50% of the bonds had traded into the hands of distressed investors.

240 Professor McConnell also testified that as new information came into the marketplace about the likely recoveries, that would be reflected in the price of the bonds. That is another way of saying that distressed investors have bet on the future outcome of this case. This is reflected in the volumes and trading prices of the bonds at various times between January 14, 2009 and June, 2014, including (i) in the immediate aftermath of the Filing Date when the bonds were trading at very low prices, (ii) during the prolonged three-day auction resulting in the residual IP sale to Rockstar at the beginning of July 2011 as purchasers placed bets on bond price increases and recoveries following the completion of that sale; and (iii) in reaction to Delaware Bankruptcy Court Judge Walrath's September 2011 decision in *In re Washington Mutual* holding that post-petition interest must be awarded at the federal judgment rate and not at the rates in the various bonds.

241 The bondholders group that at the time of the trial held a majority of the unsecured guaranteed bonds purchased the vast majority of their holdings after the filing date of January 14, 2009 and at a significant discount to par. Certain members purchased when the bonds were trading at as low as 30 cents on the dollar and others received smaller, but still substantial, discounts. This can be seen in exhibits 59 and 60. The vast majority of their collective holdings were acquired in the period between July 31, 2009, at or around the time when Nortel began to liquidate its assets, and July 18, 2011, at or around the time of the Residual IP Sale.

242 The creditor expectations of the current bondholders, who acquired their bonds post-petition, even if known or supported by evidence, is not something I would take into account in this case. I infer from the evidence that any such expectations would have been based on their views as to litigation outcomes and should not be the basis of any decision by the courts.

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243 In considering potential prejudice to the bondholders in the event of a pro rata allocation, consideration must be given to what the bondholders would gain. The bonds provide access to the assets of the issuer and guarantor. They do not provide any right to assets of any other entity in the Nortel Group. The 2006, 2007 and 2008 offering memoranda for the guaranteed bonds set out risks associated with the bonds, including the following notice regarding the lack of access to other Nortel entities:

> The Issuers' subsidiaries are separate and distinct legal entities and any subsidiary that is not a Guarantor will have no obligation, contingent or otherwise, to pay amounts due under the Notes or the Guarantees or to make any funds available to pay those amounts, whether by dividend, distribution, loan or other payment.

244 The offering memoranda also contained the following risk that investors would face in the event of insolvency of Nortel entities and the lack of access to the assets of those entities:

> In the event of a bankruptcy, liquidation or reorganization of any direct or indirect non-guarantor subsidiary of NNC, all of the creditors of that subsidiary (including trade creditors and creditors holding secured or unsecured indebtedness or guarantees issued by that subsidiary) and third parties having the benefit of liens (including statutory liens) against that subsidiary's assets will generally be entitled to payment of their claims from the assets of such non-guarantor subsidiary before any of those assets are made available for distribution to any Issuer that is a shareholder of such subsidiary. As a result, the Notes and the Guarantees are effectively junior to the obligations of non-guarantor subsidiaries.

245 Whereas the investors who acquired their bonds pursuant to the offering memoranda were specifically made aware that in the situation in which Nortel now finds itself, they would not have access to assets of other Nortel entities that had not guaranteed the bonds, the effect of a pro rata allocation is to provide the current bondholders with such access. The lockbox funds represent the proceeds of sale of all of the assets of all of the 38 entities under the IFSA. Creditors holding guarantees have access under a pro rata allocation to not only the assets of the principal obligor and guarantor corporations, but the proceeds of sale of all the assets of the selling debtors. This is access to more pools of asserts than that for which the holder of a guarantee bargained.

246 While the current bondholders may have thought, or bet on an outcome, that NNL or NNI would likely achieve a win in this litigation that would provide those two companies with sufficient assets to pay the bonds in full and with post-filing interest, there was no guarantee at all that this would be achieved. The bonds contained no covenants that required the assets of NNL or NNI to be maintained at a certain level and no covenants that required the lockbox funds to be allocated in any manner. Mr. Binning had advised the Nortel board in September, 2008 that there were no maintenance covenants in the bonds, meaning that Nortel did not have to live up to any debt servicing ration. He testified that what the guarantees under these bonds essentially gave the bondholders was access to the assets in Canada and in the US without a great degree of comfort as to what those assets would be from time to time. I accept that evidence.

247 As to the effect of a pro rata allocation on the ability of issuers to issue bonds in the future, Professor McConnell on his cross-examination said that he had no opinion on that subject and that he had not tried to quantify what effect a pro rata allocation would have on the capital markets. Thus there is no evidence that a pro rata allocation in this case will detrimentally affect the capital markets and the ability of issuers to issue bonds in the future. Professor McConnell's statement that he had no opinion on the subject is perhaps not too surprising taken the highly unusual facts surrounding the Nortel insolvency and the difficulty of determining ownership of the IP that was sold.

248 It is said that the $2 billion claim of NNI against NNL that was approved by both courts is an impediment to a pro rata allocation. I do not think that is the case. The $2 billion claim will be treated as one of the unsecured liabilities of NNL.

249 The same principles that apply to the US$ 2 billion claim by NNI against NNL will apply to the admitted claim of NNUK and Nortel Networks SpA against NNL pursuant to the Agreement Settling EMEA Canadian Claims and

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Related Claims dated July 9, 2014, and to the claim of the UKPC for £339.75 million recognized in my judgment of December 9, 2014.

Appropriate pro rata allocation method

250 The allocation each Debtor Estate will be entitled to receive from the lockbox funds is the percentage that all accepted claims against that Estate bear to the total claims against all Debtor Estates.

251 In determining what the claims against a Debtor Estates are, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once. The one that is known is the bondholder claim for $4 billion, referred to as the claim on cross-over bonds. All but one of such bond issues was issued by NNC or NNL and guaranteed by NNI. One bond issue for $150 million was issued by NNCC, a subsidiary of NNI, and guaranteed by NNL [24] . The claims on the bonds in determining the claims are to be made on the Debtor Estate of the issuer. If a claim on a guaranteed bond is not paid in full by the issuer Debtor Estate, a claim for the shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates.

252 One of the known claims is the claim of the UKPC for the approximately £2.2 billion deficit in the NNUK pension plan. If the UKPC makes a claim for this amount against NNUK and also against other EMEA Debtors, those claims against the other EMEA Debtors will not be taken into account in determining the claims against the Debtor Estates. The claim may be taken into account only once in the pro rata allocation.

253 I understand that for the Canadian Debtors and the U.S. Debtors, the claims for the most part are generally known although there are some claims still unresolved, such as the SNMPRI claim. The U.K. Administrator has not yet instituted a claims procedure, apparently awaiting a determination of this allocation proceeding. In my view, the process should be undertaken now and I expect this will happen.

254 Interim distributions have been proposed. In my view, this would be especially important for the predominantly elderly pensioner population and disabled employees who have endured hardship as a result of the loss of their benefits but also for other creditors who have waited more than five years for a distribution on their claims. An interim distribution should be made if possible.

255 Briefs should now be filed by those parties supporting an interim distribution with full details of what is requested. Opposing briefs would of course be required. The procedures and timing could be discussed at a 9:30 am appointment.

Allocation on a basis other than pro rata

256 The evidence on this subject was complex and varied dramatically from party to party. To wit:

(a) The Monitor on behalf of the Canadian Debtors contended for an allocation of $6.034 billion to the Canadian Debtors, $1.001 billion to the U.S. Debtors and $300.7 million to the EMEA Debtors. [25]

(b) The U.S. Debtors contended for an allocation of $0.77 billion to the Canadian Debtors, $5.3 billion to the U.S. Debtors and $1.23 billion to the EMEA Debtors.

(c) The EMEA Debtors contended for an allocation of $2.32 billion to the Canadian Debtors, $3.636 billion to the U.S. Debtors and $1.325 billion to the EMEA Debtors.

257 I have given consideration to the valuation issues. To a great extent, they are dependent on the various interpretations of the MRDA asserted by the parties. For that reason I would not use any of the valuations for the purpose of the pro rata allocation as I have found that the MRDA does not govern the allocation. However, my views

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and findings on the valuations are set out in Appendix A for the business line sales and Appendix B for the residual IP sale to Rockstar.

Conclusion

258 A judgment is to go that the lockbox funds are to be allocated on a pro rata allocation basis with the following principles to govern:

> (1) Each Debtor Estate is to be allocated that percentage of the lockbox funds that the total allowed claims against that Estate bear to the total allowed claims against all Debtor Estates.
>
> (2) In determining what the claims are against the Debtor Estates, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once in accordance with these reasons for judgment. Claims on bonds are to be made on the Debtor Estate of the issuer. A claim for any shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates. If the UKPC makes a claim against more than one Debtor Estate, such additional claims will not be taken into account in determining the claims against the Debtor Estates.
>
> (3) Intercompany claims against a Debtor Estate are to be included in the determination of the claims against that Estate.
>
> (4) Cash on hand in any Debtor Estate will not be taken into account in the pro rata allocation. Each Debtor Estate with cash on hand will continue to hold that cash and deal with it in accordance with its administration.
>
> (5) An interim distribution may be allowed upon further submissions. Briefs in favour of and opposed to an interim distribution are to be filed on a time-line to be considered at a 9:30 am appointment.
>
> (6) Proposed schedules for expediting any remaining claims procedures are to be provided without delay.

Epilogue

259 I cannot leave these reasons without commenting on the persons who made this unique case possible.

260 First, to the technical staff who provided the facilities to permit this trial to be conducted in two different countries at the same time, I say it was a job more than well done. It was outstanding and we are indebted to you all. Judge Gross and I have no idea how it was all set up and operated, but I know he is as grateful for the facilities as I am. Thank you.

261 Second, to the reporters and their staff, it was also a job more than well done. Apart from the instantaneous real time reporting that permitted all parties to see the evidence as it was being given, we were blessed with draft transcripts being electronically sent to us shortly after the evidence concluded each day and final transcripts later that evening.

262 Third, to the lawyers. We were blessed with outstanding counsel on both sides of the border. In a case such as this with the amount at stake, one can understand the pressures on counsel and how those pressures could get in the way of a smooth preparation and presentation of the case. From what I could see, all acted in a professional manner that does them credit. Without that, the case could not have proceeded as well as it did. Their staff should also be congratulated for the smooth way in which the case was electronically presented. It was a marvel.

263 Finally, I want to thank Judge Gross for his courtesies and good humour. It has been a pleasure to work with him. Without such a good relationship and the trust that we developed for each other, this trial and its conclusion would not have been possible.

Order accordingly.

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Appendix A

Allocation of the proceeds of the line of business sales

The experts for the various parties differ on the way that the proceeds of the sales of the LOB should be allocated amongst the Canadian estate, the U.S. estate and the EMEA estate.

Mr. Kinrich, the valuer called by the U.S. Debtors, did not value the various assets sold and attempt to allocate them by any particular method. Rather he allocated the entire sale proceeds by taking the revenues of each company whose businesses were sold and allocating to each company (and the group they were in) the percentage of its revenues to the total revenues of all companies whose businesses were sold. His resulting allocation was 11.9% or $340 million to the Canadian Debtors, 18% or $510 million to the EMEA debtors and 70% or $1.99 billion to the U.S. Debtors.

Mr. Malackowski called by the EMEA debtors valued the IP rights sold by using a revenue or license valuation method. His valuation of the IP sold in the business sales was $765.2 million.

Mr. Huffard called by the EMEA debtors then allocated the various kinds of assets sold. He valued the tangible assets that were sold at $118 million and allocated this amount to the companies that sold them. He allocated the IP that was sold and valued by Mr. Malackowski at $765.2 million by a contribution approach which allocated the IP according to the amount of R&D expenditures of each of the RPEs. He attributed the balance of the LOB sale proceeds as "customer related assets and goodwill" and allocated them on the basis of the percentage of revenues generated by each entity in 2008. Mr. Huffard did not give a separate total figure in his report for the allocation of the LOB sale proceeds.

Mr. Green called by the Canadian Debtors dealt with each kind of the various assets sold. He allocated the tangible assets sold by giving to the companies that sold them their book value, which he calculated to be $534.19 million. He valued the workforces sold by their cost that the selling companies would incur to replace them at $255.33 million and allocated those costs to the companies. He allocated the IP and customer relations by valuing what the licensed participants gave up to enable the sales on the basis that their license rights were limited to the "Products" "by or for the Participants" as defined in the MRDA, and allocated the balance of the sale proceeds to NNL as the "owner" of the IP. His resulting allocation was 54.8% or $1.58 billion to the Canadian Debtors, 10.4% or $300.97 million to the EMEA debtors and 34.7% or $1001.5 billion to the U.S. Debtors.

(i) Mr. Kinrich

Mr. Kinrich's view is that the RPEs that were licensed participants had all license and sublicense rights as owners. Assuming that to be the case for this analysis, I have some concerns with his analysis. Mr. Kinrich allocated all of the assets sold in the business sales on a revenue basis. He stated in his report that the value of the sold assets is reflected in the revenue generated by each entity that sold the assets. That is, value he said was reflected in revenue figures.

Mr. Kinrich himself in his report said that financial economists agree that a discounted cash flow analysis is the preferred technique for asset valuation and that one of the requirements is to have projected future cash flows less costs. In his report he did not say why he had not done such an analysis when dealing with the business sales. At trial he relied on texts to support his use of a revenue approach in firms with losses, one of which is *Valuing Small Businesses and Professional Practices*, which suggests gross revenue multiples may be used in restricted situations, being to approximate a range of possible values with a minimum effort, conclude an estimate of value when other data are unavailable or inadequate or as one indicator of value used in conjunction with more rigorous valuation methods. The text also said that for companies with losses or erratic earnings, multiples of price to revenue for other comparative companies may give some indication of how others asses the future of the industry or profession. But that is not what Mr. Kinrich did. He did not look at revenue multiples from the sale of any comparable companies. I viewed his attempt to bolster his revenue approach by resort at trial to texts to be an attempt at *ex post facto* rationalization. It would have been a little more persuasive if these

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rationales has been provided in his report, particularly as in his report he did a sensitivity check based on gross margin (revenue less cost of goods sold) and contribution margin (revenue less selling, general and administrative expenses).

Mr. Kinrich said at trial that he did not have available forecasts that would divide income streams by territory but that is beside the point so far as a gross revenue valuation is concerned. The issue is whether it would have been preferable to take costs into account in his revenue approach to allocation.

Because the U.S. market had the highest revenues, it follows that using a revenue approach as Mr. Kinrich did will result in the high allocation of the business sale proceeds to the U.S. (70%) and a low allocation to Canada (11.9%). However, because revenue does not consider costs, this result ignores the way in which Nortel operated as a matrix structure and the reliance by all operating areas, including the U.S., on IP generated by R&D elsewhere. The 2009 revenue that Mr. Kinrich used in his analysis to compare revenues, the basis of which was assumed license rights under the MRDA, was subject to the obligation in the MRDA to make payments pursuant to the RPSM measured by R&D expenditures of each RPE. Mr. Kinrich did not take into account.

Mr. Kinrich acknowledged on his cross-examination that while he assumed that the set of license rights as he saw them would continue in the future to exist, he gave no effect to sharing obligations that might arise under the MRDA, his reason being that he understood that the sharing provisions did not apply to sales proceeds. That in my view was no answer. What he undertook was to determine the relative value surrendered by each of the selling entities, including the RPEs. To determine the value of rights of each of the RPEs without taking into account the RPSM sharing obligations failed to properly determine relative values among the RPEs. I accept the opinion of others, including Dr. Bazelon and Mr. Green, on the point. The various businesses in Nortel historically operated on varied operating margins.

Mr. Green pointed out, with reference to texts including those that Mr. Kinrich referred to at trial, that a disadvantage of focusing on revenues is that it can lull one into assigning high values to firms generating high revenue growth while losing money and that the method assumes that the businesses are equally profitable. His view was that a revenue based allocation was inappropriate in a matrix structure such as Nortel with interrelated operating businesses in which certain entities bore disproportionate shares of expenses like R&D which would be ignored.

EMEA and the UKPC contend that Mr. Kinrich should not have used 2009 revenue figures as 2009 was an anomalous year for Nortel. Nortel filed for insolvency protection in January 2009 and from then on was operating under the supervision of courts in Canada, the US, the UK, and elsewhere. Throughout 2009, Nortel was actively engaged in selling its businesses, signing seven out of eight of its sale agreements in that year. All of this affected its ability to generate revenues. Four of the business sales were concluded before the year's end. Because of these dispositions, complete financials for 2009 were not even available for certain businesses and revenues had to be estimated based upon performance prior to the sale closing date.

Dr. Bazelon's evidence was that NNI's share of global revenue plateaued by 2008 at about 65% but in 2009 it increased by about 4%. In my view, EMEA and the UKPC have a valid point. 2009 was not a typical year for Nortel. While NNI contends that 2009 resembles the weighted average over the years 2001 to 2008, but that ignores the steadily declining trend from NNI having 74% in 2001 to about 65% in 2008. Using 2009 for his revenue analysis was overly aggressive. The effect was to shift about 4%, or $100 million, from EMEA to the U.S. Debtors.

(ii) Mr. Malackowski and Mr. Huffard

The allocation of the proceeds of the LOB sales on behalf of the EMEA Debtors is based on the evidence of Mr. Malackowski who valued the IP sold at $765.2 million and on the evidence of Mr. Huffard who allocated all of the sales proceeds using different methods for each type of asset sold. There are problems with the EMEA allocation.

Mr. Malackowski used a discounted cash flow analysis to value the IP. He said there was a defensive component and a synergistic component to the IP. To measure the defensive component, he took the revenue forecasts of Nortel in the "deal books", market derived growth rates, and royalty rates from an IPCo model. For a discount rate he used an average

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of weighted average cost of capital rates of the industry in which the Nortel business operated. To measure the synergistic component, he used revenues of a hypothetical market participant for each line of business sold, market derived growth rates, and royalty rates derived from what he said was the implied rate paid by Ericcson as a member of the Rockstar consortium. He added 15% to the discount rate used in his defensive component.

Mr. Malackowski's valuation of the IP sold at $765.2 million, if accepted, means that the IP represented roughly 25 % of the total sales proceeds of $3.1 billion. Yet, the evidence is overwhelming that IP created by Nortel's R&D was the driver of the profitability of the business. Even Mr. Huffard view was that within Nortel, IP was considered the driver of revenue in each of the businesses and purchasers of the businesses would have considered the acquisition of IP as a critical aspect. Mr. Britven, an expert called by the CCC, arrived at figures based on the purchase price allocations made by the purchasers that stated what the purchasers considered the fair value of the various acquired assets to be. Those figures put the percentage of the IP of the total business sale proceeds at 40%.

In his rebuttal report, Mr. Malackowski in an attempt to show the size of what he considered to be a windfall if the position of Mr. Green were accepted, said that all of the Nortel the IP in total in the hands of Nortel could be worth $10.4 billion, of which he allocated $3.761 to the business sales and $6.6 billion to the residual sale to Rockstar. His reason for this extra value in his report was that some of the residual IP sold to Rockstar was encumbered by the non-exclusive licenses given to the purchasers of the lines of business. Rockstar paid $4.5 billion. If Mr. Malackowski's figures are right, it means that the non-exclusive licenses given to the purchasers of the lines of business reduced the value of the residual IP sold to Rockstar from $6.6 billion to $4.5 billion, or by $2.1 billion. That reduction in value to Rockstar attributed to the non-exclusive licenses granted in the business sales means that those non-exclusive licenses were worth $2.1 billion, and it does not make sense that Mr. Malackowski valued both the outright licenses and the non-exclusive licenses given to the purchasers of the lines of business at only $765.2 billion.

The Monitor points out that the royalty rates used by Mr. Malackowski in establishing revenues to be valued were taken from the IPCo litigation light model and that within that litigation light model he chose the lowest of three rates. He did not use any Nortel intercompany-stated royalty rates. The Monitor suggests that is an explanation why the IP valuation of Mr. Malackowski is too low. For certain the royalty rates charged directly affect the revenues and thus the value obtained by a DCF method of valuation. Whether it is the only reason for the low valuation is another matter. There are many inputs in a valuation.

Mr. Huffard was the expert called by EMEA to opine on the allocation to be made of each component of the business sales. The Monitor is critical of his qualifications. Mr. Huffard is an investment banker with considerable experience advising distressed companies who has "led valuation analyses" for companies and their assets. He holds a Master of Management degree from Kellogg Graduate School of Management at Northwestern University. Mr. Huffard is not accredited as a valuator and said that in the field of investment banking that is typical.

I must say that Mr. Huffard was not forthcoming in his evidence about his experience. When asked if he had done any valuations or the allocating of assets in connection with intellectual property companies, he said several times that he had trouble understanding what an intellectual property company was and asked if Nortel was an intellectual property company. Yet when asked on his deposition whether he had done any valuations or the allocating of assets in connection with intellectual property companies, he answered "Not in connection with intellectual property companies." I think it fair to consider this answer in dealing with his evidence.

Mr. Huffard believed that there were three classes of assets to be valued and examined in the business sales. The first is net tangible assets. The second is the IP. The third is customer-related assets and goodwill not otherwise encompassed in goodwill. Mr. Huffard did not do any valuation exercise for his third class. Rather he just took the balance of the purchase price and allocated it. The values attributed to the first two classes therefore directly affected the value of his third class.

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For the tangible assets, Mr. Huffard took the book values of the assets, which consisted of accounts receivable and prepaid expenses, inventory and fixed assets. This book value in his report totalled $403 million. At trial, in his demonstrative exhibit, his total was $361 million. Why the difference was not explained. From the book values, Mr. Huffard deducted liabilities assumed by the purchasers of the lines of business, the largest of which was deferred revenue. He viewed the assumed liabilities as a fourth asset class that resulted in an increase in the purchase price from the buyer's perspective and a reduction from the seller's perspective. They had to be deducted from the assets and he did this the tangible asset class. This resulted in net tangible assets in his report of $124 million, being $39 million for Canada, a negative $27 million for EMEA, $106 million for the U.S. and $6 million for Asia and the Caribbean. At trial, his demonstrative showed the net tangible assets at $118 million with the same net figures for Canada, EMEA and the U.S. as in his report. How this occurred on the different book values in his report and in his demonstrative was not explained.

For the allocation of the IP, Mr. Huffard took Mr. Malackowski's figure of $765.2 billion. He allocated them amongst the RPEs using Mr. Malackowski's contribution approach using historical R&D spending from 1992 to 2008. His view was that the portions of the sale proceeds attributable to IP were, in effect, a capitalization of future revenues that would otherwise have been shared among the RPEs in accordance with the RPS methodology. This resulted in 40.8% or $312.2 million being allocated to Canada, 42.6% or $326 million being allocated to the U.S. and 16.5% or $126.2 million being allocated to EMEA. In his demonstrative at trial, these percentages were rounded, with 41% to Canada, 43% to the U.S. and 16% to EMEA.

Mr. Huffard then included the balance of the sale proceeds of $2.198 billion into his third class of customer-related assets and goodwill. He did no analyses of the value of either the customer-related assets or of the goodwill and allocated them based on the revenue generated by each entity in fiscal year 2008. He said he did not use net revenues to allocate among the entities because in his view cash flows are influenced by transfer pricing and inter-company arrangements for tax purposes. Based on the revenues alone, he allocated 9.2% or $202 million to Canada, 62.6% or $1.375 million to the U.S., 18.6% or $155 million to EMEA, 2.6% or $57 million to the Caribbean and 7.1% or $155 million to Asia.

While Mr. Huffard did not provide a total for the business sales allocation, by adding up the different classes, his total allocation to Canada was $553.2 million to Canada, $1.807 billion to the U.S. and $254.2 million to EMEA. This is somewhat less than the $2.85 billion available from the business sales proceeds.

As Mr. Huffard did not undertake any valuation of his third residual category, his conclusion of the amount to be included in it is dependent upon the amount of his tangible asset valuation and Mr. Malackowski's IP valuation. If Mr. Mr. Malackowski's IP valuation is too low, then the amount in this residual class allocated by Mr. Huffard will be too high.

There are problems with allocating this residual class entirely by revenues of each company or groupings of companies. Mr. Huffard described it as the value of customer-related assets and goodwill not otherwise associated with IP. He acknowledged that these assets, like any other assets, have their value fundamentally related to their ability to generate profits, and that while Nortel operated the businesses, it was not revenue that allocated those values but the RPS method of sharing profits after revenues and costs were calculated. This is the same criticism made of Mr. Kinrich in using a revenue tool to allocate the sales proceeds rather than a profitability tool.

Mr. Huffard acknowledged that in circumstance where, because of decisions made and cost-effectiveness and historic reasons, sales and customer support was done in a country which had low domestic revenues, his revenue allocation method for the customer-related assets and goodwill category was not going to compensate that country because it had low revenues. This circumstance was commonplace in Nortel with its matrix structure, with customer support carried out in one country for sales in another. He acknowledged if a large percentage of the workforce is in a place like Canada, which does R&D and which does sales support and supports the global organization but doesn't have a large native revenue stream, he was allocating the value of that workforce to the other entities where there is a revenue stream and not to Canada.

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(iii) Mr. Green

Mr. Green valued different asset classes differently. He first valued tangible assets by taking their book value and allocating them to the companies which owned them. This was the same method used by Mr. Huffard. However, different from Mr. Huffard, he did not deduct any deferred liabilities from the tangible asset amount. His evidence was that deferred liabilities are essentially amounts that would be due that are related to projects that have already been billed and perhaps paid for and so they didn't offset the physical assets, the tangible assets such as the accounts receivable, the other things that were sold. He pointed out that by his not deducting deferred liabilities, it was to the relative benefit to the U.S. Debtors because they had the highest deferred revenues and, accordingly, deducting the liabilities would most significantly decrease the U.S. Debtors' share of the value of net tangible assets. He also pointed out in his rebuttal report that not all liabilities recorded on the books of Nortel were assumed by the purchasers and for those that were it was not possible to determine on which entity's books those liabilities were recorded. I accept this position of Mr. Green in not deducting assumed liabilities in valuing and allocating the tangible assets on the basis of book values recorded on each entity's books.

Mr. Green's value for the tangible assets was $534.19 million, and he allocated $121.74 million to the Canadian Debtors, $317.59 million to the U.S. Debtors and $94.86 million to the EMEA Debtors.

Mr. Green next valued the workforce in the lines of businesses that were transferred to purchasers. His opinion was that generally speaking, the cost approach is applied to the valuation of an assembled or in-place workforce. He valued the workforce by calculating the cost to replace the work force. He concluded that the total value of the work force was $255.33 million and he allocated $78.68 million to the Canadian Debtors, $134.74 million to the U.S. Debtors and $41.91 million to the EMEA Debtors.

In the sale of the Enterprise business, several corporate entities owned by NNI were sold. Mr. Green valued these assets based on contemporaneous fair market valuations done at the time these businesses were sold. There is no evidence that these assets had a value other than as set out by Mr. Green. Mr. Green made an allocation to NNI of proceeds attributable to the sale of its subsidiaries in the amount of $110,970,000. No other valuer dealt with this asset.

Mr. Green was of the view that once the tangible assets and the workforce were valued, the balance of the business sale proceeds was attributable to IP, the primary driver of Nortel's value, and customer relationships. He valued and allocated the IP and customer relationships sold in the business sales by valuing the license rights of NNI and the EMEA RPEs surrendered by them to permit the sales to take place on the basis that their licenses were restricted to Products by or for the Participants as defined in the MRDA and as contended by the Monitor. The balance he attributed to NNL as the owner of the IP.

Mr. Green performed a DCF valuation. He projected revenues and expenses for each business sold and for this to project the future revenues of the Nortel businesses he used forecasts prepared by Nortel that were referred to as "Retained by Nortel" forecasts. They projected the revenues that would have been earned and the expenses that would have been incurred, if the operating businesses had been retained by Nortel. After calculating the operating profits of each business sold, Mr. Green aggregated those profits and applied the RPSM on the assumption that the MRDA would have remained in place, using the capital stock percentage for the first quarter of 2010, which covered a rolling average from 2005 to 2009. He applied a discount rate of 12% for the operating profits derived from existing technology and 30% for operating profits to be derived from yet to be invented technology and thus more risky. He concluded that the value of the license rights surrendered by NNI was $438.2 million and by the EMEA RPEs was $164.2 million. The balance of his residual amount, being $1.379 billion was allocated to NNL.

Mr. Green's resulting allocation was 54.8% or $1.58 billion to the Canadian Debtors, 10.4% or $300.97 million to the EMEA debtors and 34.7% or $1001.5 billion to the U.S. Debtors.

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EMEA and the U.S. Debtors contend that a basic problem with Mr. Green's analysis is his conclusion or assumption that NNL was the owner of the IP and entitled to its residual value after deducting the license rights of EMEA and NNI which he limited to Nortel Products by or for the Participants. This is a basic legal issue.

EMEA argues that customer relationships were very important to Nortel and that they should have been valued and allocated separately from IP and not included in Mr. Green's residual category. Mr. Green's explanation for not doing so was that customer intangibles represented historical relationships in which customer files and ongoing agreements exist, the value of which was represented in his revenue figures that he used and were thus subsumed in the IP license rights which he valued. He said that a separate valuation of customer relationships would be duplicative of the values of the license rights surrendered because it would be based on the same revenues and profits as used in the license rights valuation.

Mr. Malackowski argued that the MRDA did not transfer customer relationships to NNL. This does not strike me as a valuation concept and one can argue, as the Monitor does, that NN Technology was owned by NNL and it included all intangibles.

This is a valuation issue. There is no question that customer relationships were important to Nortel. However that is not the issue. The issue is how to value them. Mr. Berenblut was of the opinion that customer relations were co-mingled with IP rights because the value to use them depended on the ability to sell Nortel products and that their value would be included in the value of rights to sell Nortel products. Dr. Bazelon, an EMEA expert, agreed on cross-examination that goodwill and customer relationships are entangled with the IP and take their value from the IP, at least in part. Brian McFadden, the Chief Technology Officer at Nortel for some time, said that R&D was crucial in initiating relationships with and developing sales from customers for Nortel products. I accept Mr. Green's opinion that no separate valuation needed to be made for customer relationships.

It is also argued that Mr. Green should have separately valued and allocated goodwill. Mr. Huffard included goodwill in his residual class, although he did not attempt to value it. Mr. Britven, called by the CCC, included a value for goodwill in his business sales analysis. He took what the purchasers had allocated in their PPAs as goodwill, and referred to it as Purchaser Goodwill.

Mr. Green's response to this is that Nortel wrote off all of its acquired goodwill at the end of 2008. This indicated that, at the time, Nortel management did not believe it would be able to realize the value of the goodwill from these acquisitions in the future. As for its own "internal goodwill," Nortel was suffering losses from its operations and was not generating positive cash flows. Thus, from an accounting and finance perspective, Nortel had no goodwill from its own operations. By classifying the residual value as goodwill, Mr. Huffard accounted for an asset that did not exist within Nortel and was not transferred to the buyers. By applying the buyer's perspective, Mr. Huffard failed to answer the question of how to allocate the sales proceeds according to the value of the interests each of the Debtors transferred and rights each of them relinquished.

There is actually support for Mr. Green's position in Mr. Britven's report in which he included a value for goodwill taken from the purchasers' PPAs. These purchaser allocations are done by purchasers for accounting purposes and usually are driven in part at least by tax considerations. Mr. Britven said that Nortel wrote off the value of substantially all of the goodwill that it had on its balance sheet. He said that Nortel did not have sufficient value to support any significant goodwill value and that the goodwill in the business sales related to the attributes of the buyer, not the attributes of Nortel. He said that any goodwill recognized by purchasers in their PPAs did not reflect amounts that could have been realized by the licensed participants through the continued operations of their lines of business.

I agree with Mr. Green's approach to goodwill and accept his opinion that there was no goodwill value in the Nortel businesses that were sold.

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Regarding the DCF method used by Mr. Green to value the U.S. and EMEA license rights, Mr. Kinrich was critical of the revenue forecasts used by Mr. Green and stated that he had not followed the International Financial Reporting Standards which state that in measuring value in use, an entity shall base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the useful life of the asset.

This IFRS material was not put to Mr. Green on his cross-examination, which it should have been for this argument to be made. However, I do not think the criticism is justified. Mr. Green used projections made by Nortel. He used projections referred to as a "Retained by Nortel" scenario which projected what revenues and expenses would be either retained by Nortel or spun-out on its own as a stand-alone company. He declined to use Nortel's "Safe Hands" projections for several reasons that he explained, including the fact that they forecasted the businesses in the hands of a well-capitalized third party who could invest adequate capital in the business and who could earn greater profits than if they remained in Nortel's hands. Mr. Green did no DCF analysis as he allocated the business sales solely on revenues.

Mr. Kinrich was also critical of Mr. Green for not including a terminal value in his DCF valuation. Mr. Green's explanation for this on his deposition was that in his present value analysis, at year nine the present value factors were close to zero. So even if there were a terminal value, it would be virtually of no value in a present value computation. In his report, he said he thought that to include potential profits after nine years was too speculative. There is no competing DCF valuation to indicate what Mr. Green did was wrong.

Mr. Green's analysis in part is dependent on the interpretation of the MRDA advanced by the Monitor on behalf of the Canadian Debtors. One cannot quarrel with the logic of it if that interpretation were to govern the allocation.

Appendix B

Residual IP proceeds allocation

The residual IP was sold to Rockstar for $4.5 billion. After payment of a break fee and expense reimbursement to Google, the remaining net proceeds held for allocation amount to $4.45 billion.

There is differing expert opinion as to how to allocate the proceeds of the Rockstar sale amongst the Canadian debtors, the U.S. debtors and the EMEA debtors.

Mr. Green allocated the proceeds on the basis of his interpretation of the MRDA under which it was NNL that owned all of the patent rights that were sold to Rockstar.

Mr. Kinrich for the U.S. debtors allocated the proceeds on a revenue approach on the basis that each Participant owned all of the economic rights to the patent rights sold to Rockstar in their exclusive jurisdictions and that their revenue streams that they gave up should be valued. Mr. Green as an alternative analysis for the Canadian debtors and Mr. Malackowsi as an alternative analysis for the EMEA debtors prepared valuations correcting what they saw as errors by Mr. Kinrich.

Mr. Malackowski allocated the proceeds on a contribution basis by calculating what he saw as the contributions by each of the Participants to R&D over the life of the patents that were sold to Rockstar.

(i) Mr. Kinrich's license approach to value

Mr. Kinrich assumed that each of NNL, NNI and the EMEA debtors owned all of the economic benefits of the residual IP. He allocated all of the Rockstar proceeds to NNL, NNI and EMEA by taking what he said would be the revenue earned in each of those three geographical areas and then doing what he said was a discounted cash flow analysis ("DCF") on those revenue streams. I have held that the Licensed Participants did not own all of the economic benefits of the residual IP. However, on the assumption that they did, I will consider Mr. Kinrich's analysis.

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Mr. Kinrich obtained his revenue streams by taking one of the IPCo revenue model assumptions. He then apportioned the net revenues after costs and taxes to each of the three geographical areas by using those countries' relative telecom infrastructure expenditures for six of the eight IPCo franchises that Nortel had and apportioning all of the net revenues after costs and taxes for two of the franchises (PC and Internet advertising) to the U.S. He then applied a discount rate to those net cash flows allocated to each country.

I have considerable difficulty with a number of aspects of Mr. Kinrich's analysis. If the value of the net cash flows as stated by Mr. Kinrich is overstated, the overstated amount would belong to NNL, as the amount of the sales proceeds from the Rockstar transaction would represent more than the value of the net cash flows, which on Mr. Kinrich's assumption is what the Licensed Participants gave up in the Rockstar sale. The expert evidence called by the Monitor is exactly to that effect, contending that Rockstar paid more than the value of the cash flow projections from the IPCo model for other motives.

Nortel had no material business licensing its IP or monetizing its technology by suing others, either before or after filing for protection from creditors in early 2009. Mr. John Veschi had been hired in July 2008 to take responsibility for Nortel's IP group and to look at options for licensing its IP.

Development of the IPCo option was led by Mr. Veschi after the insolvency filings. The premise of IPCo was that the residual patents would be monetized by the threat of patent infringement litigation and, if necessary, actual infringement proceedings against various technology companies in an attempt to force such companies to pay royalties to IPCo. It was considered important that IPCo not carry on any telecommunications or other technology business, because, if it did, it would be vulnerable to counterclaims for alleged infringement being brought by the targets of its infringement litigation, which would undercut its revenue generating ability.

Over the course of 2009 and 2010, Mr. Veschi and his team, assisted by Lazard Frères & Co, Nortel's financial advisor, and Global IPCo, a law firm specializing in patent sales, prepared several versions of a preliminary financial model, in an attempt to forecast the operating profit that could be earned by IPCo so that the potential economic benefits could be weighed against value expected to be received on a sale of the portfolio.

The various versions of the preliminary financial model had three sub-models, with differing assumptions relating to how much litigation IPCo would pursue. The scenarios were dubbed "Harvest" (assuming very little litigation), "Litigation Light" and "Litigation Heavy". More litigation resulted in greater forecast revenues, at greater forecast cost. Assumptions regarding litigation success of 60 percent, 70 percent and 100 percent were used. A wide variety of assumed net cash flows were used and a variety of discount rates to value the cash flows were used.

There is a difference in the evidence of Sharon Hamilton, a partner of Ernst & Young, the Monitor, and Mr. John Ray, the principal officer of NNI, as to how reliable the IPCo forecasts were. Ms. Hamilton was of the view that the projected cash flows were largely guesswork, given that Nortel had little experience in licensing and there were no good precedents about the estimated cash flow. Mr. Ray was more confident of the forecasts taken the work that went into them.

What is clear is that there were a number of different models. Version 1 was presented on March 10 2010, version 2 on April 27, 2010, version 2.2 on May 6, 2010, version 3 undated, version 3.1 on October 25, 2010 and version 4 on November 18, 2010. Each version had different cash flow forecasts.

I think it fair to conclude that the forecasts were not considered to be in any way certain. There were many permutations and combinations, and at no time did Nortel agree that any one forecast was the appropriate one. The process never got that far before the decision was made not to operate IPCo but rather to sell the residual IP.

Mr. Kinrich chose to use version 3.1, although he did not explain why. Version 3.1 had the highest cash flows of all versions. It is noteworthy that the latest version 4 had projected cash flow forecasts of approximately half of what was projected in the earlier version 3.1 used by Mr. Kinrich.

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Mr. Green, an expert valuer called by the Monitor, points out that version 3.1 itself was not a finalized document or accepted by Nortel or its advisors. Within it there were a number of scenarios and options still being explored. The unreliability of the forecasts in the various models can be seen by the wide disparity in discount rates used. Lazard used discounts of 25, 35 and 45% to value the various projected cash flows. These are very high discounts, as more than one expert testified, and indicated a high risk to the cash flows being achieved. Mr. Kinrich used much lower discount rates of 12% and 15%, which I will come back to, which did not reflect the risks in the IPCo forecasts and which caused a higher valuation of the cash flows than would be the case if the discounts used by Lazard in the IPCo models were used.

While there were multiple scenarios in the version 3.1 model, Mr. Kinrich used only the most aggressive case that maximized revenue. Mr. Green's view is that there is inadequate explanation by Mr. Kinrich why the specific scenarios of Version 3.1 were selected for the analysis as opposed to other lower cash flow scenarios or the later Version 4 model with lower cash flows and as the analysis is unsupported, it makes the valuation unreliable. I must say that in reviewing the details of Mr. Kinrich's report it is not at all apparent what his justification was for using the cash flows that he did. It leaves an open question as to the reliability of what Mr. Kinrich was doing.

The value allocated to each of the debtors by Mr. Kinrich is based on the attribution to the geographic regions of the debtors of the projected operating cash flows in the IPCo model chosen by Mr. Kinrich. Those cash flows projected royalty payments on a regional level, namely North America, EMEA and China.

The IPCo model estimated North American licensing revenue based on sales in Canada and the U.S. Mr. Kinrich apportioned the revenue to Canada and the U.S. using those countries' relative telecom infrastructure expenditures, saying that relative telecom expenditures were a reasonable basis on which to estimate relative market size and were consistent with the structure of the IPCo model that used market size as the driver of royalty revenues. He did the same thing for EMEA as the IPCo model estimated EMEA revenue based on sales in France, Germany and the U.K.

Global IPCo, the IPCo law firm retained to assist in preparing the models, stated early on in their work that they had no opinion regarding the territorial split of patents or patent-related revenue. There was certainly no agreement by any of the Nortel entities as to how the projected IPCo cash flows would be split territorially.

Mr. Kinrich then deducted costs from the revenue streams including a number of litigation costs. It is not possible from looking at his report to know exactly what level of litigation costs was assumed by him.

After calculating the net cash flows for each country, Mr. Kinrich then said he did a discounted cash flow calculation to arrive at a valuation for each country. In my view, Mr. Kinrich did not carry out a valid DCF valuation. The discount rate he used was not appropriate and was not derived by any conventional valuation approach.

Mr. Kinrich acknowledged in his evidence that a DCF analysis requires knowledge about the cash flows over time and requires a discount rate to take those cash flows over time and convert them to present value. He acknowledged in his report that typically a discount rate is derived from the cost of capital (the cost of debt and equity split on some basis), referred to by valuators as the weighted average cost of capital. However, he did not do this. Instead he said that the value of the residual IP was known from the $4.5 billion paid for it by Rockstar and by taking his projected cash flows that he used from the IPCo model, he could back into (or reverse-engineer) a discount rate, being 12.2% when China is not included and 15% when China is included.

This analysis proceeds on the assumption that the amount paid by Rockstar was based on the revenues taken by Mr. Kinrich from the particular IPCo model that he used. However, neither Mr. Kinrich nor anyone else knew what revenue streams were used by Rockstar to base their purchase price on or indeed, if Rockstar based their purchase price solely on anticipated revenues they could earn from the patent portfolio they acquired. Without knowing that, it is not possible to say that the Rockstar purchase was based on a discount rate of 12.2% or 15%. A discount rate, as Mr. Kinrich conceded, should reflect the risk of the cash flows being achieved, but without knowing what cash flows Rockstar based its purchase

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price on, saying the Rockstar purchase reflected a certain discount rate is artificial. Rockstar did not even know what the various IPCo cash flow models were.

Mr. Green, Mr. Berenblut and Dr. Cox and Mr. Malackowski, all expert valuers, were critical of the method used by Mr. Kinrich to arrive at his discount rates of 12.2% and 15%. I accept their criticism. These discount rates were much lower than the rates used by Lazard in the IPCo models, including the very net cash flow model used by Mr. Kinrich, of 25% to 45%. Mr. Berenblut testified that he would expect the range of discount rates to be between 30% and 70%, recognizing the fact that this was a contemplated rather than an established business and recognizing the risks associated with it.

Mr. Malackowski used a discount rate of 30% in his analysis of the potential revenue from the residual IP portfolio. He derived that rate by examining risk-adjusted hurdle rates associated with implementation of technology-based IP. These rates account for a buyer's required rate of return or the associated risk of commercializing a technology.

Mr. Kinrich in his report stated that the inferred rates of 12.2% and 15% that he obtained were consistent with discount rates observed in the market place at the time, being the median weighted average cost of capital for communication equipment companies. However, even Mr. Kinrich noted in his report that IPCo would not have been a communications equipment manufacturer. There was no analysis by Mr. Kinrich to lead to a conclusion that the cost of capital for a start-up litigation and licensing business would be comparable to an established communications equipment manufacturer. Messrs. Berenblut and Cox in their reply report stated:

> The Kinrich Report's use of discount rates for established publicly traded companies in the communications industry as benchmarks for its selection of discount rates for its valuation of a yet-to-be established business to exploit the Residual IP is not supportable. A discount rate of 30 percent or more for this type of business is consistent with our understanding and experience and is also consistent with the discount rates used in the IP Co Model. The academic literature reports venture capital discount rates in the range of 30 to 70 percent.

I accept the criticism of Messrs. Green, Berenblut and Malackowski that the discount rates obtained by Mr. Kinrich were too low. Had Mr. Kinrich used higher rates such as those used by Lazard in the IPCo models, or the rate used by Mr. Malackowski, the value of the revenues given up by the Licensed Participants, assuming they belonged to the Licensed Participants, would have been far less than opined by Mr. Kinrich.

Mr. Green calculated the values from the IPCo models using the discount rates used by Lazard in the models. Taking the most optimistic cash flows from the IP Co. model, the lowest discount rate used by Nortel and its advisors, and a litigation success rate of 100%, the maximum DCF value of IP Co. is only $2.7 billion, compared to the $4.5 billion paid by Rockstar. Messrs. Berenblut and Cox calculated that if a 30 percent discount rate is used to discount the cash flows used by Mr. Kinrich, the resulting net present value of the expected cash flows from the IP Co Model is $1.8 billion. They think this figure is overstated because of the range of values for all of the various scenarios in the IPCo models with various discounts of 25 to 45% and litigation strategies and assumed success rates of the litigation strategies from 60 to 75 to 100%. That range went from $424 million to $2.7 billion. Mr. Green put the range of values in the IPCo models from $400 million to $2.7 billion.

The report of Messrs. Berenblut and Cox explains why Rockstar would be likely to have paid more for the residual IP than Nortel could have made from it, that is, on the theory that the Licensed Participants owned all of the benefits sold to Rockstar, more than what the Licensed Participants gave up in the Rockstar transaction. The defensive value of the residual IP to the members of the Rockstar consortium made the residual IP far more valuable to Rockstar than it was in the hands of Nortel.

As explained by them, Rockstar obtained ownership of the residual IP and each of the members of the consortium (including Apple, Microsoft, Ericsson and Blackberry) received a license to the residual IP. The structure enabled Rockstar to exercise all rights of ownership of the residual IP against third parties, while providing the individual consortium members with the defensive benefits to prevent others from suing them for patent infringement. As a single

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company, Nortel was less likely to be able to derive defensive benefits equal to the combined and cumulative defensive benefits that could be gained by several large companies with extensive product and service lines that ranged well beyond what Nortel offered. Several members participating in the Rockstar portfolio are more likely to find patents contained in the Residual IP that will be useful to responses to litigation. Furthermore, as a company in financial difficulty, Nortel was less likely to be an attractive target for patent litigation and therefore less in need of patents to assert in response.

Mr. Green also made the same this point. He stated that the members of the Rockstar consortium purchased the residual IP portfolio, at least in part, as a defensive measure. It was his experience that having access to a large patent portfolio can help protect a large technology firm from lawsuits from other large companies. Access to a large patent portfolio, like the residual IPCo portfolio, can act as a deterrent because potential opposing parties must factor in the probability of a counter-suit. The defensive value of access to a significant patent portfolio is valuable to purchasers like the Rockstar consortium members, but would not be relevant to an entity like IPCo which intended to pursue an offensive licensing and litigation strategy, but had no operating business in the technology sector as all such businesses had been sold. The defensive value of such a portfolio to large companies is not measured exclusively by the present value of the cash flows from licensing.

Dr. Catherine Tucker, an economist called by the U.S. Debtors with considerable technology experience, stated the same thing. In her report she said that patents are not just used in litigation to assert rights to a particular technology or domain. There is also the important role of a patent being used in a counter-suit should the company itself be sued for patent infringement. She referred to Kent Walker, Google's General Counsel, who wrote at the time of the Rockstar bid that it was supposed to create a disincentive for others to sue Google. This defensive attribute, of course, would not have been available to IPCo if it decided to operate a patent licensing business as it would not have been in a product producing business that would be vulnerable to patent suits.

Mr. Green also expressed the view that the identity of the bidders themselves in the residual IP auction also illustrates that the basis on which value of the residual IP portfolio was determined is not consistent with that in the Kinrich report. The bidders included Google, Apple, Microsoft, Ericsson and other large technology companies with worldwide operations rather than companies whose primary business model was patent licensing and litigation. If the value of the residual IP sale was closely related to the cash flows from a licensing/litigation strategy, one would expect licensing/litigation businesses to have been bidders in the auction. Instead, the bidders in the auction were operating technology companies, which suggests that the value of the residual IP was determined in the market on some strategic basis in addition to the value of the IP in a licensing/litigation business.

I accept the evidence of Messrs. Berenblut and Cox and Mr. Green that the approach of Mr. Kinrich of allocating proceeds based on cash flows from a licensing /litigation business model such as the IPCo models is inappropriate and that what Rockstar paid for was more than the value of the potential revenues from the business that was being considered by IPCo. That is, it was more than what the Licensed Participants gave up in the Rockstar sale, assuming it was theirs to give up.

The U.S. Debtors contend that it is wrong to say that Rockstar paid more than the value of what the Licensed Participants gave up when they terminated their licenses in anticipation of the Rockstar sale and to say that the extra value belongs to NNL as the owner of the NN Technology. They say that NNL could not transfer its rights without the consent of NNI and the EMEA Licensed Participants, just as NNI and the EMEA Licensed Participants required the consent of NNL to do so. They say that all parties consented to the transfer of their MRDA interests as part of the Rockstar sale, effectively agreeing to the assignment of their rights under article 14(e) of the MRDA which permitted an assignment of a party's rights under the MRDA only with the consent of all of the other parties.

I do not accept that contention. The MRDA did provide in article 14(a) that the MRDA could not be assigned by any licensed participant without the consent of the other Licensed Participants. But neither the MRDA nor the licenses of the Licensed Participants were assigned to Rockstar. Rockstar would not have taken an assignment of the MRDA with its obligations and duties amongst the participants. I accept the evidence of Mr. Britven, an expert valuer and the

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national intellectual property consulting practice leader with Duff & Phelps in Houston, that no third party would want to step into the shoes of a Licensed Participant by taking a transfer of the MRDA with its obligations to share profits and transfer ownership of patents to NNL, among other things. Even Mr. Ray eventually admitted that there was no transfer of license rights to Rockstar.

What occurred was a sale of the residual IP to Rockstar with NNI and the EMEA debtors terminating their licenses under the MRDA as a condition precedent to the sale. What is at issue is the value of those licenses that were terminated. If the value of what could be earned from the licenses was less than Rockstar paid for the residual IP, the difference would belong to NNL, the legal owner of that IP.

Mr. Green did an alternative valuation on the assumption, with which he disagreed, that IPCo would have operated on a stand-alone business and that the licenses surrendered by U.S. Debtors and EMEA debtors would have included the rights to the residual IP portfolio. He used version 3.1 of the IPCo model, as Mr. Kinrich had, but made some changes. He used the three discount rates that had been used by Lazard in the various IPCo models and used the three assumptions in the IPCo models as to the anticipated success in litigation against infringing third parties. He also deducted from the revenue streams going out to 2020 the RPS percentages for 2010 under the MRDA on the theory that if the Licensed Participants had rights under their licenses to earn the revenues proposed in the IPCo models, those licenses came with an obligation to make RPS adjustments in favour of the other Licensed Participants. Any gain on the sale above the DCF valuations on the revenue streams was allocated to Canada.

If one assumed the median discount rate (of 35%) and the median litigation success rate (of 70%), and excluding the revenues from China, then Mr. Kinrich's allocation of the Rockstar Sale proceeds, as adjusted by Mr. Green, would be as follows. Also shown is the allocation advocated by Mr. Kinrich.

	Adjusted Kinrich Allocation of Rockstar Sale Proceeds	***Kinrich's Actual Proposed Allocation of Rockstar Sale Proceeds***
Canada	$4,003.06 million	$430 million
U.S.	$346.12 million	$3,310 million
EMEA	$105.19 million	$710 million
Total	$4,454.37 million	

If revenues from China were included, the results would be an allocation of $3905.44 million to Canada, $420.99 million to the U.S. and $127.94 million to EMEA.

The U.S. Debtors contend that Mr. Green was wrong to apply the RPSM to the value of the cash flows. They say firstly that the MRDA expressly provided in the third addendum signed in December 2008 that it does not apply to the sale of a business. What that amendment provided was that the operating income or loss used to calculate the RPSM was to exclude "gain/loss on the sale of business". That is not a reference to the proceeds of the sale of a business, but rather a reference to the gain or loss, presumably capital gain or loss, recognized on a sale of a business. That makes sense because the RPSM was dealing with the split of profits or losses from operating earnings to be allocated to the participants under the MRDA. Ordinarily the gain or loss on the sale of capital assets would be recognized in an earnings statement but the parties to the MRDA did not want that taken into account in the RPSM.

However, what Mr. Green was valuing in this analysis was the annual profits that would be earned by the Licensed Participants from operating IPCo in the future, assuming the Licensed Participants had the right to do so under their licenses. He was assuming that the profits would be split in accordance with the RPSM in the MRDA. I agree with the theory that if one is to value the benefits that could have been earned by the Licensed Participants if they had operated IPCo, which is what the U.S. Debtors say they would have done but for the Rockstar sale, the Licensed Participants would have been subject to some profit split.

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The U.S. debtors point out that what the profit split would be is a matter of conjecture and that it is not possible to assume, as Mr. Green did, that it would be the same in the future. The RPSM under the MRDA was based on the amount of R&D spend each year by Nortel and the Licensed Participants. After Nortel became insolvent, the R&D expenditures essentially stopped after 2009 and there is no evidence of what R&D would have been undertaken if IPCo had been run as a business by Nortel.

Certainly there would have had to be some transfer pricing in place if Nortel had run IPCo as a business. What the parties would have worked out is unknown. The tax authorities would certainly have been interested in the transfer pricing associated with the running of the IPCo had that occurred and it does not mean that the parties would not have had to agree on a profit split of some sort. They would have been required to do so.

It is perhaps fair to be critical of Mr. Green for assuming the transfer pricing would continue to be the same under an IPCo business run by Nortel as it had been before. It is also fair, however, to ask that if the U.S. debtors contend, as they do, that they are entitled to be paid for what they gave up in the Rockstar sale and that the present value of the anticipated net cash flows is what they gave up, one may have expected them to lead some transfer pricing evidence as to what transfer pricing would have been appropriate.

The assumption that the transfer pricing that the parties would have worked out in the event that Nortel operated IPCo would have been the same as provided in the MRDA has some logic to it. The residual IP was created by R&D conducted by the parties, at least in part, during the MRDA that split profits on the basis of the R&D expenditures of NNL and the Licensed Participants. R&D was the driver of the profitability of Nortel and the RPSM was chosen at the request of the tax authorities as the most appropriate method for determining the compensation to each of the participants for the R&D performed by them. The profits to be earned from operating IPCo could perhaps be seen to be an extension of the results of the R&D that had been spent.

The lack of transfer pricing evidence and analysis on the point, however, as to how the profits would be split in an IPCo business casts some doubt on the accuracy of Mr. Green's alternative analysis. It is not a basis, however, to reject it out of hand as contended by the U.S. debtors.

Mr. Malackowski's preferred allocation approach is a contributions approach based on R&D expenditures made by each of the participants to the MRDA. He prepared an alternative revenue or licensed based allocation which contained dramatically different results from his contributions approach. His revenue approach allocated 33.6% of the Rockstar sale proceeds to the EMEA debtors versus 17.6% using his contribution approach. It allocated 11% to the Canadian debtors versus 39.5% using his contribution approach and it allocated 55.4% to the U.S. debtors versus 42.9% using his contribution approach.

For his revenue or license approach, Mr. Malackowski used the data generated as a result of his valuation methodology to allocate the proceeds of the Residual IP Sale. He valued the Residual IP Portfolio by determining what revenues were expected to be generated by a worldwide licensing strategy in specific geographic territories and allocating the values to those territories. He estimated global revenues for the business areas in which the technology was used, royalty rates, licensing expenses, tax and discount rates. Mr. Malackowski concluded that the value of the residual IP was $3.570 billion, approximately one billion less than actually paid by Rockstar. He then "reconciled" this value with the actual purchase price of $4.5 billion by increasing pro rata the values he had calculated for each business franchise.

For the exclusive territories of Canada, United States, Britain, Ireland and France, he allocated all of the value for those territories to each of the countries. For the rest of the world ("ROW") he allocated 20% to each of the countries. It was this latter allocation of ROW that was the main cause of the increase in the allocation to EMEA as it had what he called "three seats at the table of five".

I have difficulty with Mr. Malackowski's revenue or license model of allocating the Rockstar sale proceeds. The first is that there is no explanation by Mr. Malackowski why his market based valuation was $1 billion less than the actual

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sale proceeds. Rather than simply grossing his value up to "reconcile" it with the actual proceeds, it seems to me that his valuation was an indication that Rockstar paid for more than what could be achieved in revenues from the acquired IP portfolio. Mr. Green expressed the opinion that the adjustment was inappropriate and unsupported by valuation principles, and assumed that Rockstar just used different royalty or revenue assumptions. I accept that criticism.

Mr. Green also expressed other criticisms of Mr. Malackowski's calculations, all of which appear logical and which I accept. For example:

> (i) Mr. Malackowski assumed all revenues for a country should be included in the royalty base, whereas he should have considered that only revenues from products and not services on which no patent royalty would likely be available.
>
> (ii) Mr. Malackowski assumed that revenues from all licensees will begin to be earned in 2011 i.e. he assumed that all licensing efforts against dozens of targets across multiple jurisdictions would be 100% successful within a few months of the portfolio being sold. Mr. Green's view is that his assumption is hard to credit and is inconsistent with the fact that the royalty rates selected by Mr. Malackowski are the IPCo "litigation light" rates, which would, by definition, require at least some form of enforcement action, which would necessarily delay the receipt of royalty payments.
>
> (iii) Mr. Malackowski assumed increasing royalties through 2022 without considering that the patents and technologies are wasting assets and many are likely to expire before the end of the period used by Mr. Malackowski.
>
> (iv) Mr. Malackowski deducted costs of 20% of royalty revenues, stating that he based the rate on the observed financial performance of sophisticated non-practicing entities such as Acacia Research Group. Mr. Green reviewed Acacia's public filings and those of other licensing entities and have found a significant discrepancy between their reported costs and those that the Malackowski Report asserts are representative. The Acacia public filings disclosed that the company's costs of operation from 2005 through 2012 have ranged from 112% of revenue in 2005 to a low of 52% of revenue in 2012. Other licensing entities, such as Interdigital and Rambus, report operating costs from 2005 to 2012 ranging from a low of 28% of revenues to as much as 164% of revenues.

These errors lead to the conclusion that Mr. Malackowski's valuation of $3.570 billion of the residual IP sold to Rockstar was likely overstated, indicating an even greater discrepancy between his value and the actual sale price. It also indicates issues with the territorial split of the revenues. The assumption of Mr. Malackowski that the entire sale proceeds were based on revenue forecasts by Rockstar, permitting him to simply increase his $3.570 billion value by another $1 billion without analyses ignores the likelihood that Rockstar paid what it did in part as a defensive move for its participants to protect their operating businesses, which Nortel no longer had. I do not have confidence in using Mr. Malackowski's analysis to allocate the proceeds of the Rockstar sale on a license or revenue basis.

In the end, I also cannot accept Mr. Kinrich's calculation of the amounts from the Rockstar sale to be allocated to NNL, NNI and EMEA. Assuming the Licensed Participants had a right to the value of the residual IP that Nortel could have achieved, and looking at the various scenarios in the IPCo models, I would recalculate those values and allocate the proceeds by adjusting the calculations of Mr. Kinrich and averaging them with the calculations of Mr. Green in his alternative approach.

I would take the mid-point between the low value of $400 million to $2.7 billion, or $1.5 billion using the discount rates of Mr. Green and Messrs. Berenblut and Cox. Using the same split as Mr. Kinrich, on the assumption that value would not be realized in China, would result in an allocation of 9.3% or $139.5 million to the Canadian debtors, 14% or $210 million to EMEA and 76.7% or $1.15 billion to the U.S. debtors. The balance of the $4.45 billion, or $2.9 billion, would be allocated to Canada. On the assumption that value could be realized in China, the resulting allocation would be 11.1%

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or $166.5 million to the Canadian debtors, 22% or $330 million to EMEA and 66.9% or $1.0 billion to the U.S. debtors. The balance of the $4.45 billion, or $2.9 billion, would be allocated to the Canadian debtors.

I would then average these allocations with the allocations arrived at by Mr. Green in his alternative analysis, set out in paragraphs 358 and 359 above, which were based on the median discount rates and litigation success rates used in the IPCo models.

The results of that allocation, assuming the revenues from China are included, would be an allocation to Canada of $3,485.97 million, to EMEA of $228.97 million and to the U.S. of $710.5 million, or a total of $4,425.44 million. I would round these figures up on a pro rate basis to arrive at the proceeds available of $4,454.37.

The results of that allocation, assuming the revenues from China are not included, would be an allocation to Canada of $3,521.28 million, to EMEA of $157.6 million and to the U.S. of $748.06, or a total of $4,426.94 million. I would round these figures up on a pro rate basis to arrive at the proceeds available of $4,454.37.

The U.S interests assert that on a license or revenue analysis, very little revenue should be attributed to China. They assert that the IPCo models included both a "China in" and "China out" option. I must say I have carefully looked at the IPCo model 3.1 used by Mr. Kinrich and I cannot find a China out option. On cross-examination of Mr. Malackowski, who thinks China revenues should be included, it was put to him that the IPCo model had a "toggle" for China, which I take to be a sheet with revenues for China.

In any event, Mr. Kinrich testified that he at first took the mid-point of the particular China forecasts he used after doing an economic literature search on patent value and speaking with Mr. Zenkich, who told him that the market would pay little to nothing for a China patent, he reduced his revenues for China downward more towards the US in some qualitative fashion. He reduced then by 75%. Mr. Zenkich, an expert in valuing patents, testified that in 2009-2010 participants in the market for patent portfolios assigned little to no value to Chinese patents.

The thinking of Nortel's patent people changed over time. In December 2000, Angela Anderson, Director, Intellectual Property Law in the U.K stated that China was a sizeable and growing market accessible at moderate cost. She said that the target filing % (3% of cases) would be higher but for enforcement issues. "Show the flag, but don't over-invest." She testified that at that time, it was clear that China was going to become more of a potential marketplace for Nortel products. In addition, the patent system was starting to look like a real patent system, so it made sense to start using the patent system in China at that time.

By 2006, Nortel intended to file far more patents in China. The plan was to file up to 30% of the top patents in China and in 18 months' time raise this to up to 50%, selecting those having the highest commercial potential. In the IPCo model of May, 2010 that included revenues from China, it stated that early 2010 modelling did not include China in its royalty base but the new plan included China but only in the years 2015 to 2020. It stated that 80% of its patents and 70 % of the applications in China were for wireless 4G technology. The logic of waiting until 2015 was the time for 4G market maturity. EMEA contends, and I have no reason to question it, that the assumptions in the IPCo model regarding China were conservative.

Mr. Malackowski's view was that in doing a revenue or license approach, it would be wrong to exclude China revenues. His reasoning was that Nortel had decided to file high interest patents in China, that patent protection was improving in China and had improved over the past five to ten years and that China was a very important and large market. He has had experience in China. His firm has a partner in Shenzhen for addressing the work they do in China.

Mr. Zenkich testified that the basis for his conclusion that no one would pay anything for a Chinese patent was based on his business of being a patent broker. He testified that when his clients had large patent portfolios, there was no interest expressed in the Chinese patents that were part of those portfolios. Similarly, they were never asked by clients who looked to purchase patents to identify Chinese assets for purchase. I take this to be no evidence of knowledge of values that could be achieved for a Chinese patent, but only that Mr. Zenkich had no knowledge of a client being interested in in a

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Chinese patent. Included in material referred to in his report was a 2011 report entitled "China's Emerging Patent Trading Market" that referred to a patent auction in China in 2010 which sold 38 lots and the intention of the seller to hold another auction in 2011. The article also referred to efforts being made to set up an exchange in China with the support of governments that would facilitate transactions. That article was contradictory of the view expressed by Mr. Zenkich.

Mr. Zenkich referred to a 2012 publication by the U.S. Patent Office that referred to comments it had received to the effect that there were difficulties with enforcing Chinese patents. That is certainly anecdotal evidence of statements made by others, and it cannot be belittled. How accurate are all of the statements is perhaps a matter of some debate. For example, a comment by one person as to the cap on damages in China was shown during the evidence to be incorrect. While Mr. Zenkich had stated in his report his belief that that significant interest in patent granting activity in China over the last ten years has increased the risk that patents may be challenged as invalid, even if granted, he acknowledged on cross-examination that he had no experience in trying to enforce patents in China and that his company had no experience in trying to enforce a patent anywhere in the world. He also acknowledged that he did not independently conduct surveys or seek out patent data of this kind of activity and that he was unable to identify a single instance where a Chinese patent was found invalid and its US or European counterpart was not. One of the documents cited by Mr. Zenkich in his report was a publication by a Beijing law firm of October 2009 that stated that the major cities, in particular Beijing, Shanghai and Guangzhou, can be considered as a reliable forum for patent infringement actions. Mr. Zenkich chose instead to rely on the U.S. Patent Office document that contained comments regarding the difficulty of enforcing patents in China.

I am afraid that I cannot put a great deal of reliance on Mr. Zenkich's evidence of the unreliability of the Chinese patent system. I accept he may be of the view that it is unreliable, but his view was not supported by any cogent, reliable and admissible evidence. The views of Mr. Kinrich are also not supported by any cogent evidence. He appears to have largely relied on Mr. Zenkich.

In my view, if a license or revenue approach to value is to be used to value the residual IP, it should include revenues from China that were used in the IPCo model, mainly for the reasons expressed by Mr. Malackowski and the fact that the projections were somewhat conservative.

The conclusion I come to, if an allocation of the proceeds of the Rockstar sale were to be based on a license or revenue approach, would be an allocation to Canada of $3,485.97 million, to EMEA of $228.97 million and to the U.S. of $710.495 million, or a total of $4,425.435 million. I would round these figures up slightly on a pro rate basis to equate to the proceeds available of $4,454.37.

(ii) Mr. Malackowski's contribution approach to value

The EMEA debtors contend that the allocation of the proceeds of the Rockstar sale should be made on the basis of the contribution to R&D made by each of the RPE entities that created the residual IP sold to Rockstar. They contend that the contributions by each RPE to measure this should not be the contributions made during the five year look-back period used to allocate the residual profits under the MRDA but rather the contributions made during the period of time that the residual IP that was sold to Rockstar was invented. Based on the evidence of Mr. Malackowski, they say the look-back period should be from 1991 to 2006[26] .

There are two fundamental issues that have been raised to the calculations if the contribution approach to allocation is to be used. The Canadian Debtors contend that there is no basis to use a contribution approach to allocate the proceeds of the Rockstar sale or the business line sales. They say that if a contribution approach is nevertheless used, the look-back period for looking at R&D contributions should be the five year look-back period under the MRDA from 2005 to 2009. The U.S. Debtors also disagree that a contribution approach should be used to allocate the Rockstar and business line sale, but contend that if a contribution approach is used, they agree with the EMEA debtors as to the length of look-back period but contend that all R&D spending must be taken into account. They contend that what must be taken into account is not only the R&D costs incurred by each RPE in their own exclusive territory, but also all transfer pricing

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adjustments made by an RPE, particularly the adjustments made under the CSA agreements prior to the MRDA coming into force.

Mr. Malackowski said in his report that to measure contribution, ideally, the contributions of the RPE's labs to the development of the patented technologies could be fully and accurately determined by interviewing all of the firm's R&D staff, and by reviewing all the documentation related to the firm's research (e.g. lab notebooks, invention disclosures, meeting minutes, research presentations etc.). This approach was not possible for Nortel's IP due to the size of the portfolio, the limitations on time and the availability of information. Mr. Malackowski did not have access to lab notebooks and R&D staff. Moreover, as R&D was organized across the Nortel Group and carried out in a highly coordinated and integrated manner across the various RPEs, it was even more difficult to separate out the distinct contributions of the various RPEs. In these circumstances he said he had to select a proxy data that reasonably reflected the research efforts of the various RPE's labs.

Mr. Malackowski chose to measure contributions to the development of the IP by measuring each RPE's spending on R&D. He stated that in a large organization, where R&D funding supports a large number of R&D personnel and results in a large number of patents over time, this funding can be valid and indeed the most accurate proxy measurement for determining the contribution of each research group to the development of IP. He stated that it is common practice to regard each dollar spent on R&D as fungible for the purposes of measuring relative contribution to R&D in a group, as Nortel did under the RPSM.

Mr. Malackowski stated that in his experience, in large IP portfolios the vast majority of the value of the portfolio is usually derived from a minority of the patents. This is due in part to the fact that technology IP can be overlapping and duplicative. Value is often derived from a relatively small number of patents that are essential to industry standard technology or that cover an essential process or solution to a common problem. Mr. Malackowski expressed the view that the patents that were categorized as high interest by Global IP likely represented the vast majority of the value of the residual patent portfolio. Approximately 37% of the total residual patent portfolio was identified as high interest.

The evidence was that it generally took one year for Nortel R&D spending to result in a patent application for an invention. He therefore thought it appropriate to determine contribution to the creation of Nortel's IP by measuring R&D spending starting the year before the filing of the earliest unexpired patent categorized by Global IP as high interest, i.e. in 1991. He stated that the most logical end point was in 2006, the year before the last high interest patent was filed. He provided calculations for four look back periods produced by two different start points and end points. His two start points were 1991, reflecting the year before the earliest unexpired high interest patent in the residual patent portfolio, and 2001. His two end points were 2006, representing the year before the last high interest patent in the residual patent portfolio, and 2008, representing the last year of ordinary course operations [27] . 2001 was the start of the MRDA.

By looking at the expenditures on R&D for this period from 1991 to 2006, Mr. Malackowski allocated 39.5% or $1.777 billion to Canada, 42.9% or $1.930 billion to U.S. and 17.6% or $793 million to EMEA. For the period 1991 to 2008, he allocated 40.6% or $1.827 billion to Canada, 43% or $1.935 billion to U.S. and 16.4% or $738 million to EMEA.

The effect of using the longer look-back period substantially reduces the amount allocated to Canada, the reason being that the R&D expenditures from 2005 to 2009 during the five year RPSM were proportionally done more by Canada than EMEA and the U.S. The percentages from 2005 to 2009 were 49.5 for Canada, 38.8 for the U.S. and 11.7 for EMEA.

Mr. Malackowski's report contains discussion why he looked at a long period back to 1991 to measure R&D spending. He said that old patents maybe more valuable than recently filed ones. He said that technologies are adopted by the market slowly over time and do not realize their full value until later in the life of the patent. He did recognize that newer patents will have longer life before they expire and they may have favour due to technological obsolescence, but pointed out that there is risk in newer technologies that they may not be accepted by the market. Based on these considerations he concluded that he should take into account R&D spending from the year before the first high interest patent.

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Mr. Malackowski did not consider what Nortel's thinking was about the life to its technology. In the first version of the MRDA the R&D spending used to split residual profits was calculated using an amortized 30% rate, with expenditures from any one year declining by 30% in the following years. In Nortel's response to questions from the tax authorities in 2003 in connection with its request for an APA for that MRDA, Nortel stated:

> It is difficult to ascertain the exact useful life of R&D developed at Nortel; however, Nortel's analyses indicated that a 30% amortization was conservative yet reasonable. Numerous sources suggest that the useful life of telecommunications R&D is short; however, there is no one definitive external source that explicitly determines that a 30% amortization rate is correct.

The tax authorities did query this response in a question that referred to information from Nortel that it said seemed to suggest that the useful life of R&D is equivalent to product useful life. "However, isn't it the case that benefits from R&D may persist beyond product useful life? For instance, value may result from further developing the intangible."

In preparation for APA negotiations with the tax authorities, Gilles Fortier, NNL's taxation manager for transfer pricing, circulated a document among Nortel tax executives dated May 10, 2002 summarizing the "key drivers" for Nortel, on the one hand, and the tax authorities, on the other, with regard to the APA. The position of the tax authorities was stated to be that the life of Nortel's intellectual property was 7-10 years or more whereas Nortel was suggesting 4-7 years. This position of Nortel was consistent with using a 30% amortization rate for R&D spending in allocating profits under the CSA. Nortel wanted a shorter period because using a longer period would increase the profits in NNI for tax purposes that Nortel did not want. Canada had a lower tax rate due to its generous research and development policies.

A later application by NNL and NNI for an APA with the tax authorities for the years 2007 to 2011, in which a straight five year R&D expenditure would be used to allocate profits, indicated that NNL and NNI thought that the useful life of the Nortel intangibles was estimated to be approximately five years with a gestation lag of one year. Included in the APA request was the following:

> The economic life of technology is difficult to measure because as long as the technology is being sold, it is also being continuously updated and enhanced. Indeed, software and hardware development in the telecommunications industry is widely understood to be an iterative process, because of the tendency to superimpose improvements upon older versions of the technology. Therefore, any discussion of product useful life must consider when an individual product was originated, how to apportion the impact of successive improvements, and when the product was completely superseded.
>
> Nortel's telecommunications technology consists of hardware and software, and it continues to grow and change as demand for bandwidth and functionality grows. As a result, there has been an evolution in the commercial and economic life span of technologies from longer to shorter cycles.
>
> Nortel's Chief Technology Office estimated that a dollar spent on R&D typically has a shelf life of about five years, and additionally, the time from when the investment in the R&D is made to the time when revenue can be generated from the investment ranges from about 6 to 12 months.
>
> Recognizing the difficulties inherent in estimating the useful life, based on information obtained in our discussion with Nortel management, and our review of the R&D policy documents, the useful life of the Nortel intangibles is estimated to be approximately five years with a gestation lag of one year.

The evidence from Mr. Malackowski's report is that 99% of the high-interest patents sold to Rockstar had an invention date prior to 2006 and the bulk were from 1995 to 2004. This is considerable evidence that what Nortel was telling the tax authorities did not turn out to be the case. This is not to suggest that Nortel did not believe what it was representing to the tax authorities, or perhaps more appropriately put, that Nortel's transfer pricing tax people did not think that a legitimate tax case could be asserted supporting its 30% declining amortization calculation in the first MRDA and then

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its five year look-back period in the second version of the MRDA. It is clear, however, that Nortel expected negotiations with the tax authorities would take place that could alter the 30% amortization rate and the later five year flat rate, and the MRDA expressly contemplated that in Schedule A. It cannot be said that Nortel as an enterprise conclusively concluded that its profit allocation keys of 30% or five years were necessarily correct. It was a tax position prepared by Nortel and its advisors.

If a contribution theory is to be used to measure the value of what the parties gave up, I think it inevitable that a longer look-back period would be appropriate. The market has indicated that. However, I would lengthen the time to be taken into account. One of the weaknesses of using a contribution approach is that not every dollar spent results in valuable technology. The theory then must be that what one loses in the corners is gained in the straights. That being the case, I see no reason to disregard the R&D expenditures in 2007 to 2009. They were real and cannot be said to have contributed to the residual IP sold to Rockstar [28] . The fact that Rockstar has started out by enforcing earlier patents does not mean that later patents or patent applications will not be of value or that Rockstar did not pay anything for them.

I would take the R&D expenditures from 1991 to 2009. The data is available from exhibit B.1.7.1 of Mr. Malackowski's report. The resulting percentage of expenditures is 40.93% for Canada, 42.87% for the U.S. and 16.2% for EMEA.

The U.S. Debtors contend that because under the CSA agreement NNI was required to allocate transfer payments to other RPEs, those payments should be included in what is considered to have been contributed to R&D. They rely on upon the opinion of Laureen Ryan, a forensic accountant who went through the transfer pricing worksheets and calculated $4.4 billion allocated to other RPEs under the CSA agreement. On her figures, the percentages for R&D expenditures for 1989 to 2000 would be 21% for Canada, 6% for EMEA and 73% for the U.S.

There is a problem with Ms. Ryan's evidence. The first is that she did no cash analysis to determine if NNI actually paid out any cash to any other RPE as part of its transfer pricing requirements under the CSA and later MRDA. There is no evidence in the record that anything allocated to any party was actually transferred by way of cash and Ms. Ryan conceded that she could not say if anything was actually paid. She did speak to her general understanding that money was transferred by NNI to NNL but I take that to be hearsay evidence and not any cogent evidence that any funds were transferred in fact. Just as important, there was no evidence as to how cash transferred from NNI or any other RPE was actually used. Cash was moved throughout the Nortel Group as required, but what those requirements were at any time is not a matter of record or available evidence. Ms. Ryan also conceded that she was not able to say where any of the money came from to actually do the R&D spending, whether from customers, governments, shareholders or other Nortel entities.

While Ms. Ryan in her report and evidence calculated what she said were allocations for R&D made by NNI to the other RPEs under the MRDA, the U.S. Debtors made no argument in their closing briefs that these payments should be attributed to NNI. One problem with the evidence on this point is that Ms. Ryan assumed that the RPEs used transfer pricing adjustments for only for only two types of expenses: direct R&D spending figures, and sales, general, and administrative costs. Ms. Ryan pro-rated the intercompany funding between those two expenses. That assumption was obviously incorrect because, as Ms. Ryan conceded, it ignores very significant additional costs incurred by the RPEs, including restructuring costs, costs of revenues, manufacturing, and distribution. The very need for an assumption to be made was because Nortel never kept records of what transferred cash from one Nortel company to another was used for. Ms. Ryan also erred in failing to deduct the $2 billion settlement with the IRS and CRA regarding the $2 billion that was deemed to be a dividend paid by NNI to NNL. She also failed to take into account the sale of Nortel's UMTS business to Alcatel.

As stated above, Mr. Malackowski thought that ideally to determine contribution to R&D by any particular RPE, he would need to have access to lab notebooks and other records and to Nortel R&D personnel. As he did not have that he had to select a proxy data that reasonably reflected the research efforts of the various RPE's labs. He chose to measure contributions to the development of the IP by measuring each RPE's spending on R&D. He testified that this would be reflective of the types of activities that we know lead directly to the inventive process. It is the engineering time and

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the related expenses that result in the innovation. He testified that a transfer pricing adjustment is an allocation that is done for other purposes, specifically tax efficiency, not for recording the matching between the inventive nature of contribution and results, and he viewed it as inappropriate.

Ms. Ryan is a specialist in accounting and forensic investigations. I prefer the evidence of Mr. Malackowski on this point that for his contribution analysis, it is not appropriate to add to any RPE's contribution amounts that were allocated from that RPE under the transfer pricing regimes in the CSA or MRDA.

Mr. Malackowski did an "inventorship" analysis in his reply report of the countries in which the inventors of the residual patent portfolio resided. He stated that while he did not consider inventorship to be the appropriate basis for allocation, it was a useful metric for testing the allocations of the various parties.

The results of Mr. Malackowski's analysis indicated that for the high interest patents, 46.3% were from Canada, 33% from the U.S., 18.7% from EMEA and 2.6% from ROW. For the entire portfolio, 51.9% were from Canada, 27.4% were from the U.S., 17.7% were from EMEA and 2.9% were from ROW. Using the percentages for the entire residual patent portfolio, which is what was sold, and allocating ROW equally to the others, would give Canada 52.9% of $4.45 billion or $2.35 billion, U.S. 28.4% or $1.26 billion and EMEA 18.7% or $832 million.

Mr. Britven, an expert called by the Monitor, while of the opinion that a contribution allocation theory was not correct, also did an inventor based analysis. That analysis allocated 51.3% to Canada, 28.9% to the U.S., 18.2% to EMEA and 1.6% to others. That is very close to the figures from Mr. Malackowski's inventorship analysis

I conclude that if the contribution allocation theory asserted by the EMEA debtors is accepted, the percentage allocation of the residual IP sold to Rockstar of $4.45 billion is 40.93% or $1.82 billion for Canada, 42.87% or $1.92 billion for the U.S. and 16.2% or $720 million for EMEA to be rounded down pro rate to get a total of $4.45 billion.

(iii) Mr. Green's approach

Mr. Green allocated virtually all of the proceeds of the Rockstar sale to Canada. [29] There were two categories of patents involved in the sale:

1. patents that had been used in several business lines and in respect of which non-exclusive licenses had been granted to the business line purchasers; and

2. the remaining patents, which had not been used in any Nortel business.

For the group of patents identified in (1) i.e. patents that had been used in several business lines and in respect of which non-exclusive licenses had been granted to the business line purchasers, the value of the U.S. and EMEA Debtors' licenses with respect to those patents (which is the value that they would have earned had they continued to operate the businesses) was determined by Mr. Green and allocated to them as part of his allocation of the business line sale proceeds.

With respect to those patents described in (2) that were not used in any of Nortel's operating businesses, Mr. Green considered whether there was any evidence that the U.S. and EMEA Debtors had any prospect of generating earnings through the exercise of their license rights in connection with those patents. He concluded that they did not because the U.S. and EMEA Debtors' license rights were limited to the right to make Products — i.e. products made or designed (or proposed to be made or designed) by or for a Participant, embodying or using the Nortel IP. This was consistent with the position taken by the Monitor in this case. Thus he allocated none of the proceeds of the Rockstar sale to the U.S. and EMEA Debtors and all of the proceeds to Canada.

Mr. Green's valuation is a straight result of the interpretation put on the MRDA by the Monitor. One cannot quarrel with the logic of it if that interpretation were to govern the allocation.

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Footnotes

1 EMEA is an acronym for 19 Nortel subsidiaries in Europe, the Middle East and Africa.

2 All reference to dollars is to U.S. currency.

3 Judge Kevin Gross is the U.S. bankruptcy judge.

4 See *Nortel Networks Corp., Re* (2013), 2 C.B.R. (6th) 1 (Ont. S.C.J. [Commercial List]); aff'd (2013), 5 C.B.R. (6th) 254 (Ont. C.A.); 2013 WL 1385271; aff'd 737 F.3d 265 (U.S. C.A. 3rd Cir. 2013).

5 A later Allocation Protocol which set out procedural matters to govern the allocation hearing was made and approved by orders of both Courts in May, 2013.

6 Unless otherwise indicated, statements of fact in these reasons are findings of fact.

7 Nortel Networks Australia was also a RPE until December 31, 2007.

8 This was an alternative argument for the CCC to its first argument that the MRDA should govern the allocation.

9 There were different CSAs for different types of costs. The relevant CSAs were the R&D CSAs that provided for the sharing of costs of the R&D carried out by the Nortel entities doing R&D. NNL made a separate CSA with each of those entities.

10 I prefer this test to that articulated in *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (Ont. C.A.), in which it was said that interpreting a contract that accords with sound commercial principles is limited to situations in which there is some ambiguity. I do not think that is correct and it is not what other cases of appellate authority have stated. See my comments in *Thomas Cook Canada Inc. v. Skyservice Airlines Inc.* (2011), 83 C.B.R. (5th) 106 (Ont. S.C.J. [Commercial List]) at para. 13 and *Oncap L.P. v. Computershare Trust Co. of Canada* (2011), 94 B.L.R. (4th) 314 (Ont. S.C.J. [Commercial List]) at paras. 21 to 24. See also Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2nd ed. (Markham Ont.:LexisNexis 2012 at p. 46 fn. 191.

11 There was a separate R&D CSA made with each participant. They were the same. Reference during argument was to the CSA made between Northern Telecom Limited [now NNL] and Northern Telecom Inc. [now NNI], and I refer to it in these reasons.

12 The amended Schedule A was effective January 1, 2006 and reflected a change in the calculation of the amount spent on R&D by each participant.

13 The NN Technology in the MRDA was called the NT Technology in the CSA as the parties at the time of the CSA in 1992 were Northern Telecom, later changed to Nortel Networks.

14 Rulings on admissibility of evidence were left for decision to be made after argument at the conclusion of the trial.

15 At page 30 of the report, Horst Frisch, in referring to intercompany transactions between participants under a RPSM allocation, state-"The old CSPs possess and will continue to possess valuable intangible property." What property is being referred to is not stated. It could be a reference to license rights.

16 *C.I. Covington Fund Inc. v. White*, [2000] O.J. No. 4589 (Ont. S.C.J.) paras. 38-39), *aff'd* [2001] O.J. No. 3918 (Ont. Div. Ct.). *G.D. Searle & Co. v. Novopharm Ltd.*, [2007] F.C.J. No. 625 (F.C.A.), *leave to appeal to SCC refused* [2007] S.C.C.A. No. 340 (S.C.C.). *Sterling Engineering Co. v. Patchett* (1955), 72 R.P.C. 50 (U.K. H.L.). This has now been codified in section 39 of the *Patents Act 1977* (U.K.), c. 37.

17 *Board of Trustees of the Leland Stanford Junior University v. Roche Molecular Systems, Inc.* (2011), 131 S.Ct. 2188, 98 U.S.P.Q.2d 1761 (U.S. Sup. Ct. 2011) at p. 2195-2196, quoting *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (U.S. Sup. Ct. 1933) at p. 189.

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18 See the affidavit of Peter Currie sworn April 11, 2014 for a full description of Nortel's matrix structure and operations.

19 Early in these proceedings, on the motion in 2009 to approve the IFSA, counsel to the U.S. Debtors stated in its written brief that NNL owned the IP. The report of the administrators for the EMEA Debtors of June 14, 2009 stated that all IP rights belonged to NNL. Once the size of the sale proceeds became known, these positions of the U.S. Debtors and EMEA Debtors changed.

20 In *Corning, Re*, 419 F.3d 196 (U.S. C.A. 3rd Cir. 2005), at 205 the U.S. Court of Appeals observed that substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities, (save for inter-entity liabilities which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor."

21 The projected cash on hand in all of the Nortel entities as of June 30, 2014 after payment of secured creditors was $1.525 billion, being $343 million in the Canadian Debtors, $744 million in the U.S. Debtors and $438 million in the EMEA Debtors. See schedule 5 of the Britven report, ex. 45.

22 Mr. Kilimnik prepared an expert report on which he was deposed prior to the trial. At the opening of the trial, counsel for the ad hoc group of bondholders said that Mr. Kilimnik would be called as a witness. However, on the day before he was scheduled to testify, his report was withdrawn by the bondholders and he was not called as a witness at the trial.

23 I also prefer the evidence of Mr. Kilimnik and Mr. Binning as to the data in exhibit 58 that compared Nortel bond spreads to government yields and what could be drawn from it. Professor McConnell said he could not draw an inference from the data but also said that he was not contradicting Mr. Binning.

24 There was one series of bonds for $200 million issued by NNL with a NNC guarantee but no guarantee by NNI.

25 The CCC contended for an "ownership" allocation very similar to the Monitor, being $5.805 billion to the Canadian Debtors, $1.009 billion to the U.S. Debtors and $488 million to the EMEA Debtors.

26 For the IP sold in the business line sales, EMEA says that the look-back period should be from 1991 to 2008, two years longer than for the Rockstar sale.

27 Mr. Malackowski said he did not think it appropriate to look at 2009 R&D expenditures post-filing as he understood that little basic research was being performed during this time given that R&D spending was cut dramatically and none of the patents designated as high interest by Global IP were filed during this time period. The R&D expenditures in 2008 were $1.458 billion and in 2009 were $1.076 billion. Mr. Malackowski also said an appropriate look-back period for the business sales would be 2001 to 2008.

28 The Canadian expenditure in 2009 was not just to preserve the business lines as asserted by EMEA. Canada spent $564 million in 2009 on R&D, far more than the $180 million spent on the CDMA and LTE businesses.

29 He allocated $426,097 to the U.S. representing the value of the workforce transferred to Rockstar, being very few people.

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2016 ONCA 332
Ontario Court of Appeal

Nortel Networks Corp., Re

2016 CarswellOnt 6785, 2016 ONCA 332, 130 O.R. (3d) 481,
265 A.C.W.S. (3d) 834, 348 O.A.C. 131, 36 C.B.R. (6th) 1

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

Alexandra Hoy A.C.J.O., R.A. Blair, S.E. Pepall JJ.A.

Judgment: May 3, 2016
Docket: CA M45307, M45309, M45310 M45311, M45312, M45313

Proceedings: refusing leave to appeal *Nortel Networks Corp., Re* (2015), 27 C.B.R. (6th) 175, 2015 CarswellOnt 7072, 2015 ONSC 2987, Newbould J. (Ont. S.C.J. [Commercial List]); and refusing leave to appeal *Nortel Networks Corp., Re* (2015), 27 C.B.R. (6th) 51, 2015 ONSC 4170, 2015 CarswellOnt 10304, Newbould J. (Ont. S.C.J. [Commercial List])

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Shayne Kukulowicz, Michael Wunder, Ryan Jacobs, Geoffrey Shaw, Jane Dietrich, for Moving party, Official Committee of Unsecured Creditors of Nortel Networks Inc. et al.
Andrew Kent, Brett Harrison, Laura Brazil, for Moving party, Bank of New York Mellon as Indenture Trustee
Steven L. Graff, Ian Aversa, Miranda Spence, for Moving party, Nortel Trade Claims Consortium
Michael E. Barrack, D.J. Miller, John L. Finnigan, Michael S. Shakra, Andrea McEwan, for Responding parties, Board of the Pension Protection Fund and Nortel Networks U.K. Pension Trust Ltd.
Benjamin Zarnett, Jessica Kimmel, Peter Ruby, Peter Kolla, for Responding party, Monitor, Ernst & Young Inc.
Kenneth Kraft, John Salmas, for Responding party, Wilmington Trust, National Association
Derrick Tay, Jennifer Stam, for Responding parties, Canadian Debtors(2)
Kenneth Rosenberg, Lily Harmer, Massimo Starnino, for Responding party, Superintendent of Financial Services as Administrator of the Pension Benefits Guarantee Fund
Mark Zigler, Ari Kaplan, for Responding parties, Former Employees of Nortel and LTD Beneficiaries
Arthur O. Jacques, Paul Steep, Byron Shaw, for Responding party, Canadian Creditors' Committee
Barry E. Wadsworth, for Responding party, CAW-Canada
Matthew P. Gottlieb, Matthew Milne-Smith, for Responding parties, Joint Administrators of the EMEA Debtors(3) other than Nortel Networks S.A.

Subject: Contracts; Estates and Trusts; Evidence; Insolvency; Intellectual Property; International; Property

MOTIONS for leave to appeal from decisions reported at *Nortel Networks Corp., Re* (2015), 2015 ONSC 2987, 2015 CarswellOnt 7072, 27 C.B.R. (6th) 175 (Ont. S.C.J. [Commercial List]) and *Nortel Networks Corp., Re* (2015), 2015

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ONSC 4170, 2015 CarswellOnt 10304, 27 C.B.R. (6th) 51 (Ont. S.C.J. [Commercial List]), regarding allocation of proceeds of sale of debtor's assets.

***Per curiam*:**

A. Introduction

1 January 14, 2009 was not a good day. At that time, Nortel Networks Corp. ("NNC") and the other Nortel Canadian Debtors filed for insolvency protection under the *Companies Creditors' Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). That same day, Nortel Networks Inc. ("NNI") and other U.S. Debtors filed voluntary petitions for relief under Chapter 11 of the U.S. *Bankruptcy Code*, 11 U.S.C. §§1101 - 1174, and other Nortel entities incorporated in Europe, the Middle East and Africa ("EMEA") were placed under administration in England by the High Court of England and Wales under the U.K. *Insolvency Act 1986*, c. 45. Shortly afterwards, courts in Canada and the United States approved a cross-border, court-to-court protocol that established procedures for the co-ordination of cross-border proceedings in Canada and the U.S.

2 More than seven years later, many Januarys have come and gone and these insolvency proceedings continue. During that time:

- more than 6,800 Nortel former employees or pensioners have died;
- well in excess of $1 billion has been incurred in costs; and
- Nortel's assets have been sold and some $7.3 billion [1] in sale proceeds have been placed in escrow (the "Lockbox Funds").

3 The leave motions now before this court arise from the joint trial dealing with the allocation of the Lockbox Funds. Newbould J. (the "trial judge) of Ontario's Superior Court of Justice (Commercial List) and Judge Gross of the U.S. Bankruptcy Court for the District of Delaware presided over the joint trial. [2] It was held over the course of six weeks. Each judge rendered separate decisions on May 12, 2015. Each concluded that the Lockbox Funds should be allocated on a *pro rata* basis among the various Nortel debtor estates. Although their analysis differed somewhat, the outcome was the same.

4 Appeal proceedings were initiated in Canada and the U.S. The moving parties were authorized to file their leave materials in the absence of an issued judgment on the basis that counsel would subsequently file the formal judgment. The formal judgment was issued on April 26, 2016 and filed with this court on April 27, 2016.

5 Before this court, the six moving parties, led by the U.S. Debtors, seek leave to appeal the trial judge's judgment pursuant to s. 13 of the *CCAA*. They submit that the trial judge made fundamental errors and that the proposed appeal is of significance to the practice of insolvency and to the parties, and will not delay the completion of the *CCAA* proceedings.

6 The responding parties, led by the Board of the Pension Protection Fund and Nortel Networks UK Pension Trust Limited ("UKPC"), submit that the record supports the trial judge's factual findings, which were integral to his analysis, including his findings that Nortel's assets were jointly created, that the Nortel group of companies operated on a fully-integrated global basis and that Nortel did not operate separate businesses in separate countries. In their submission, the proposed appeal is not *prima facie* meritorious. In addition, the remaining elements of the test for leave to appeal under the *CCAA* have not all been met.

7 After consideration of each of the factums [3] and other materials filed on the leave motions, we agree with the responding parties that the test for leave has not been met. For the reasons that follow, we dismiss the moving parties' motions for leave to appeal.

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B. Genesis of Dispute

8 NNC was a publicly-traded Canadian corporation at the helm of a global networking solutions and telecommunications business, and the direct or indirect parent of more than 130 subsidiaries located in more than 100 countries. These companies were collectively referred to as the "Nortel Group" or "Nortel".

9 NNC was the successor to a long line of companies, headquartered in Canada, that date back to the founding of the Bell Telephone Company of Canada in 1883. NNC's principal, direct operating subsidiary was Nortel Networks Limited ("NNL"), also a Canadian company. NNL was the direct or indirect parent of operating companies located around the world. It owned 100 percent of the equity of each of the following entities: NNI, Nortel's operating company in the United States; Nortel Networks UK Ltd. ("NNUK"), Nortel's operating company in the United Kingdom; and, Nortel Networks (Ireland) Ltd. ("NN Ireland"), Nortel's operating company in Ireland. It also owned 91.17 per cent of the equity of Nortel Networks S.A. ("NNSA"), Nortel's operating company in France.

10 Following the insolvency filings, Nortel's initial plan was to downsize and carry on portions of the telecommunications business. However, by June 2009, the decision was made to liquidate Nortel's assets.

11 On June 29, 2009, an Interim Funding and Settlement Agreement ("IFSA") was approved by both the Canadian and American courts. Among other things, it addressed interim funding for NNL and the anticipated sales of Nortel's business lines and residual intellectual property ("IP"). The parties, consisting of the Canadian Debtors, the U.S. Debtors [4], and the EMEA Debtors [5], agreed to cooperate with the sales process and also agreed that the proceeds of sale would be held in escrow. The issue of allocation was deferred.

12 Under the IFSA, there would be no distribution out of escrow without "either (i) agreement of all of the Selling Debtors [6] or (ii) ... determination by the relevant dispute resolver(s) under the terms of the Protocol ... applicable to the Sale Proceeds". The parties were then to negotiate and attempt to reach agreement "on a protocol for resolving disputes concerning the allocation of Sale Proceeds from Sale Transactions (the "Interim Sales Protocol")". Despite numerous attempts at resolution, agreement on both an Interim Sales Protocol and allocation proved to be elusive.

13 Meanwhile, over $7 billion was generated from various asset sales and other realizations. From mid-2009 until March 2011, proceeds of $3.285 billion were generated from the sale of Nortel's various business lines, including some patents. Of that amount, $2.85 billion is available for allocation. In June 2011, proceeds of approximately $4.5 billion were generated from the sale of Nortel's residual intellectual property, consisting of approximately 7,000 patents and patent applications, to the Rockstar consortium. In total, approximately $7.3 billion is currently held in escrow.

14 By orders dated January 21, 2010, the Canadian and U.S. courts approved a "Final Canadian Funding and Settlement Agreement". The Agreement addressed a number of issues and allowed NNI a $2 billion claim against NNL in NNL's *CCAA* proceeding, which claim is not subject to offset or counterclaims.

15 The parties still could not agree on an Interim Sales Protocol or on allocation. In the spring of 2013, the Canadian court and the U.S. bankruptcy court granted orders approving an "Allocation Protocol". The purpose of this Protocol was to set out "binding procedures for determining the allocation of the Sale Proceeds among the Selling Debtors" [7]. It provided for a joint hearing to determine allocation before the Canadian court and the U.S. bankruptcy court. [8] Any party in interest was at liberty to advance any theory on allocation. Leave to appeal that order was denied by this court on June 20, 2013.

16 The issue of allocation of the Lockbox Funds then proceeded to trial.

C. Trial Judge's Decision

(1) Trial Decision

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17 The trial judge's reasons may be summarized. He commenced by reviewing the history of the Nortel Group. He described the operations and the four main product groups or lines of business. Before turning to his analysis of the legal issues, he made a number of important findings about the Nortel Group's structure. He found, and repeatedly reiterated, that the Nortel Group operated as a highly-integrated multinational enterprise. For instance, he stated:

> [16] The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.
>
> [17] As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada, NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.

18 The trial judge also found that R&D, which was performed at labs around the world, was the primary driver of Nortel's value and profit.

19 After reviewing the necessary background, the trial judge turned to the legal issues before him, starting with the interpretation of the Master Research and Development Agreement ("MRDA"). The MRDA dealt with transfer-pricing arrangements, effective from 2001 onwards, among NNL, NNI, NNUK, NNSA and NN Ireland, who were parties to the agreement. [9]

20 The parties took differing and competing positions on the meaning and application of the MRDA:

• The Monitor (on behalf of the Canadian Debtors), supported by the Canadian Creditors' Committee ("CCC"), took the position that under the MRDA, NNL owned the IP whereas other participants to the MRDA were simply licensees. They argued that the proceeds derived from the sale of the residual IP belonged exclusively to NNL.

• The U.S. Debtors and other U.S. interests, including the Bondholders, argued that NNI and the other licensees held all of the rights and value in the IP in their respective exclusive territories as defined in the MRDA.

• The EMEA Debtors asserted that parties to the MRDA jointly owned all of the IP in proportion to their financial contributions to R&D and that all should share in the sale proceeds attributable to IP in those same proportions. The joint ownership arose independent of, but was recognized in, the MRDA.

• The UKPC took the position that the MRDA should not govern allocation and that a *pro rata* allocation based on a *pari passu* distribution should be used. The CCC also adopted this as its alternative position.

21 The trial judge found that, by its terms, the MRDA was to be construed in accordance with, and governed by, Ontario law. He reviewed the applicable principles of contractual interpretation, including the law on factual matrix (surrounding circumstances), commercial reasonableness, and recitals. In reviewing the law, he considered the recent authority from the Supreme Court of Canada on contractual interpretation, *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633 (S.C.C.), which was released during the course of the trial. He considered in detail the parties' positions, the language of the MRDA and evidence on factual matrix.

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22 He concluded that the MRDA was an operating agreement and was not intended to, nor did it, deal with the disposal of all of Nortel's assets in a situation in which no revenue was being earned and no profits or losses were occurring. Rather, he found that the MRDA was developed for, and driven by, transfer-pricing concepts for tax purposes and did not govern allocation after Nortel ceased operations:

> [177] I accept that the MRDA was a transfer pricing document created for tax purposes. The licenses were a part of it. The licenses granted under it were never dealt with separately from the MRDA. Their only purpose was to support the intended tax treatment resulting from the MRDA.
>
> . . . . .
>
> [185] I conclude that the circumstances surrounding the creation of the MRDA lead to no other result but that the construct of legal title to the NN Technology being in NNL in return for NNL granting exclusive licenses to the Licensed Participants was only for the purpose of supporting the proposed method to split profits or losses on a tax efficient basis while Nortel operated as a going concern business. The agreement in its application was intended to apply only to Nortel while it operated and not to deal with rights after Nortel and its subsidiaries stopped operating its businesses.

23 Thus, he rejected the primary positions of the Monitor, the CCC, the U.S. Debtors and other U.S. interests, as well as the EMEA Debtors' joint ownership theory.

24 Having found that the MRDA did not govern allocation on Nortel's insolvency and having rejected the joint ownership theory, the trial judge turned to the metric to be used to allocate the Lockbox Funds. He found that the intangible assets that were sold were not separately located or owned in any one jurisdiction. Rather, they were created by all of the so-called "Residual Profit Entities" or "RPEs" (namely, NNL, NNI, NNUK, NNSA and NN Ireland), which were located in different jurisdictions. In addition, the matrix structure allowed Nortel to draw on employees from different functional disciplines worldwide, regardless of region or country, according to need.

25 He held that NNL was not entitled to the proceeds of sale simply because the patents were in its name:

> [197] This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business. R&D and the intellectual property created from it was the primary driver of Nortel's value and profits. All parties agree on that. It would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL's name.

26 He determined that he had wide powers under the *CCAA* to do what was just in the circumstances. Section 11 of the *CCAA*, which reflected prior jurisprudence, expressly provides that a court may make any order it considers appropriate in the circumstances, subject to the provisions of the Act. He wrote:

> [208] In this case, insolvency practitioners, academics, international bodies, and others have watched as Nortel's early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation. The costs have well exceeded $1 billion. A global solution in this unprecedented situation is required and perforce, as this situation has not been faced before, it will by its nature involve innovation. Our courts have such jurisdiction. [Footnote omitted.]

27 He observed that it is a fundamental tenet of insolvency law that all debts be paid *pari passu* and that all unsecured creditors receive equal treatment. In his view, a *pro rata* allocation could be achieved by directing an allocation of the Lockbox Funds to each Debtor Estate based on the percentage that the claims against that Estate bore to the total claims against all of the Debtor Estates.

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28 In reaching this conclusion, the trial judge dealt with the argument that a *pro rata* allocation would amount to substantive consolidation. He concluded that a *pro rata* allocation would not constitute substantive consolidation in the unique circumstances of this case. In any event, even if it were substantive consolidation, there was precedent that justified substantive consolidation in this case: *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]); *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. Gen. Div. [Commercial List]); *Northland Properties Ltd., Re* (1988), 29 B.C.L.R. (2d) 257 (B.C. S.C.).

29 Ultimately, he concluded that the Lockbox Funds were to be allocated on a *pro rata* basis in accordance with certain governing principles, which are outlined below.

30 After his reasons were released, the U.S. Debtors supported by the Official Committee, the Ad Hoc Group of Bondholders and the Law Debenture Trust Company of New York filed motions for clarification, reconsideration or amendment in Canada and the U.S. and a number of points were clarified.

31 In the end result, the judgment that was signed, issued and entered on April 26, 2016 provided that the allocation proceed on a *pro rata* basis in accordance with the following principles:

(a) Each Debtor Estate [10] is to be allocated that percentage of the Lockbox Funds that the total allowed pre-filing claims against that Debtor Estate bear to the total allowed pre-filing claims against all Debtor Estates.

(b) In determining what the claims are against the Debtor Estates, pre-filing claims of the kind provable under the *Companies' Creditors Arrangement Act* that have received court approval and which have been paid may be taken into account to the extent that they have been paid under the settlement.

(c) In determining what the pre-filing claims are against each Debtor Estate, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once.

i. Claims on bonds are to be made on the Debtor Estate of the issuer and shall be included in that Debtor Estate's total allowed claims for the purpose of determining its allocation. A claim can be recognized by the Debtor Estate that guaranteed the bond, but those claims will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

ii. If the UK Pension Claimants make a claim for the approximately £2.2 billion deficit in the NNUK pension plan against NNUK and also against other EMEA Debtors or the EMEA Non-Filed Entities, the claim against NNUK will be taken into account in determining claims against the Debtor Estates for allocation purposes but the additional claims against the EMEA Debtors or the EMEA Non-Filed Entities will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

(d) Subject to the general proviso in (c), above, in respect of claims that can be made against more than one Debtor Estate, pre-filing intercompany claims against a Debtor Estate shall be included in the determination of the claims against that Debtor Estate for purposes of its allocation.

(e) The following specific pre-filing claims shall be included in the determination of the allowed claims against NNL for purposes of determining its allocation:

i. the US$2.0627 billion claim of NNI against NNL that was approved by this Court and the U.S. Court;

ii. the claims of NNUK and Nortel Networks SpA against NNL pursuant to the Agreement Settling EMEA Canadian Claims and Related Claims dated July 9, 2014; and

iii. the claim of the UK Pension Claimants against NNL recognized in this Court's judgment of December 9, 2014, as such claim is finally determined.

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(f) Cash on hand in any Debtor Estate will not be taken into account in determining its allocation. Each Debtor Estate with cash on hand will continue to hold that cash and deal with it in accordance with its administration.

D. Analysis

32 Six moving parties now seek leave to appeal from the trial judge's allocation decision: the U.S. Debtors, the Ad Hoc Group of Bondholders, the Conflicts Administrator of Nortel Networks S.A., the Official Committee of Unsecured Creditors of NNI and others, the Bank of New York Mellon as Indenture Trustee, and the Nortel Trade Claims Consortium.

33 We will commence our analysis by discussing the test for leave to appeal under the *CCAA* and then address the moving parties' positions in relation to that test.

(1) Test for Leave to Appeal

34 Section 13 of the *CCAA* provides that any person dissatisfied with an order or a decision made under the Act may appeal from the order or decision with leave. Leave to appeal is granted sparingly in *CCAA* proceedings and only where there are serious and arguable grounds that are of real and significant interest to the parties. In addressing whether leave should be granted, the court will consider whether:

(a) the proposed appeal is *prima facie* meritorious or frivolous;

(b) the points on the proposed appeal are of significance to the practice;

(c) the points on the proposed appeal are of significance to the action; and

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

See, for e.g.: *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 24; *Timminco Ltd., Re*, 2012 ONCA 552, 2 C.B.R. (6th) 332 (Ont. C.A.), at para. 2; and *Nortel Networks Corp., Re*, 2013 ONCA 427, 5 C.B.R. (6th) 254 (Ont. C.A.), at para. 3.

(a) Whether Appeal is Prima Facie Meritorious

35 The moving parties take the position that leave should be granted because the appeal is *prima facie* meritorious. In making that argument, they raise three main issues — substantive consolidation, the interpretation of the MRDA, and questions of fairness. We will deal with each issue in turn.

(i) Substantive consolidation

Position of the Moving Parties

36 First, the moving parties submit that the trial judge erred in not recognizing that the allocation ordered departed from "corporate separateness" and was a form of substantive consolidation.

37 Secondly, it is alleged that the trial judge erred by applying an inappropriately low threshold for the application of substantive consolidation.

38 In its supplementary factum, the Bank of New York Mellon, as Indenture Trustee, makes a related argument. It submits that since the Nortel proceeding no longer involves a restructuring, the *CCAA*'s purpose is spent and the proceeds should thereafter be distributed under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), or at least in a manner consistent with the *BIA* scheme. It says the *BIA* does not contemplate consolidation but rather distribution on an entity-by-entity basis.

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39 Finally, the Ad Hoc Group of Bondholders makes a related argument. It submits that the allocation decision takes property interests that belong to certain debtor estates and gives them to others. They argue that, even though the authority provided under s. 11 is broad, the *CCAA* does not permit a court to redistribute property in this way.

Analysis

40 The moving parties' arguments on substantive consolidation are not *prima facie* meritorious.

41 Professor Janis Sarra, a leading expert on insolvency law in Canada, describes substantive consolidation in her article "Corporate Group Insolvencies: Seeing the Forest and the Trees" (2008) 24 B.F.L.R. 63, at pp. 80 - 81:

> Substantive consolidation essentially treats member entities of a corporate group as one entity. In the context of liquidation, it creates a common pool of assets to meet creditors' claims. In the context of restructuring, it may create the opportunity f or creditors to share in the future upside potential of a restructured entity or entities by centralizing and negotiating an arrangement in respect of their claims. Canadian courts have recognized substantive consolidation under both the *BIA* and the *CCAA* where there is evidence of intertwined assets and liabilities; integrated administrative functioning and operations; a perception by creditors that they are dealing with an integrated entity; common control and governance structures; where it would be impracticable to separate the affairs of related entities; where it is more cost effective and beneficial to creditors to have the proceedings administered as a single estate; and where it would result in an expeditious and administratively efficient administration of the proceeding.

42 As we have noted, the trial judge concluded that *pro rata* allocation was appropriate, that it did not amount to substantive consolidation, and that even if it could be said that a *pro rata* allocation involved substantive consolidation, it was not precluded by law in the unique circumstances of the case.

43 In reaching those conclusions, he made numerous factual findings, in addition to those already mentioned, including the following:

- "Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP through integrated R&D activities that were global in scope": para. 223.

- "[N]o one entity or region was able to provide the full line of Nortel products and services": para. 202.

- "Nortel's matrix structure also allowed Nortel to draw on employees from different functional disciplines worldwide ... regardless of region or country according to need": para. 203.

- "R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis": para. 202.

- "The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements [did] not mean that Nortel operated a separate business in each country. It did not": para. 202.

- "The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions": para. 202.

- The assets are "so intertwined that it is difficult to separate them for purposes of dealing with different entities": para. 222.

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• There is "no recognized measurable right in any one of the selling Debtor Estates to all or a fixed portion of the proceeds of sale": para 224.

• "Nortel has had significant difficulty in determining the ownership of its princip[al] assets, namely the $7.3 billion representing the proceeds of the sales of the lines of business and the residual patent portfolio", which "constitutes more than 80 per cent of the total assets of all Nortel entities": para. 222.

44 In addition to his factual findings supporting the *pro rata* order, the trial judge explained why the allocation in this case did not constitute substantive consolidation, either actual or deemed:

• The Lockbox Funds were largely due to the sale of IP and no one Debtor Estate had any right to the funds. They did not belong in whole or in part to any one Estate or combination of Estates.

• The various entities and the various Estates were not being treated as one entity and the creditors of each entity would not become creditors of a single entity. Each entity remained separate and with its own creditors.

• Each entity would maintain its own cash on hand and would be administered separately.

• The inter-company claims would not be eliminated.

45 Similarly, Judge Gross explained at p. 554 of his reasons that the *pro rata* allocation, which was not a distribution, "both recognizes the integrity of the corporate separateness and the integrated synergistic operations of Nortel." Furthermore, he noted that a "pro rata allocation does not merge the Nortel Debtors into a single survivor and does not erase intercompany claims": p. 554.

46 In our view, there is no *prima facie* merit to the argument that we should interfere with the trial judge's conclusion that the allocation decision did not amount to substantive consolidation. His conclusion was based on the nature and effect of his allocation decision and his factual findings. He made the findings having heard from 36 witnesses and having received and reviewed thousands of exhibits and dozens of deposition transcripts over the course of a six-week trial. Those factual findings were central to the result. Absent palpable and overriding error, those factual findings are afforded deference by this court: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.), at para. 10.

47 The moving parties also allege that the trial judge erred by applying an inappropriately low threshold for the application of substantive consolidation in finding that, even if the allocation did constitute substantive consolidation, it was permissible. They point to *Northland* as the leading authority on substantive consolidation but say that it is time to revisit that decision in Canada.

48 The trial judge correctly observed that while the *CCAA* does not expressly address the issue of substantive consolidation, jurisprudence in Canada has recognized substantive consolidation as being appropriate in certain exceptional circumstances: see, for e.g., *Lehndorff General Partner Ltd.*, *PSINet Ltd.*, and *Northland Properties Ltd.*

49 He also correctly observed that the court has jurisdiction to make any order that it considers appropriate in the circumstances under s. 11 of the *CCAA*. Although that section came into effect after the Nortel filing under the *CCAA*, it reflects past jurisprudence: *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), at para. 68. Specifically, s. 11 states:

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

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50 That said, since there is no *prima facie* merit to the argument that the *pro rata* allocation constitutes substantive consolidation, there is no need to re-visit the jurisprudence governing substantive consolidation in Canada or to consider whether the threshold for substantive consolidation should be changed.

51 Furthermore, we see no merit in the argument raised by the Bank of New York Mellon that the trial judge erred by failing to allocate the Lockbox Funds in a manner consistent with the *BIA* scheme, which contemplates distribution on an entity-by-entity basis. Under the *CCAA* allocation decision, distribution to creditors will be done on an entity-by-entity basis.

52 Finally, the argument raised by the Ad Hoc Group of Bondholders and the Official Committee also lacks merit. It presumes that the various Nortel companies had distinct and separable property rights in Nortel's IP. The trial judge repeatedly rejected that proposition. As we explain in the following sections, we see no merit in the argument that the trial judge erred in failing to recognize such distinct property rights. As such, we see no merit in the argument that he exercised his authority in a way that ignored such rights.

53 This ground of appeal is not *prima facie* meritorious.

(ii) The Interpretation of the MRDA

Position of Moving Parties

54 The moving parties take the position that the trial judge erred in concluding that the MRDA has no application to the allocation of the Lockbox Funds. On their reading, the MRDA provides NNI and other "Integrated Entities" with valuable rights to Nortel's IP in their respective exclusive jurisdictions. They note that the trial judge and Judge Gross diverged on the issue of IP rights under the MRDA.

55 The thrust of their contractual argument is two-fold: (1) the trial judge misinterpreted the MRDA by disregarding the words of the agreement; and (2) he failed to apply the Supreme Court of Canada's decision in *Sattva Capital Corp.* by taking an impermissibly narrow view of the scope of factual matrix evidence. In particular, they submit that the trial judge failed to take into account evidence relating to, and explaining, the tax-driven nature of the MRDA and the purposes the parties were trying to achieve through the agreement.

Analysis

56 We reject the moving parties' submissions on the interpretation of the MRDA.

57 On August 1, 2014, the Supreme Court of Canada released *Sattva Capital Corp.* The essence of that decision is best captured by excerpts from the reasons of the court written by Rothstein J.:

- "Historically, determining the legal rights and obligations of the parties under a written contract was considered a question of law": para. 43.

- "[T]he historical approach should be abandoned. Contractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix": para. 50.

- "[T]his Court in *Housen [v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235] found that deference to fact-finders promoted the goals of limiting the number, length, and cost of appeals, and of promoting the autonomy and integrity of trial proceedings .... These principles also weigh in favour of deference to first instance decision-makers on points of contractual interpretation. The legal obligations arising from a contract are, in most cases, limited to the interest of the particular parties. Given that our legal system leaves broad scope to tribunals of first instance to resolve

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issues of limited application, this supports treating contractual interpretation as a question of mixed fact and law": para. 52.

• "[I]t may be possible to identify an extricable question of law from within what was initially characterized as a question of mixed fact and law .... Legal errors made in the course of contractual interpretation include 'the application of an incorrect principle, the failure to consider a required element of a legal test, or the failure to consider a relevant factor'": para. 53.

• "However, courts should be cautious in identifying extricable questions of law in disputes over contractual interpretation": para. 54.

• "The close relationship between the selection and application of principles of contractual interpretation and the construction ultimately given to the instrument means that the circumstances in which a question of law can be extricated from the interpretation process will be rare": para. 55.

58 Justice Rothstein also discussed the need to consider the surrounding circumstances, or factual matrix of a contract, when interpreting a written agreement. The goal of contractual interpretation is to ascertain the objective intentions of the parties. In doing so, "a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract": para. 47. Recognizing that words do not have an immutable meaning, the court should consider the contract's commercial purpose, taking into account its genesis, background, context, and the market in which the parties are operating.

59 In this case, the moving parties suggest that the trial judge erred in his interpretation of the MRDA and failed to pay heed to *Sattva Capital Corp.* In our view, the moving parties' arguments are not *prima facie* meritorious.

60 We are not persuaded that there is any reason to interfere with the trial judge's interpretation of the agreement on the basis of palpable and overriding error. Nor, in our view, have the moving parties pointed to any extricable legal error warranting intervention by this court.

61 As mentioned, although *Sattva Capital Corp.* was released during the course of the allocation trial, the trial judge nonetheless considered and applied *Sattva Capital Corp.* in interpreting the MRDA. In over 40 paragraphs, he addressed the relevant law on, and evidence of, factual matrix: see paras. 55 - 57, 117 - 157. He properly rejected evidence of subjective intention as being inadmissible.

62 We would also observe that, as noted by the Monitor and the Canadian Debtors, to be fully successful on their appeal, the U.S. Debtors would have to persuade the court that the trial judge should have: (i) concluded that the MRDA controlled allocation of Nortel's assets in the event of insolvency; (ii) adopted the interpretation of the MRDA advanced by the U.S. Debtors; and (iii) accepted the expert valuation evidence tendered by the U.S. Debtors.

63 The trial judge did none of these things. All of his conclusions to the contrary engage questions of fact or mixed fact and law that are well within his province.

64 For instance, the trial judge rejected the U.S. Debtors' valuation evidence as unreliable and the moving parties' factums are silent on how this finding could be overcome. The acceptance or rejection of the evidence of a witness is squarely within the fact-finding arena of the trial judge. The moving parties have suggested no reason why the trial judge's findings on valuation would be reversed.

65 In conclusion, this ground of appeal does not warrant granting leave to appeal.

(iii) Fairness to the Parties and Related Arguments

Position of Moving Parties

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66 Next, the moving parties submit that they were denied procedural fairness in various respects and that the allocation decision is, among other things, arbitrary, and inequitable. In this regard, we do not propose to address every argument in the multitude of factums filed. The principal submissions on fairness and related arguments that merit comment are as follows.

67 The moving parties say they were given no notice or opportunity to make submissions on the remedy granted. Moreover, there was no record before the court on the full spectrum of claims asserted against the Selling Debtors and no one proposed the specific remedy granted.

68 The U.S. Debtors also submit that the remedy did not respond to the question before the court, which they say was the allocation of the Sale Proceeds (i.e. the proceeds from a particular Sale Transaction) among the Selling Debtors (i.e. the Nortel parties to a particular Sale Transaction). In their view, the trial judge did not answer that question but instead allocated the Sale Proceeds to Nortel entities that did not transfer assets in a particular Sale Transaction and were, thus, not entitled to any Sale Proceeds.

69 The Ad Hoc Group of Bondholders similarly submits that the trial judge answered the wrong question. For instance, it says that the only question properly before the court was to determine the relative value of the assets, rights and interests that each Selling Debtor sold or relinquished, which generated the Sale Proceeds. Moreover, they say that the decision disregards their legitimate expectations.

70 The U.S. Debtors further submit that the allocation is arbitrary since there is no logical connection between what will be or will not be counted for allocation purposes. In particular, they point to the fact the allocation excludes $4 billion in bondholder guarantee claims from the U.S. Debtors' allocation. They say that, as a result, the U.S. Debtors will receive no allocation of funds on account of approximately two-thirds of their claims.

71 Similarly, the Ad Hoc Group of Bondholders submits the allocation is arbitrary as it produces a redistribution of assets among debtors that violates the rule that equity holders get paid after creditors.

72 The Conflicts Administrator of NNSA also takes issue with the fairness of the allocation decision. It says that NNSA is prejudiced by the decision because of the relatively small quantum of its creditors' claims in comparison with those of other debtor estates.

73 Finally, the Official Committee, which represents all general unsecured creditors of the U.S. Debtors, complains that the trial judge exercised his discretion in an unprincipled way and strayed into improper "commercial judicial moralism".

Analysis

74 We are not satisfied that there is *prima facie* merit to the moving parties' submissions.

75 As explained, the trial judge was required to "determine the allocation of the Sale Proceeds among the Selling Debtors" under the Allocation Protocol.

76 Given the trial judge's conclusion that the MRDA did not govern allocation and his rejection of the EMEA Debtors' joint ownership theory, the trial judge had to determine what other metric should be used to allocate the Lockbox Funds among the U.S., Canadian and EMEA Debtor Estates.

77 The Allocation Protocol permitted submissions on "any theory of allocation". At trial, the UKPC and the CCC, in the alternative, sought a *pro rata* distribution of the funds held in escrow and each submitted expert reports that supported a *pro rata* result. Moreover, the U.S. Debtors, the Official Committee and the Ad Hoc Group of Bondholders all made submissions before the trial judge opposing a *pro rata* allocation and had an opportunity to test the evidence. They submitted a motion to strike the *pro rata* allocation evidence, attacked the reliability of the expert reports and cross-examined the experts.

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78 Thus, all parties knew that a *pro rata* allocation was in play. The fact that the specifics of the allocation ordered by the trial judge were not identical to those advanced by any of the parties does not, in our view, create unfairness to the parties. This is not a situation where the trial judge addressed an issue that was not before him, failed to grapple with the arguments or evidence, or came up with a new theory of the case.

79 The two judges were not required to determine value but allocation. The IFSA provided for a right to receive an allocation of the Sale Proceeds without restricting the basis upon which that allocation might be determined by the two courts. In particular, we note that the trial judges were given authority to decide the issue of allocation. In addition to the terms of the Allocation Protocol, we note s.10(a) of the IFSA:

> [T]his Agreement is not, and shall not be deemed to be, an acknowledgement by any Party of the assumption, ratification, adoption or rejection of the Transfer Pricing Agreements or any other Transfer Pricing methodology employed by the Nortel Group or its individual members for any purpose nor shall it be determinative of, or have any impact whatsoever on, the allocation of proceeds to any Debtor from any sale of assets of the Nortel Group;
>
> [Emphasis added.]

80 We also observe that the trial judge turned his mind to expectations and found that there was no evidence to support the Bondholders' argument that their legitimate expectations would be disregarded by a *pro rata* allocation.

81 Furthermore, we see no basis for the assertion that the allocation framework is arbitrary and unfair since it excludes $4 billion in Bondholder guarantee claims from the U.S. Debtors' allocation. Under the allocation decision, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once for allocation purposes. This principle is applicable to all claims. The allocation decision also specifies that claims on bonds are to be made on the Debtor Estate of the issuer. Claims on those bonds may also be made on the Debtor Estate of the guarantor but those claims will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

82 On the reconsideration motion, it was argued that the trial judge's decision should be changed to provide that the claims by the bondholders on the guaranteed bonds against the issuer and guarantor Debtor Estates should be included in the claims for allocation purposes. It was contended that, without such a change, there would be a manifest injustice, especially to the creditors of the U.S. Debtors other than the bondholders.

83 The trial judge rejected that argument, noting that the $2 billion admitted claim against NNL endures. Further, cash on hand in the U.S. Debtors' Estates would be available to their creditors. He also noted that the issue of the treatment of the guaranteed bonds, and whether they should be counted once or twice in a *pro rata* allocation, was a live issue in evidence at trial, which was open to the U.S. Debtors to explore. He found, at para. 16, that "any lack of briefing by the U.S. Debtors and the [Official Committee] was a deliberate tactic taken by them in attacking the pro rata allocation method proposed at trial". He concluded that, even if he were to reconsider the double-counting issue, he would not change his mind:

> I see no injustice in the result.... There must also be considered other claims that could be made against more than one Debtor Estate, including the pension claim by the UKPC against NNUK that could be made against other EMEA Debtors and claims that could be made on bonds issued by NNL and guaranteed by NNC. The allocation decision precludes the double counting of any such claims for allocation purposes. The U.S. Debtors and [Official Committee] do not suggest that any of these other claims should be permitted to be claimed twice for allocation purposes. I see no basis to treat the guaranteed bonds any differently for allocation purposes. The principles that govern allocation should be applied consistently to each debtor.

84 We are not persuaded that there is *prima facie* merit to the argument that the allocation is arbitrary. The trial judge was clearly alive to the fairness concerns and gave reasons for adopting the approach he did after careful consideration of the evidence and argument at trial.

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85 We would also observe that there was no other clear answer to the question of who was entitled to receive the sale proceeds. As Judge Gross noted at p. 500 of his reasons, the parties "submitted widely varying approaches for deciding the issue leaving virtually no middle ground." The U.S. Debtors and Bondholders argued that in excess of $5 billion belonged to the U.S. Estate and that the Canadian Estate should receive only $0.77 billion. The Canadian Debtors and the Monitor, in sharp contrast, argued that in excess of $6 billion belonged to the Canadian Estate and that the U.S. Estate should receive just over $1 billion. The highly integrated nature of the Nortel business operations and the nature of the assets sold defied either outcome.

86 Judge Gross's comments in his reasons on the allocation trial, at pp. 532-533, accurately sum up the context in which the two courts came to adopt the *pro rata* allocation approach:

> The Court is convinced that where, as here, operating entities in an integrated, multi-national enterprise developed assets in common and there is nothing in the law or facts giving any of those entities certain and calculable claims to the proceeds from the liquidation of those assets in an enterprise-wide insolvency, adopting a prorata allocation approach, which recognizes inter-company and settlement related claims and cash in hand, yields the most acceptable result.
>
> There is nothing in the law or facts of this case which weighs in favour of adopting one of the wide ranging approaches of the Debtors. There is no uniform code or international treaty or binding agreement which governs how Nortel is to allocate the Sales Proceeds between the various insolvency estates or subsidiaries spread across the globe.

87 Nor are we satisfied that there is *prima facie* merit to the Official Committee's argument that the trial judge exercised his discretion in an unprincipled way by straying into improper "commercial judicial moralism". To the extent the Official Committee is suggesting that it amounts to judicial moralism when a judge takes into account fairness concerns, we reject that argument. The trial judge considered the evidence before him in considerable detail and worked with the facts presented to him. Based on those facts, he concluded that a *pro rata* order constituted the answer to the allocation issue. The fact that the answer is also fair should not detract from the force of his conclusion.

88 Finally, we are not persuaded that there is any merit to the argument that the allocation violates the rule that equity holders get paid after creditors. The Ad Hoc Group of Bondholders submits that the trial judge's decision results in NNL (NNI's parent company) receiving allocation proceeds from the sale of NNI's assets and rights that ought to have been allocated to the NNI estate for the benefit of NNI's creditors. This argument is premised on NNI having a right to the particular proceeds as a result of the MRDA interpretation advanced by the U.S. Debtors and Bondholders. As we have discussed above, the trial judge rejected that argument.

89 For these reasons, we conclude that none of the fairness and related arguments put forward by the moving parties are *prima facie* meritorious.

(b) Significance of Issues to the Practice

Position of Moving Parties

90 The moving parties submit that the trial judge's decision presents important issues of first impression in the cross-border insolvency context. They submit that, without appellate intervention, there is a risk substantive consolidation will become far more widely available. In addition, they say that it creates significant uncertainty on the separation of subsidiaries within a corporate group and on the consequences of an insolvency proceeding on the rights of stakeholders, including creditors. In their submission, an appeal would permit this court to clarify these issues. Furthermore, the appeal would allow this court to clarify the proper interpretation and effect of *Sattva Capital Corp.* on commercial agreements.

Analysis

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91 As discussed above, the moving parties have raised three main issues they say warrant leave — namely, substantive consolidation, the interpretation of the MRDA, and fairness. Of the three issues, the moving parties submit that the first two raise issues of significant interest to the practice.

92 We disagree.

93 The facts of this case are unique and exceptional. As we have already discussed, substantive consolidation is not engaged and so this case would not provide an opportunity for this court to provide guidance on that question. Nor does this case engage any issues that require any clarification on the application of *Sattva Capital Corp.* . In short, granting leave would not provide an opportunity for this court to provide guidance on legal issues of significance to the practice.

(c) Significance of Issues to the Action

Position of Moving Parties

94 The moving parties state that the allocation of the Lockbox Funds is the overriding issue in the *CCAA* proceedings.

Analysis

95 We accept that the allocation of the Lockbox Funds is a significant issue in this *CCAA* proceeding. That said, we are of the view that, standing alone, this factor is insufficient to warrant granting leave to appeal. To perhaps state the obvious, typically parties tend to seek leave to appeal a decision that is of significance to an action.

(d) Progress of Proceedings

Position of Moving Parties

96 The moving parties submit that the proposed appeal will not unduly hinder the progress of Nortel's *CCAA* proceeding. They state that many steps and issues remain before creditor distributions can be made, including the determination of claims. In addition, the allocation decisions of the Canadian court and the U.S. court must both be final orders in their respective jurisdictions before funds can be released from escrow. It is argued that this court should grant leave to ensure that it maintains the ability to address any issues should Judge Gross's decision be varied or overturned on appeal.

97 The moving parties also make the point that there are no operating businesses that are in the process of restructuring because the Nortel businesses and assets have been liquidated and the joint trial was a "stand-alone component" of the *CCAA* proceeding. Thus, it is argued that the traditional concerns leading courts to "sparingly" grant leave to appeal in *CCAA* proceedings are not applicable here. In fact, the Official Committee submits that where an appeal would have existed as of right under the *BIA*, it is nonsensical to deny leave here simply because Nortel's liquidation proceeded under the *CCAA*.

Analysis

98 This brings us to the final consideration: progress. Repeatedly, the parties have been encouraged to resolve their differences, but without success. For instance, in a 2011 decision, *Nortel Networks Inc., Re*, 669 F.3d 128 (U.S. C.A. 3rd Cir. 2011), the Third Circuit Court of Appeals admonished the parties at p. 143:

> We are concerned that the attorneys representing the respective sparring parties may be focusing on some of the technical differences governing bankruptcy in the various jurisdictions without considering that there are real live individuals who will ultimately be affected by the decisions being made in the courtrooms. It appears that the largest claimants are pension funds in the U.K. and the United States, representing pensioners who are undoubtedly

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> dependent, or who will become dependent, on their pensions. They are the Pawns in the moves being made by the Knights and the Rooks.
>
> Mediation, or continuation of whatever mediation is ongoing, by the parties in good faith is needed to resolve the differences. [Footnote omitted.]

99 Former Chief Justice Winkler also encouraged the parties to find a way to resolve this matter. In April 2012, he warned about the "prospect of additional delays and the potential for conflicting decisions" if the parties failed to reach a negotiated settlement.

100 Numerous mediations have been ordered but have failed.

101 In the Annual Review of Insolvency, Kevin P. McElcheran described *Nortel* as a case that has become "an emblem of waste and dysfunction in a system intended to foster consensus based solutions to commercial insolvency", noting that it has "eclipsed all previous Canadian cases in both duration and expense": 2014 Ann. Rev. Insolv. L. 24 at p. 24. And that was in 2014.

102 Consistent allocation decisions have been issued by the Canadian and U.S. courts. A further appeal proceeding in Canada would achieve nothing but more delay, greater expense, and an erosion of creditor recoveries. There are asymmetric appeal routes in Canada and the U.S. However, we do not accept that the separate appeal proceedings in the U.S. somehow diminish the need to bring these proceedings in Canada to a conclusion. In our view, any additional step is a barrier to progress.

103 Furthermore, the fact that this case is a liquidation and not a restructuring does not render delay immaterial, where so many individuals and businesses continue to await a resolution of this proceeding. The potential of an interim distribution, remote or otherwise, does not alter this reality. In addition, the parties acceded to a liquidation under the *CCAA*. They cannot now reject the parameters of that statute, which requires leave to appeal, and where the jurisprudence on the applicable test is settled and long-standing.

E. Standing Issue

104 There is the additional issue of the standing of the Nortel Trade Claims Consortium that needs to be addressed. It represents a group of creditors that collectively holds over $130 million in unsecured claims against NNI and certain of its U.S. affiliates. It includes institutional investors and former Nortel employees. Unlike other U.S. creditors, the Consortium's sole recourse is against the U.S. Debtors' estates.

105 At trial, the Consortium was represented by the Official Committee. It says that, given the trial decision, its interests may diverge from those of the rest of the Official Committee. It submits that the Consortium should have standing to seek leave to appeal. It relies on the court's jurisdiction to grant leave to appeal, pursuant to s. 13 of the *CCAA*, to "any person dissatisfied with an order or a decision made under [the] Act". It argues that the trial judge exceeded his jurisdiction by deciding matters that are properly for the U.S. court to decide.

106 It is unnecessary to decide the standing issue. Even if the Consortium had standing, we would dismiss its leave motion for the same reasons we have dismissed the other leave motions. In any event, we see no merit in its argument that the trial judge exceeded his jurisdiction.

F. Disposition

107 In conclusion, we are not persuaded that the test for leave to appeal has been met. For these reasons, we dismiss all of the motions for leave to appeal.

Motions dismissed.

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Footnotes

1 All references to dollars are to U.S. dollars, unless otherwise specified.

2 Judge Gross's reasons are reported at 532 B.R. 494 (U.S. Bankr. D. Del. 2015).

3 In accordance with the directions of the Court of Appeal case management judge, there was one main factum filed on behalf of the moving parties by the U.S. Debtors and one main factum filed on behalf of the responding parties by the UKPC. Six supplementary factums and one reply factum were also filed.

4 With the exception of Nortel Networks (CALA) Inc.

5 The Joint Administrators were also party to the IFSA but only for the purposes of Section 17 (No Personal Liability of the Joint Administrators).

6 A description of "Selling Debtor" is found in s.12 (a) of the IFSA: "Each Debtor hereby agrees that its execution of definitive documentation with a purchaser (or, in the case of any auction, the successful bidder in any such auction) of, or closing of any sale of, material assets of any of the Debtors to which such Debtor (a "Selling Debtor") is proposed to be a party..."

7 Selling Debtors was defined in the Allocation Protocol as the "Canadian Debtors, U.S. Debtors, EMEA Debtors and Nortel Networks Optical Components Ltd., Nortel Networks AS, Nortel Networks AG, Nortel Networks South Africa (Pty) Limited, and Nortel Networks (Northern Ireland) Limited."

8 The EMEA Debtors were held to have attorned to the jurisdiction of the Canadian court and the U.S. bankruptcy court.

9 Nortel Networks Australia was also a party to the agreement. It ceased being a Residual Profit Entity on December 31, 2007.

10 The order defines "Debtor Estate" as "each of the individual legal entities" set out in Schedule B. Schedule B lists the 45 entities, including the Canadian Debtors, the U.S. Debtors, the EMEA Debtors and five "EMEA Non-Filed Entities" who have not commenced insolvency proceedings. See also the similar definition given to Selling Debtors under the Allocation Protocol.

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2000 ABQB 442
Alberta Court of Queen's Bench

Canadian Airlines Corp., Re

2000 CarswellAlta 662, 2000 ABQB 442, [2000] 10 W.W.R. 269, [2000] A.W.L.D. 654, [2000] A.J. No. 771, 20 C.B.R. (4th) 1, 265 A.R. 201, 84 Alta. L.R. (3d) 9, 98 A.C.W.S. (3d) 334, 9 B.L.R. (3d) 41

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

In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c. B-15, as Amended, Section 185

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

Paperny J.

Heard: June 5-19, 2000
Judgment: June 27, 2000 *
Docket: Calgary 0001-05071

Counsel: *A.L. Friend, Q.C.*, *H.M. Kay, Q.C.*, *R.B. Low, Q.C.*, and *L. Goldbach*, for Petitioners.
S.F. Dunphy, *P. O'Kelly*, and *E. Kolers*, for Air Canada and 853350 Alberta Ltd.
D.R. Haigh, Q.C., *D.N. Nishimura*, *A.Z.A. Campbell* and *D. Tay*, for Resurgence Asset Management LLC.
L.R. Duncan, Q.C., and *G. McCue*, for Neil Baker, Michael Salter, Hal Metheral, and Roger Midiaty.
F.R. Foran, Q.C., and *P.T. McCarthy, Q.C.*, for Monitor, PwC.
G.B. Morawetz, *R.J. Chadwick* and *A. McConnell*, for Senior Secured Noteholders and the Bank of Nova Scotia Trust Co.
C.J. Shaw, Q.C., for Unionized Employees.
T. Mallett and *C. Feasby*, for Amex Bank of Canada.
E.W. Halt, for J. Stephens Allan, Claims Officer.
M. Hollins, for Pacific Costal Airlines.
P. Pastewka, for JHHD Aircraft Leasing No. 1 and No. 2.
J. Thom, for Royal Bank of Canada.
J. Medhurst-Tivadar, for Canada Customs and Revenue Agency.
R. Wilkins, Q.C., for Calgary and Edmonton Airport Authority.

Subject: Corporate and Commercial; Insolvency

APPLICATION by airline for approval of plan of arrangement; COUNTER-APPLICATION by investment corporation for declaration that plan constituted merger or transfer of airline's assets to AC Corp., that plan would not affect investment corporation, and directing repurchase of notes pursuant to trust indenture, and that actions of airline and AC Corp. in formulating plan were oppressive and unfairly prejudicial; COUNTER-APPLICATION by minority shareholders.

***Paperny J.*:**

I. Introduction

1 After a decade of searching for a permanent solution to its ongoing, significant financial problems, Canadian Airlines Corporation ("CAC") and Canadian Airlines International Ltd. ("CAIL") seek the court's sanction to a plan of

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arrangement filed under the *Companies' Creditors Arrangement Act* ("CCAA") and sponsored by its historic rival, Air Canada Corporation ("Air Canada"). To Canadian, this represents its last choice and its only chance for survival. To Air Canada, it is an opportunity to lead the restructuring of the Canadian airline industry, an exercise many suggest is long overdue. To over 16,000 employees of Canadian, it means continued employment. Canadian Airlines will operate as a separate entity and continue to provide domestic and international air service to Canadians. Tickets of the flying public will be honoured and their frequent flyer points maintained. Long term business relationships with trade creditors and suppliers will continue.

2 The proposed restructuring comes at a cost. Secured and unsecured creditors are being asked to accept significant compromises and shareholders of CAC are being asked to accept that their shares have no value. Certain unsecured creditors oppose the plan, alleging it is oppressive and unfair. They assert that Air Canada has appropriated the key assets of Canadian to itself. Minority shareholders of CAC, on the other hand, argue that Air Canada's financial support to Canadian, before and during this restructuring process, has increased the value of Canadian and in turn their shares. These two positions are irreconcilable, but do reflect the perception by some that this plan asks them to sacrifice too much.

3 Canadian has asked this court to sanction its plan under s. 6 of the CCAA. The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all the stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan represent a fair and reasonable compromise that will permit a viable commercial entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.

II. Background

Canadian Airlines and its Subsidiaries

4 CAC and CAIL are corporations incorporated or continued under the *Business Corporations Act* of Alberta, S.A. 1981, c. B-15 ("ABCA"). 82% of CAC's shares are held by 853350 Alberta Ltd.("853350") and the remaining 18% are held publicly. CAC, directly or indirectly, owns the majority of voting shares in and controls the other Petitioner, CAIL and these shares represent CAC's principal asset. CAIL owns or has an interest in a number of other corporations directly engaged in the airline industry or other businesses related to the airline industry, including Canadian Regional Airlines Limited ("CRAL"). Where the context requires, I will refer to CAC and CAIL jointly as "Canadian" in these reasons.

5 In the past fifteen years, CAIL has grown from a regional carrier operating under the name Pacific Western Airlines ("PWA") to one of Canada's two major airlines. By mid-1986, Canadian Pacific Air Lines Limited ("CP Air"), had acquired the regional carriers Nordair Inc. ("Nordair") and Eastern Provincial Airways ("Eastern"). In February, 1987, PWA completed its purchase of CP Air from Canadian Pacific Limited. PWA then merged the four predecessor carriers (CP Air, Eastern, Nordair, and PWA) to form one airline, "Canadian Airlines International Ltd.", which was launched in April, 1987.

6 By April, 1989, CAIL had acquired substantially all of the common shares of Wardair Inc. and completed the integration of CAIL and Wardair Inc. in 1990.

7 CAIL and its subsidiaries provide international and domestic scheduled and charter air transportation for passengers and cargo. CAIL provides scheduled services to approximately 30 destinations in 11 countries. Its subsidiary, Canadian Regional Airlines (1998) Ltd. ("CRAL 98") provides scheduled services to approximately 35 destinations in Canada and the United States. Through code share agreements and marketing alliances with leading carriers, CAIL and its subsidiaries provide service to approximately 225 destinations worldwide. CAIL is also engaged in charter and cargo services and the provision of services to third parties, including aircraft overhaul and maintenance, passenger and cargo handling, flight simulator and equipment rentals, employee training programs and the sale of Canadian Plus frequent flyer points. As at December 31, 1999, CAIL operated approximately 79 aircraft.

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8 CAIL directly and indirectly employs over 16,000 persons, substantially all of whom are located in Canada. The balance of the employees are located in the United States, Europe, Asia, Australia, South America and Mexico. Approximately 88% of the active employees of CAIL are subject to collective bargaining agreements.

Events Leading up to the CCAA Proceedings

9 Canadian's financial difficulties significantly predate these proceedings.

10 In the early 1990s, Canadian experienced significant losses from operations and deteriorating liquidity. It completed a financial restructuring in 1994 (the "1994 Restructuring") which involved employees contributing $200,000,000 in new equity in return for receipt of entitlements to common shares. In addition, Aurora Airline Investments, Inc. ("Aurora"), a subsidiary of AMR Corporation ("AMR"), subscribed for $246,000,000 in preferred shares of CAIL. Other AMR subsidiaries entered into comprehensive services and marketing arrangements with CAIL. The governments of Canada, British Columbia and Alberta provided an aggregate of $120,000,000 in loan guarantees. Senior creditors, junior creditors and shareholders of CAC and CAIL and its subsidiaries converted approximately $712,000,000 of obligations into common shares of CAC or convertible notes issued jointly by CAC and CAIL and/or received warrants entitling the holder to purchase common shares.

11 In the latter half of 1994, Canadian built on the improved balance sheet provided by the 1994 Restructuring, focussing on strict cost controls, capacity management and aircraft utilization. The initial results were encouraging. However, a number of factors including higher than expected fuel costs, rising interest rates, decline of the Canadian dollar, a strike by pilots of Time Air and the temporary grounding of Inter-Canadien's ATR-42 fleet undermined this improved operational performance. In 1995, in response to additional capacity added by emerging charter carriers and Air Canada on key transcontinental routes, CAIL added additional aircraft to its fleet in an effort to regain market share. However, the addition of capacity coincided with the slow-down in the Canadian economy leading to traffic levels that were significantly below expectations. Additionally, key international routes of CAIL failed to produce anticipated results. The cumulative losses of CAIL from 1994 to 1999 totalled $771 million and from January 31, 1995 to August 12, 1999, the day prior to the issuance by the Government of Canada of an Order under Section 47 of the *Canada Transportation Act* (relaxing certain rules under the *Competition Act* to facilitate a restructuring of the airline industry and described further below), the trading price of Canadian's common shares declined from $7.90 to $1.55.

12 Canadian's losses incurred since the 1994 Restructuring severely eroded its liquidity position. In 1996, Canadian faced an environment where the domestic air travel market saw increased capacity and aggressive price competition by two new discount carriers based in western Canada. While Canadian's traffic and load factor increased indicating a positive response to Canadian's post-restructuring business plan, yields declined. Attempts by Canadian to reduce domestic capacity were offset by additional capacity being introduced by the new discount carriers and Air Canada.

13 The continued lack of sufficient funds from operations made it evident by late fall of 1996 that Canadian needed to take action to avoid a cash shortfall in the spring of 1997. In November 1996, Canadian announced an operational restructuring plan (the "1996 Restructuring") aimed at returning Canadian to profitability and subsequently implemented a payment deferral plan which involved a temporary moratorium on payments to certain lenders and aircraft operating lessors to provide a cash bridge until the benefits of the operational restructuring were fully implemented. Canadian was able successfully to obtain the support of its lenders and operating lessors such that the moratorium and payment deferral plan was able to proceed on a consensual basis without the requirement for any court proceedings.

14 The objective of the 1996 Restructuring was to transform Canadian into a sustainable entity by focussing on controllable factors which targeted earnings improvements over four years. Three major initiatives were adopted: network enhancements, wage concessions as supplemented by fuel tax reductions/rebates, and overhead cost reductions.

15 The benefits of the 1996 Restructuring were reflected in Canadian's 1997 financial results when Canadian and its subsidiaries reported a consolidated net income of $5.4 million, the best results in 9 years.

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16 In early 1998, building on its 1997 results, Canadian took advantage of a strong market for U.S. public debt financing in the first half of 1998 by issuing U.S. $175,000,000 of senior secured notes in April, 1998 ("Senior Secured Notes") and U.S. $100,000,000 of unsecured notes in August, 1998 ("Unsecured Notes").

17 The benefits of the 1996 Restructuring continued in 1998 but were not sufficient to offset a number of new factors which had a significant negative impact on financial performance, particularly in the fourth quarter. Canadian's eroded capital base gave it limited capacity to withstand negative effects on traffic and revenue. These factors included lower than expected operating revenues resulting from a continued weakness of the Asian economies, vigorous competition in Canadian's key western Canada and the western U.S. transborder markets, significant price discounting in most domestic markets following a labour disruption at Air Canada and CAIL's temporary loss of the ability to code-share with American Airlines on certain transborder flights due to a pilot dispute at American Airlines. Canadian also had increased operating expenses primarily due to the deterioration of the value of the Canadian dollar and additional airport and navigational fees imposed by NAV Canada which were not recoverable by Canadian through fare increases because of competitive pressures. This resulted in Canadian and its subsidiaries reporting a consolidated loss of $137.6 million for 1998.

18 As a result of these continuing weak financial results, Canadian undertook a number of additional strategic initiatives including entering the *oneworldTM* Alliance, the introduction of its new "Proud Wings" corporate image, a restructuring of CAIL's Vancouver hub, the sale and leaseback of certain aircraft, expanded code sharing arrangements and the implementation of a service charge in an effort to recover a portion of the costs relating to NAV Canada fees.

19 Beginning in late 1998 and continuing into 1999, Canadian tried to access equity markets to strengthen its balance sheet. In January, 1999, the Board of Directors of CAC determined that while Canadian needed to obtain additional equity capital, an equity infusion alone would not address the fundamental structural problems in the domestic air transportation market.

20 Canadian believes that its financial performance was and is reflective of structural problems in the Canadian airline industry, most significantly, over capacity in the domestic air transportation market. It is the view of Canadian and Air Canada that Canada's relatively small population and the geographic distribution of that population is unable to support the overlapping networks of two full service national carriers. As described further below, the Government of Canada has recognized this fundamental problem and has been instrumental in attempts to develop a solution.

Initial Discussions with Air Canada

21 Accordingly, in January, 1999, CAC's Board of Directors directed management to explore all strategic alternatives available to Canadian, including discussions regarding a possible merger or other transaction involving Air Canada.

22 Canadian had discussions with Air Canada in early 1999. AMR also participated in those discussions. While several alternative merger transactions were considered in the course of these discussions, Canadian, AMR and Air Canada were unable to reach agreement.

23 Following the termination of merger discussions between Canadian and Air Canada, senior management of Canadian, at the direction of the Board and with the support of AMR, renewed its efforts to secure financial partners with the objective of obtaining either an equity investment and support for an eventual merger with Air Canada or immediate financial support for a merger with Air Canada.

Offer by Onex

24 In early May, the discussions with Air Canada having failed, Canadian focussed its efforts on discussions with Onex Corporation ("Onex") and AMR concerning the basis upon which a merger of Canadian and Air Canada could be accomplished.

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25 On August 23, 1999, Canadian entered into an Arrangement Agreement with Onex, AMR and Airline Industry Revitalization Co. Inc. ("AirCo") (a company owned jointly by Onex and AMR and controlled by Onex). The Arrangement Agreement set out the terms of a Plan of Arrangement providing for the purchase by AirCo of all of the outstanding common and non-voting shares of CAC. The Arrangement Agreement was conditional upon, among other things, the successful completion of a simultaneous offer by AirCo for all of the voting and non-voting shares of Air Canada. On August 24, 1999, AirCo announced its offers to purchase the shares of both CAC and Air Canada and to subsequently merge the operations of the two airlines to create one international carrier in Canada.

26 On or about September 20, 1999 the Board of Directors of Air Canada recommended against the AirCo offer. On or about October 19, 1999, Air Canada announced its own proposal to its shareholders to repurchase shares of Air Canada. Air Canada's announcement also indicated Air Canada's intention to make a bid for CAC and to proceed to complete a merger with Canadian subject to a restructuring of Canadian's debt.

27 There were several rounds of offers and counter-offers between AirCo and Air Canada. On November 5, 1999, the Quebec Superior Court ruled that the AirCo offer for Air Canada violated the provisions of the *Air Canada Public Participation Act*. AirCo immediately withdrew its offers. At that time, Air Canada indicated its intention to proceed with its offer for CAC.

28 Following the withdrawal of the AirCo offer to purchase CAC, and notwithstanding Air Canada's stated intention to proceed with its offer, there was a renewed uncertainty about Canadian's future which adversely affected operations. As described further below, Canadian lost significant forward bookings which further reduced the company's remaining liquidity.

Offer by 853350

29 On November 11, 1999, 853350 (a corporation financed by Air Canada and owned as to 10% by Air Canada) made a formal offer for all of the common and non-voting shares of CAC. Air Canada indicated that the involvement of 853350 in the take-over bid was necessary in order to protect Air Canada from the potential adverse effects of a restructuring of Canadian's debt and that Air Canada would only complete a merger with Canadian after the completion of a debt restructuring transaction. The offer by 853350 was conditional upon, among other things, a satisfactory resolution of AMR's claims in respect of Canadian and a satisfactory resolution of certain regulatory issues arising from the announcement made on October 26, 1999 by the Government of Canada regarding its intentions to alter the regime governing the airline industry.

30 As noted above, AMR and its subsidiaries and affiliates had certain agreements with Canadian arising from AMR's investment (through its wholly owned subsidiary, Aurora Airline Investments, Inc.) in CAIL during the 1994 Restructuring. In particular, the Services Agreement by which AMR and its subsidiaries and affiliates provided certain reservations, scheduling and other airline related services to Canadian provided for a termination fee of approximately $500 million (as at December 31, 1999) while the terms governing the preferred shares issued to Aurora provided for exchange rights which were only retractable by Canadian upon payment of a redemption fee in excess of $500 million (as at December 31, 1999). Unless such provisions were amended or waived, it was practically impossible for Canadian to complete a merger with Air Canada since the cost of proceeding without AMR's consent was simply too high.

31 Canadian had continued its efforts to seek out all possible solutions to its structural problems following the withdrawal of the AirCo offer on November 5, 1999. While AMR indicated its willingness to provide a measure of support by allowing a deferral of some of the fees payable to AMR under the Services Agreement, Canadian was unable to find any investor willing to provide the liquidity necessary to keep Canadian operating while alternative solutions were sought.

32 After 853350 made its offer, 853350 and Air Canada entered into discussions with AMR regarding the purchase by 853350 of AMR's shareholding in CAIL as well as other matters regarding code sharing agreements and various services

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provided to Canadian by AMR and its subsidiaries and affiliates. The parties reached an agreement on November 22, 1999 pursuant to which AMR agreed to reduce its potential damages claim for termination of the Services Agreement by approximately 88%.

33 On December 4, 1999, CAC's Board recommended acceptance of 853350's offer to its shareholders and on December 21, 1999, two days before the offer closed, 853350 received approval for the offer from the Competition Bureau as well as clarification from the Government of Canada on the proposed regulatory framework for the Canadian airline industry.

34 As noted above, Canadian's financial condition deteriorated further after the collapse of the AirCo Arrangement transaction. In particular:

a) the doubts which were publicly raised as to Canadian's ability to survive made Canadian's efforts to secure additional financing through various sale-leaseback transactions more difficult;

b) sales for future air travel were down by approximately 10% compared to 1998;

c) CAIL's liquidity position, which stood at approximately $84 million (consolidated cash and available credit) as at September 30, 1999, reached a critical point in late December, 1999 when it was about to go negative.

35 In late December, 1999, Air Canada agreed to enter into certain transactions designed to ensure that Canadian would have enough liquidity to continue operating until the scheduled completion of the 853350 take-over bid on January 4, 2000. Air Canada agreed to purchase rights to the Toronto-Tokyo route for $25 million and to a sale-leaseback arrangement involving certain unencumbered aircraft and a flight simulator for total proceeds of approximately $20 million. These transactions gave Canadian sufficient liquidity to continue operations through the holiday period.

36 If Air Canada had not provided the approximate $45 million injection in December 1999, Canadian would likely have had to file for bankruptcy and cease all operations before the end of the holiday travel season.

37 On January 4, 2000, with all conditions of its offer having been satisfied or waived, 853350 purchased approximately 82% of the outstanding shares of CAC. On January 5, 1999, 853350 completed the purchase of the preferred shares of CAIL owned by Aurora. In connection with that acquisition, Canadian agreed to certain amendments to the Services Agreement reducing the amounts payable to AMR in the event of a termination of such agreement and, in addition, the unanimous shareholders agreement which gave AMR the right to require Canadian to purchase the CAIL preferred shares under certain circumstances was terminated. These arrangements had the effect of substantially reducing the obstacles to a restructuring of Canadian's debt and lease obligations and also significantly reduced the claims that AMR would be entitled to advance in such a restructuring.

38 Despite the $45 million provided by Air Canada, Canadian's liquidity position remained poor. With January being a traditionally slow month in the airline industry, further bridge financing was required in order to ensure that Canadian would be able to operate while a debt restructuring transaction was being negotiated with creditors. Air Canada negotiated an arrangement with the Royal Bank of Canada ("Royal Bank") to purchase a participation interest in the operating credit facility made available to Canadian. As a result of this agreement, Royal Bank agreed to extend Canadian's operating credit facility from $70 million to $120 million in January, 2000 and then to $145 million in March, 2000. Canadian agreed to supplement the assignment of accounts receivable security originally securing Royal's $70 million facility with a further Security Agreement securing certain unencumbered assets of Canadian in consideration for this increased credit availability. Without the support of Air Canada or another financially sound entity, this increase in credit would not have been possible.

39 Air Canada has stated publicly that it ultimately wishes to merge the operations of Canadian and Air Canada, subject to Canadian completing a financial restructuring so as to permit Air Canada to complete the acquisition on a financially sound basis. This pre-condition has been emphasized by Air Canada since the fall of 1999.

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40 Prior to the acquisition of majority control of CAC by 853350, Canadian's management, Board of Directors and financial advisors had considered every possible alternative for restoring Canadian to a sound financial footing. Based upon Canadian's extensive efforts over the past year in particular, but also the efforts since 1992 described above, Canadian came to the conclusion that it must complete a debt restructuring to permit the completion of a full merger between Canadian and Air Canada.

41 On February 1, 2000, Canadian announced a moratorium on payments to lessors and lenders. As a result of this moratorium Canadian defaulted on the payments due under its various credit facilities and aircraft leases. Absent the assistance provided by this moratorium, in addition to Air Canada's support, Canadian would not have had sufficient liquidity to continue operating until the completion of a debt restructuring.

42 Following implementation of the moratorium, Canadian with Air Canada embarked on efforts to restructure significant obligations by consent. The further damage to public confidence which a CCAA filing could produce required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection.

43 Before the Petitioners started these CCAA proceedings, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

44 Canadian and Air Canada have also been able to reach agreement with the remaining affected secured creditors, being the holders of the U.S. $175 million Senior Secured Notes, due 2005, (the "Senior Secured Noteholders") and with several major unsecured creditors in addition to AMR, such as Loyalty Management Group Canada Inc.

45 On March 24, 2000, faced with threatened proceedings by secured creditors, Canadian petitioned under the CCAA and obtained a stay of proceedings and related interim relief by Order of the Honourable Chief Justice Moore on that same date. Pursuant to that Order, PricewaterhouseCoopers, Inc. was appointed as the Monitor, and companion proceedings in the United States were authorized to be commenced.

46 Since that time, due to the assistance of Air Canada, Canadian has been able to complete the restructuring of the remaining financial obligations governing all aircraft to be retained by Canadian for future operations. These arrangements were approved by this Honourable Court in its Orders dated April 14, 2000 and May 10, 2000, as described in further detail below under the heading "The Restructuring Plan".

47 On April 7, 2000, this court granted an Order giving directions with respect to the filing of the plan, the calling and holding of meetings of affected creditors and related matters.

48 On April 25, 2000 in accordance with the said Order, Canadian filed and served the plan (in its original form) and the related notices and materials.

49 The plan was amended, in accordance with its terms, on several occasions, the form of Plan voted upon at the Creditors' Meetings on May 26, 2000 having been filed and served on May 25, 2000 (the "Plan").

The Restructuring Plan

50 The Plan has three principal aims described by Canadian:

(a) provide near term liquidity so that Canadian can sustain operations;

(b) allow for the return of aircraft not required by Canadian; and

(c) permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset values and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

51 The proposed treatment of stakeholders is as follows:

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1. Unaffected Secured Creditors- Royal Bank, CAIL's operating lender, is an unaffected creditor with respect to its operating credit facility. Royal Bank holds security over CAIL's accounts receivable and most of CAIL's operating assets not specifically secured by aircraft financiers or the Senior Secured Noteholders. As noted above, arrangements entered into between Air Canada and Royal Bank have provided CAIL with liquidity necessary for it to continue operations since January 2000.

Also unaffected by the Plan are those aircraft lessors, conditional vendors and secured creditors holding security over CAIL's aircraft who have entered into agreements with CAIL and/or Air Canada with respect to the restructuring of CAIL's obligations. A number of such agreements, which were initially contained in the form of letters of intent ("LOIs"), were entered into prior to the commencement of the CCAA proceedings, while a total of 17 LOIs were completed after that date. In its Second and Fourth Reports the Monitor reported to the court on these agreements. The LOIs entered into after the proceedings commenced were reviewed and approved by the court on April 14, 2000 and May 10, 2000.

The basis of the LOIs with aircraft lessors was that the operating lease rates were reduced to fair market lease rates or less, and the obligations of CAIL under the leases were either assumed or guaranteed by Air Canada. Where the aircraft was subject to conditional sale agreements or other secured indebtedness, the value of the secured debt was reduced to the fair market value of the aircraft, and the interest rate payable was reduced to current market rates reflecting Air Canada's credit. CAIL's obligations under those agreements have also been assumed or guaranteed by Air Canada. The claims of these creditors for reduced principal and interest amounts, or reduced lease payments, are Affected Unsecured Claims under the Plan. In a number of cases these claims have been assigned to Air Canada and Air Canada disclosed that it would vote those claims in favour of the Plan.

2. Affected Secured Creditors- The Affected Secured Creditors under the Plan are the Senior Secured Noteholders with a claim in the amount of US$175,000,000. The Senior Secured Noteholders are secured by a diverse package of Canadian's assets, including its inventory of aircraft spare parts, ground equipment, spare engines, flight simulators, leasehold interests at Toronto, Vancouver and Calgary airports, the shares in CRAL 98 and a $53 million note payable by CRAL to CAIL.

The Plan offers the Senior Secured Noteholders payment of 97 cents on the dollar. The deficiency is included in the Affected Unsecured Creditor class and the Senior Secured Noteholders advised the court they would be voting the deficiency in favour of the Plan.

3. Unaffected Unsecured Creditors-In the circular accompanying the November 11, 1999 853350 offer it was stated that:

> The Offeror intends to conduct the Debt Restructuring in such a manner as to seek to ensure that the unionized employees of Canadian, the suppliers of new credit (including trade credit) and the members of the flying public are left unaffected.
>
> The Offeror is of the view that the pursuit of these three principles is essential in order to ensure that the long term value of Canadian is preserved.

Canadian's employees, customers and suppliers of goods and services are unaffected by the CCAA Order and Plan.

Also unaffected are parties to those contracts or agreements with Canadian which are not being terminated by Canadian pursuant to the terms of the March 24, 2000 Order.

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4. Affected Unsecured Creditors- CAIL has identified unsecured creditors who do not fall into the above three groups and listed these as Affected Unsecured Creditors under the Plan. They are offered 14 cents on the dollar on their claims. Air Canada would fund this payment.

The Affected Unsecured Creditors fall into the following categories:

a. Claims of holders of or related to the Unsecured Notes (the "Unsecured Noteholders");

b. Claims in respect of certain outstanding or threatened litigation involving Canadian;

c. Claims arising from the termination, breach or repudiation of certain contracts, leases or agreements to which Canadian is a party other than aircraft financing or lease arrangements;

d. Claims in respect of deficiencies arising from the termination or re-negotiation of aircraft financing or lease arrangements;

e. Claims of tax authorities against Canadian; and

f. Claims in respect of the under-secured or unsecured portion of amounts due to the Senior Secured Noteholders.

52 There are over $700 million of proven unsecured claims. Some unsecured creditors have disputed the amounts of their claims for distribution purposes. These are in the process of determination by the court-appointed Claims Officer and subject to further appeal to the court. If the Claims Officer were to allow all of the disputed claims in full and this were confirmed by the court, the aggregate of unsecured claims would be approximately $1.059 million.

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

54 In connection with its assessment of the Plan, the Monitor performed a liquidation analysis of CAIL as at March 31, 2000 in order to estimate the amounts that might be recovered by CAIL's creditors and shareholders in the event of disposition of CAIL's assets by a receiver or trustee. The Monitor concluded that a liquidation would result in a shortfall to certain secured creditors, including the Senior Secured Noteholders, a recovery by ordinary unsecured creditors of between one cent and three cents on the dollar, and no recovery by shareholders.

55 There are two vociferous opponents of the Plan, Resurgence Asset Management LLC ("Resurgence") who acts on behalf of its and/or its affiliate client accounts and four shareholders of CAC. Resurgence is incorporated pursuant to the laws of New York, U.S.A. and has its head office in White Plains, New York. It conducts an investment business specializing in high yield distressed debt. Through a series of purchases of the Unsecured Notes commencing in April 1999, Resurgence clients hold $58,200,000 of the face value of or 58.2% of the notes issued. Resurgence purchased 7.9 million units in April 1999. From November 3, 1999 to December 9, 1999 it purchased an additional 20,850,000 units. From January 4, 2000 to February 3, 2000 Resurgence purchased an additional 29,450,000 units.

56 Resurgence seeks declarations that: the actions of Canadian, Air Canada and 853350 constitute an amalgamation, consolidation or merger with or into Air Canada or a conveyance or transfer of all or substantially all of Canadian's assets to Air Canada; that any plan of arrangement involving Canadian will not affect Resurgence and directing the

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repurchase of their notes pursuant to the provisions of their trust indenture and that the actions of Canadian, Air Canada and 853350 are oppressive and unfairly prejudicial to it pursuant to section 234 of the Business Corporations Act.

57 Four shareholders of CAC also oppose the plan. Neil Baker, a Toronto resident, acquired 132,500 common shares at a cost of $83,475.00 on or about May 5, 2000. Mr. Baker sought to commence proceedings to "remedy an injustice to the minority holders of the common shares". Roger Midiaty, Michael Salter and Hal Metheral are individual shareholders who were added as parties at their request during the proceedings. Mr. Midiaty resides in Calgary, Alberta and holds 827 CAC shares which he has held since 1994. Mr. Metheral is also a Calgary resident and holds approximately 14,900 CAC shares in his RRSP and has held them since approximately 1994 or 1995. Mr. Salter is a resident of Scottsdale, Arizona and is the beneficial owner of 250 shares of CAC and is a joint beneficial owner of 250 shares with his wife. These shareholders will be referred in the Decision throughout as the "Minority Shareholders".

58 The Minority Shareholders oppose the portion of the Plan that relates to the reorganization of CAIL, pursuant to section 185 of the *Alberta Business Corporations Act* ("ABCA"). They characterize the transaction as a cancellation of issued shares unauthorized by section 167 of the ABCA or alternatively is a violation of section 183 of the ABCA. They submit the application for the order of reorganization should be denied as being unlawful, unfair and not supported by the evidence.

III. Analysis

59 Section 6 of the CCAA provides that:

> 6. 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 receiving 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.

60 Prior to sanctioning a plan under the CCAA, the court must be satisfied in regard to each of the following criteria:

> (1) there must be compliance with all statutory requirements;
>
> (2) all material 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 CCAA; and
>
> (3) the plan must be fair and reasonable.

61 A leading articulation of this three-part test appears in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 182-3, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) and has been regularly followed, see for example *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 172 and *Re T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 7. Each of these criteria are reviewed in turn below.

1. Statutory Requirements

62 Some of the matters that may be considered by the court on an application for approval of a plan of compromise and arrangement include:

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(a) the applicant comes within the definition of "debtor company" in section 2 of the CCAA;

(b) the applicant or affiliated debtor companies have total claims within the meaning of section 12 of the CCAA in excess of $5,000,000;

(c) the notice calling the meeting was sent in accordance with the order of the court;

(d) the creditors were properly classified;

(e) the meetings of creditors were properly constituted;

(f) the voting was properly carried out; and

(g) the plan was approved by the requisite double majority or majorities.

63 I find that the Petitioners have complied with all applicable statutory requirements. Specifically:

(a) CAC and CAIL are insolvent and thus each is a "debtor company" within the meaning of section 2 of the CCAA. This was established in the affidavit evidence of Douglas Carty, Senior Vice President and Chief Financial Officer of Canadian, and so declared in the March 24, 2000 Order in these proceedings and confirmed in the testimony given by Mr. Carty at this hearing.

(b) CAC and CAIL have total claims that would be claims provable in bankruptcy within the meaning of section 12 of the CCAA in excess of $5,000,000.

(c) In accordance with the April 7, 2000 Order of this court, a Notice of Meeting and a disclosure statement (which included copies of the Plan and the March 24th and April 7th Orders of this court) were sent to the Affected Creditors, the directors and officers of the Petitioners, the Monitor and persons who had served a Notice of Appearance, on April 25, 2000.

(d) As confirmed by the May 12, 2000 ruling of this court (leave to appeal denied May 29, 2000), the creditors have been properly classified.

(e) Further, as detailed in the Monitor's Fifth Report to the Court and confirmed by the June 14, 2000 decision of this court in respect of a challenge by Resurgence Asset Management LLC ("Resurgence"), the meetings of creditors were properly constituted, the voting was properly carried out and the Plan was approved by the requisite double majorities in each class. The composition of the majority of the unsecured creditor class is addressed below under the heading "Fair and Reasonable".

2. Matters Unauthorized

64 This criterion has not been widely discussed in the reported cases. As recognized by Blair J. in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) and Farley J. in *Re Cadillac Fairview Inc.* (February 6, 1995), Doc. B348/94 (Ont. Gen. Div. [Commercial List]), within the CCAA process the court must rely on the reports of the Monitor as well as the parties in ensuring nothing contrary to the CCAA has occurred or is contemplated by the plan.

65 In this proceeding, the dissenting groups have raised two matters which in their view are unauthorized by the CCAA: firstly, the Minority Shareholders of CAC suggested the proposed share capital reorganization of CAIL is illegal under the ABCA and Ontario Securities Commission Policy 9.1, and as such cannot be authorized under the CCAA and secondly, certain unsecured creditors suggested that the form of release contained in the Plan goes beyond the scope of release permitted under the CCAA.

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a. Legality of proposed share capital reorganization

66 Subsection 185(2) of the ABCA provides:

(2) If a corporation is subject to an order for reorganization, its articles may be amended by the order to effect any change that might lawfully be made by an amendment under section 167.

67 Sections 6.1(2)(d) and (e) and Schedule "D" of the Plan contemplate that:

a. All CAIL common shares held by CAC will be converted into a single retractable share, which will then be retracted by CAIL for $1.00; and

b. All CAIL preferred shares held by 853350 will be converted into CAIL common shares.

68 The Articles of Reorganization in Schedule "D" to the Plan provide for the following amendments to CAIL's Articles of Incorporation to effect the proposed reorganization:

(a) consolidating all of the issued and outstanding common shares into one common share;

(b) redesignating the existing common shares as "Retractable Shares" and changing the rights, privileges, restrictions and conditions attaching to the Retractable Shares so that the Retractable Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital;

(c) cancelling the Non-Voting Shares in the capital of the corporation, none of which are currently issued and outstanding, so that the corporation is no longer authorized to issue Non-Voting Shares;

(d) changing all of the issued and outstanding Class B Preferred Shares of the corporation into Class A Preferred Shares, on the basis of one (1) Class A Preferred Share for each one (1) Class B Preferred Share presently issued and outstanding;

(e) redesignating the existing Class A Preferred Shares as "Common Shares" and changing the rights, privileges, restrictions and conditions attaching to the Common Shares so that the Common Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital; and

(f) cancelling the Class B Preferred Shares in the capital of the corporation, none of which are issued and outstanding after the change in paragraph (d) above, so that the corporation is no longer authorized to issue Class B Preferred Shares;

Section 167 of the ABCA

69 Reorganizations under section 185 of the ABCA are subject to two preconditions:

a. The corporation must be "subject to an order for re-organization"; and

b. The proposed amendments must otherwise be permitted under section 167 of the ABCA.

70 The parties agreed that an order of this court sanctioning the Plan would satisfy the first condition.

71 The relevant portions of section 167 provide as follows:

167(1) Subject to sections 170 and 171, the articles of a corporation may by special resolution be amended to

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(e) change the designation of all or any of its shares, and add, change or remove any rights, privileges, restrictions and conditions, including rights to accrued dividends, in respect of all or any of its shares, whether issued or unissued,

(f) change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series into the same or a different number of shares of other classes or series,

(g.1) cancel a class or series of shares where there are no issued or outstanding shares of that class or series,

72 Each change in the proposed CAIL Articles of Reorganization corresponds to changes permitted under s. 167(1) of the ABCA, as follows:

Proposed Amendment in Schedule "D"	**Subsection 167(1), ABCA**
(a) — consolidation of Common Shares	167(1)(f)
(b) — change of designation and rights	167(1)(e)
(c) — cancellation	167(1)(g.1)
(d) — change in shares	167(1)(f)
(e) — change of designation and rights	167(1)(e)
(f) — cancellation	167(1)(g.1)

73 The Minority Shareholders suggested that the proposed reorganization effectively cancels their shares in CAC. As the above review of the proposed reorganization demonstrates, that is not the case. Rather, the shares of CAIL are being consolidated, altered and then retracted, as permitted under section 167 of the ABCA. I find the proposed reorganization of CAIL's share capital under the Plan does not violate section 167.

74 In R. Dickerson et al, *Proposals for a New Business Corporation Law for Canada*, Vol.1: Commentary (the "Dickerson Report") regarding the then proposed Canada Business Corporations Act, the identical section to section 185 is described as having been inserted with the object of enabling the "court to effect any necessary amendment of the articles of the corporation in order to achieve the objective of the reorganization without having to comply with the formalities of the Draft Act, particularly shareholder approval of the proposed amendment".

75 The architects of the business corporation act model which the ABCA follows, expressly contemplated reorganizations in which the insolvent corporation would eliminate the interest of common shareholders. The example given in the Dickerson Report of a reorganization is very similar to that proposed in the Plan:

> For example, the reorganization of an insolvent corporation may require the following steps: first, reduction or even elimination of the interest of the common shareholders; second, relegation of the preferred shareholders to the status of common shareholders; and third, relegation of the secured debenture holders to the status of either unsecured Noteholders or preferred shareholders.

76 The rationale for allowing such a reorganization appears plain; the corporation is insolvent, which means that on liquidation the shareholders would get nothing. In those circumstances, as described further below under the heading "Fair and Reasonable", there is nothing unfair or unreasonable in the court effecting changes in such situations without shareholder approval. Indeed, it would be unfair to the creditors and other stakeholders to permit the shareholders (whose interest has the lowest priority) to have any ability to block a reorganization.

77 The Petitioners were unable to provide any case law addressing the use of section 185 as proposed under the Plan. They relied upon the decisions of *Re Royal Oak Mines Inc.* (1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List]) and *T. Eaton Co.*, *supra* in which Farley J.of the Ontario Superior Court of Justice emphasized that shareholders are at the bottom of the hierarchy of interests in liquidation or liquidation related scenarios.

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78 Section 185 provides for amendment to articles by court order. I see no requirement in that section for a meeting or vote of shareholders of CAIL, quite apart from shareholders of CAC. Further, dissent and appraisal rights are expressly removed in subsection (7). To require a meeting and vote of shareholders and to grant dissent and appraisal rights in circumstances of insolvency would frustrate the object of section 185 as described in the Dickerson Report.

79 In the circumstances of this case, where the majority shareholder holds 82% of the shares, the requirement of a special resolution is meaningless. To require a vote suggests the shares have value. They do not. The formalities of the ABCA serve no useful purpose other than to frustrate the reorganization to the detriment of all stakeholders, contrary to the CCAA.

Section 183 of the ABCA

80 The Minority Shareholders argued in the alternative that if the proposed share reorganization of CAIL were not a cancellation of their shares in CAC and therefore allowed under section 167 of the ABCA, it constituted a "sale, lease, or exchange of substantially all the property" of CAC and thus required the approval of CAC shareholders pursuant to section 183 of the ABCA. The Minority Shareholders suggested that the common shares in CAIL were substantially all of the assets of CAC and that all of those shares were being "exchanged" for $1.00.

81 I disagree with this creative characterization. The proposed transaction is a reorganization as contemplated by section 185 of the ABCA. As recognized in *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.) aff'd (1988), 70 C.B.R. (N.S.) xxxii (S.C.C.), the fact that the same end might be achieved under another section does not exclude the section to be relied on. A statute may well offer several alternatives to achieve a similar end.

Ontario Securities Commission Policy 9.1

82 The Minority Shareholders also submitted the proposed reorganization constitutes a "related party transaction" under Policy 9.1 of the Ontario Securities Commission. Under the Policy, transactions are subject to disclosure, minority approval and formal valuation requirements which have not been followed here. The Minority Shareholders suggested that the Petitioners were therefore in breach of the Policy unless and until such time as the court is advised of the relevant requirements of the Policy and grants its approval as provided by the Policy.

83 These shareholders asserted that in the absence of evidence of the going concern value of CAIL so as to determine whether that value exceeds the rights of the Preferred Shares of CAIL, the Court should not waive compliance with the Policy.

84 To the extent that this reorganization can be considered a "related party transaction", I have found, for the reasons discussed below under the heading "Fair and Reasonable", that the Plan, including the proposed reorganization, is fair and reasonable and accordingly I would waive the requirements of Policy 9.1.

b. Release

85 Resurgence argued that the release of directors and other third parties contained in the Plan does not comply with the provisions of the CCAA.

86 The release is contained in section 6.2(2)(ii) of the Plan and states as follows:

> As of the Effective Date, each of the Affected Creditors will be deemed to forever release, waive and discharge all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities...that are based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Applicants and Subsidiaries, the CCAA Proceedings, or the Plan against: (i) The Applicants and Subsidiaries; (ii) The Directors, Officers and employees of the Applicants or Subsidiaries in each case as of the date of filing (and in addition, those who became Officers and/or Directors thereafter but prior

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to the Effective Date); (iii) The former Directors, Officers and employees of the Applicants or Subsidiaries, or (iv) the respective current and former professionals of the entities in subclauses (1) to (3) of this s.6.2(2) (including, for greater certainty, the Monitor, its counsel and its current Officers and Directors, and current and former Officers, Directors, employees, shareholders and professionals of the released parties) acting in such capacity.

87 Prior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company. In 1997, section 5.1 was added to the CCAA. Section 5.1 states:

> 5.1 (1) A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> (2) A provision for the compromise of claims against directors may not include claims that:
>
> > (a) relate to contractual rights of one or more creditors; or
> >
> > (b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> (3) The Court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

88 Resurgence argued that the form of release does not comply with section 5.1 of the CCAA insofar as it applies to individuals beyond directors and to a broad spectrum of claims beyond obligations of the Petitioners for which their directors are "by law liable". Resurgence submitted that the addition of section 5.1 to the CCAA constituted an exception to a long standing principle and urged the court to therefore interpret s. 5.1 cautiously, if not narrowly. Resurgence relied on *Crabtree (Succession de) c. Barrette*, [1993] 1 S.C.R. 1027 (S.C.C.) at 1044 and *Bruce Agra Foods Inc. v. Everfresh Beverages Inc. (Receiver of)* (1996), 45 C.B.R. (3d) 169 (Ont. Gen. Div.) at para. 5 in this regard.

89 With respect to Resurgence's complaint regarding the breadth of the claims covered by the release, the Petitioners asserted that the release is not intended to override section 5.1(2). Canadian suggested this can be expressly incorporated into the form of release by adding the words "*excluding the claims excepted by s. 5.1(2) of the CCAA*" immediately prior to subsection (iii) and clarifying the language in Section 5.1 of the Plan. Canadian also acknowledged, in response to a concern raised by Canada Customs and Revenue Agency, that in accordance with s. 5.1(1) of the CCAA, directors of CAC and CAIL could only be released from liability arising before March 24, 2000, the date these proceedings commenced. Canadian suggested this was also addressed in the proposed amendment. Canadian did not address the propriety of including individuals in addition to directors in the form of release.

90 In my view it is appropriate to amend the proposed release to expressly comply with section 5. 1(2) of the CCAA and to clarify Section 5.1 of the Plan as Canadian suggested in its brief. The additional language suggested by Canadian to achieve this result shall be included in the form of order. Canada Customs and Revenue Agency is apparently satisfied with the Petitioners' acknowledgement that claims against directors can only be released to the date of commencement of proceedings under the CCAA, having appeared at this hearing to strongly support the sanctioning of the Plan, so I will not address this concern further.

91 Resurgence argued that its claims fell within the categories of excepted claims in section 5.1(2) of the CCAA and accordingly, its concern in this regard is removed by this amendment. Unsecured creditors JHHD Aircraft Leasing No. 1 and No. 2 suggested there may be possible wrongdoing in the acts of the directors during the restructuring process which should not be immune from scrutiny and in my view this complaint would also be caught by the exception captured in the amendment.

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92 While it is true that section 5.2 of the CCAA does not authorize a release of claims against third parties other than directors, it does not prohibit such releases either. The amended terms of the release will not prevent claims from which the CCAA expressly prohibits release. Aside from the complaints of Resurgence, which by their own submissions are addressed in the amendment I have directed, and the complaints of JHHD Aircraft Leasing No. 1 and No. 2, which would also be addressed in the amendment, the terms of the release have been accepted by the requisite majority of creditors and I am loathe to further disturb the terms of the Plan, with one exception.

93 Amex Bank of Canada submitted that the form of release appeared overly broad and might compromise unaffected claims of affected creditors. For further clarification, Amex Bank of Canada's potential claim for defamation is unaffected by the Plan and I am prepared to order Section 6.2(2)(ii) be amended to reflect this specific exception.

3. Fair and Reasonable

94 In determining whether to sanction a plan of arrangement under the CCAA, the court is guided by two fundamental concepts: "fairness" and "reasonableness". While these concepts are always at the heart of the court's exercise of its discretion, their meanings are necessarily shaped by the unique circumstances of each case, within the context of the Act and accordingly can be difficult to distill and challenging to apply. Blair J. described these concepts in *Olympia & York Developments Ltd. v. Royal Trust Co.*, *supra*, at page 9:

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

95 The legislation, while conferring broad discretion on the court, offers little guidance. However, the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and, in many instances, a much broader constituency of affected persons. Parliament has recognized that reorganization, if commercially feasible, is in most cases preferable, economically and socially, to liquidation: *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), [1989] 2 W.W.R. 566 (Alta. Q.B.) at 574; *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, [1989] 3 W.W.R. 363 (B.C. C.A.) at 368.

96 The sanction of the court of a creditor-approved plan is not to be considered as a rubber stamp process. Although the majority vote that brings the plan to a sanction hearing plays a significant role in the court's assessment, the court will consider other matters as are appropriate in light of its discretion. In the unique circumstances of this case, it is appropriate to consider a number of additional matters:

a. The composition of the unsecured vote;

b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;

c. Alternatives available to the Plan and bankruptcy;

d. Oppression;

e. Unfairness to Shareholders of CAC; and

f. The public interest.

a. Composition of the unsecured vote

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97 As noted above, an important measure of whether a plan is fair and reasonable is the parties' approval and the degree to which it has been given. Creditor support creates an inference that the plan is fair and reasonable because the assenting creditors believe that their interests are treated equitably under the plan. Moreover, it creates an inference that the arrangement is economically feasible and therefore reasonable because the creditors are in a better position then the courts to gauge business risk. As stated by Blair J. at page 11 of *Olympia & York Developments Ltd.*, *supra*:

> As other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspect of the Plan or descending into the negotiating arena or 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.

98 However, given the manner of voting under the CCAA, the court must be cognizant of the treatment of minorities within a class: see for example *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.) and *Re Alabama, New Orleans, Texas & Pacific Junction Railway* (1890), 60 L.J. Ch. 221 (Eng. C.A.). The court can address this by ensuring creditors' claims are properly classified. As well, it is sometimes appropriate to tabulate the vote of a particular class so the results can be assessed from a fairness perspective. In this case, the classification was challenged by Resurgence and I dismissed that application. The vote was also tabulated in this case and the results demonstrate that the votes of Air Canada and the Senior Secured Noteholders, who voted their deficiency in the unsecured class, were decisive.

99 The results of the unsecured vote, as reported by the Monitor, are:

> 1. For the resolution to approve the Plan: 73 votes (65% in number) representing $494,762,304 in claims (76% in value);
>
> 2. Against the resolution: 39 votes (35% in number) representing $156,360,363 in claims (24% in value); and
>
> 3. Abstentions: 15 representing $968,036 in value.

100 The voting results as reported by the Monitor were challenged by Resurgence. That application was dismissed.

101 The members of each class that vote in favour of a plan must do so in good faith and the majority within a class must act without coercion in their conduct toward the minority. When asked to assess fairness of an approved plan, the court will not countenance secret agreements to vote in favour of a plan secured by advantages to the creditor: see for example, *Hochberger v. Rittenberg* (1916), 36 D.L.R. 450 (S.C.C.)

102 In *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 192-3 aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), dissenting priority mortgagees argued the plan violated the principle of equality due to an agreement between the debtor company and another priority mortgagee which essentially amounted to a preference in exchange for voting in favour of the plan. Trainor J. found that the agreement was freely disclosed and commercially reasonable and went on to approve the plan, using the three part test. The British Columbia Court of Appeal upheld this result and in commenting on the minority complaint McEachern J.A. stated at page 206:

> In my view, the obvious benefits of settling rights and keeping the enterprise together as a going concern far outweigh the deprivation of the appellants' wholly illusory rights. In this connection, the learned chambers judge said at p.29:
>
> > I turn to the question of the right to hold the property after an order absolute and whether or not this is a denial of something of that significance that it should affect these proceedings. There is in the material before me some evidence of values. There are the principles to which I have referred, as well as to the rights of majorities and the rights of minorities.

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> Certainly, those minority rights are there, but it would seem to me that in view of the overall plan, in view of the speculative nature of holding property in the light of appraisals which have been given as to value, that this right is something which should be subsumed to the benefit of the majority.

103 Resurgence submitted that Air Canada manipulated the indebtedness of CAIL to assure itself of an affirmative vote. I disagree. I previously ruled on the validity of the deficiency when approving the LOIs and found the deficiency to be valid. I found there was consideration for the assignment of the deficiency claims of the various aircraft financiers to Air Canada, namely the provision of an Air Canada guarantee which would otherwise not have been available until plan sanction. The Monitor reviewed the calculations of the deficiencies and determined they were calculated in a reasonable manner. As such, the court approved those transactions. If the deficiency had instead remained with the aircraft financiers, it is reasonable to assume those claims would have been voted in favour of the plan. Further, it would have been entirely appropriate under the circumstances for the aircraft financiers to have retained the deficiency and agreed to vote in favour of the Plan, with the same result to Resurgence. That the financiers did not choose this method was explained by the testimony of Mr. Carty and Robert Peterson, Chief Financial Officer for Air Canada; quite simply it amounted to a desire on behalf of these creditors to shift the "deal risk" associated with the Plan to Air Canada. The agreement reached with the Senior Secured Noteholders was also disclosed and the challenge by Resurgence regarding their vote in the unsecured class was dismissed There is nothing inappropriate in the voting of the deficiency claims of Air Canada or the Senior Secured Noteholders in the unsecured class. There is no evidence of secret vote buying such as discussed in *Re Northland Properties Ltd.*

104 If the Plan is approved, Air Canada stands to profit in its operation. I do not accept that the deficiency claims were devised to dominate the vote of the unsecured creditor class, however, Air Canada, as funder of the Plan is more motivated than Resurgence to support it. This divergence of views on its own does not amount to bad faith on the part of Air Canada. Resurgence submitted that only the Unsecured Noteholders received 14 cents on the dollar. That is not accurate, as demonstrated by the list of affected unsecured creditors included earlier in these Reasons. The Senior Secured Noteholders did receive other consideration under the Plan, but to suggest they were differently motivated suggests that those creditors did not ascribe any value to their unsecured claims. There is no evidence to support this submission.

105 The good faith of Resurgence in its vote must also be considered. Resurgence acquired a substantial amount of its claim after the failure of the Onex bid, when it was aware that Canadian's financial condition was rapidly deteriorating. Thereafter, Resurgence continued to purchase a substantial amount of this highly distressed debt. While Mr. Symington maintained that he bought because he thought the bonds were a good investment, he also acknowledged that one basis for purchasing was the hope of obtaining a blocking position sufficient to veto a plan in the proposed debt restructuring. This was an obvious ploy for leverage with the Plan proponents

106 The authorities which address minority creditors' complaints speak of "substantial injustice" (*Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.), "confiscation" of rights (*Re Campeau Corp.* (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.); *Re SkyDome Corp.* (March 21, 1999), Doc. 98-CL-3179 (Ont. Gen. Div. [Commercial List])) and majorities "feasting upon" the rights of the minority (*Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.). Although it cannot be disputed that the group of Unsecured Noteholders represented by Resurgence are being asked to accept a significant reduction of their claims, as are all of the affected unsecured creditors, I do not see a "substantial injustice", nor view their rights as having been "confiscated" or "feasted upon" by being required to succumb to the wishes of the majority in their class. No bad faith has been demonstrated in this case. Rather, the treatment of Resurgence, along with all other affected unsecured creditors, represents a reasonable balancing of interests. While the court is directed to consider whether there is an injustice being worked within a class, it must also determine whether there is an injustice with respect the stakeholders as a whole. Even if a plan might at first blush appear to have that effect, when viewed in relation to all other parties, it may nonetheless be considered appropriate and be approved: *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 1 (Ont. Gen. Div.) and *Re Northland Properties Ltd.*, *supra* at 9.

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107 Further, to the extent that greater or discrete motivation to support a Plan may be seen as a conflict, the Court should take this same approach and look at the creditors as a whole and to the objecting creditors specifically and determine if their rights are compromised in an attempt to balance interests and have the pain of compromise borne equally.

108 Resurgence represents 58.2% of the Unsecured Noteholders or $96 million in claims. The total claim of the Unsecured Noteholders ranges from $146 million to $161 million. The affected unsecured class, excluding aircraft financing, tax claims, the noteholders and claims under $50,000, ranges from $116.3 million to $449.7 million depending on the resolutions of certain claims by the Claims Officer. Resurgence represents between 15.7% - 35% of that portion of the class.

109 The total affected unsecured claims, excluding tax claims, but including aircraft financing and noteholder claims including the unsecured portion of the Senior Secured Notes, ranges from $673 million to $1,007 million. Resurgence represents between 9.5% - 14.3% of the total affected unsecured creditor pool. These percentages indicate that at its very highest in a class excluding Air Canada's assigned claims and Senior Secured's deficiency, Resurgence would only represent a maximum of 35% of the class. In the larger class of affected unsecured it is significantly less. Viewed in relation to the class as a whole, there is no injustice being worked against Resurgence.

110 The thrust of the Resurgence submissions suggests a mistaken belief that they will get more than 14 cents on liquidation. This is not borne out by the evidence and is not reasonable in the context of the overall Plan.

b. Receipts on liquidation or bankruptcy

111 As noted above, the Monitor prepared and circulated a report on the Plan which contained a summary of a liquidation analysis outlining the Monitor's projected realizations upon a liquidation of CAIL ("Liquidation Analysis").

112 The Liquidation Analysis was based on: (1) the draft unaudited financial statements of Canadian at March 31, 2000; (2) the distress values reported in independent appraisals of aircraft and aircraft related assets obtained by CAIL in January, 2000; (3) a review of CAIL's aircraft leasing and financing documents; and (4) discussions with CAIL Management.

113 Prior to and during the application for sanction, the Monitor responded to various requests for information by parties involved. In particular, the Monitor provided a copy of the Liquidation Analysis to those who requested it. Certain of the parties involved requested the opportunity to question the Monitor further, particularly in respect to the Liquidation Analysis and this court directed a process for the posing of those questions.

114 While there were numerous questions to which the Monitor was asked to respond, there were several areas in which Resurgence and the Minority Shareholders took particular issue: pension plan surplus, CRAL, international routes and tax pools. The dissenting groups asserted that these assets represented overlooked value to the company on a liquidation basis or on a going concern basis.

Pension Plan Surplus

115 The Monitor did not attribute any value to pension plan surplus when it prepared the Liquidation Analysis, for the following reasons:

> 1) The summaries of the solvency surplus/deficit positions indicated a cumulative net deficit position for the seven registered plans, after consideration of contingent liabilities;
>
> 2) The possibility, based on the previous splitting out of the seven plans from a single plan in 1988, that the plans could be held to be consolidated for financial purposes, which would remove any potential solvency surplus since the total estimated contingent liabilities exceeded the total estimated solvency surplus;

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3) The actual calculations were prepared by CAIL's actuaries and actuaries representing the unions could conclude liabilities were greater; and

4) CAIL did not have a legal opinion confirming that surpluses belonged to CAIL.

116 The Monitor concluded that the entitlement question would most probably have to be settled by negotiation and/or litigation by the parties. For those reasons, the Monitor took a conservative view and did not attribute an asset value to pension plans in the Liquidation Analysis. The Monitor also did not include in the Liquidation Analysis any amount in respect of the claim that could be made by members of the plan where there is an apparent deficit after deducting contingent liabilities.

117 The issues in connection with possible pension surplus are: (1) the true amount of any of the available surplus; and (2) the entitlement of Canadian to any such amount.

118 It is acknowledged that surplus prior to termination can be accessed through employer contribution holidays, which Canadian has taken to the full extent permitted. However, there is no basis that has been established for any surplus being available to be withdrawn from an ongoing pension plan. On a pension plan termination, the amount available as a solvency surplus would first have to be further reduced by various amounts to determine whether there was in fact any true surplus available for distribution. Such reductions include contingent benefits payable in accordance with the provisions of each respective pension plan, any extraordinary plan wind up cost, the amounts of any contribution holidays taken which have not been reflected, and any litigation costs.

119 Counsel for all of Canadian's unionized employees confirmed on the record that the respective union representatives can be expected to dispute all of these calculations as well as to dispute entitlement.

120 There is a suggestion that there might be a total of $40 million of surplus remaining from all pension plans after such reductions are taken into account. Apart from the issue of entitlement, this assumes that the plans can be treated separately, that a surplus could in fact be realized on liquidation and that the Towers Perrin calculations are not challenged. With total pension plan assets of over $2 billion, a surplus of $40 million could quickly disappear with relatively minor changes in the market value of the securities held or calculation of liabilities. In the circumstances, given all the variables, I find that the existence of any surplus is doubtful at best and I am satisfied that the Monitor's Liquidation Analysis ascribing it zero value is reasonable in this circumstances.

CRAL

121 The Monitor's liquidation analysis as at March 31, 2000 of CRAL determined that in a distress situation, after payments were made to its creditors, there would be a deficiency of approximately $30 million to pay Canadian Regional's unsecured creditors, which include a claim of approximately $56.5 million due to Canadian. In arriving at this conclusion, the Monitor reviewed internally prepared unaudited financial statements of CRAL as of March 31, 2000, the Houlihan Lokey Howard and Zukin, distress valuation dated January 21, 2000 and the Simat Helliesen and Eichner valuation of selected CAIL assets dated January 31, 2000 for certain aircraft related materials and engines, rotables and spares. The Avitas Inc., and Avmark Inc. reports were used for the distress values on CRAL's aircraft and the CRAL aircraft lease documentation. The Monitor also performed its own analysis of CRAL's liquidation value, which involved analysis of the reports provided and details of its analysis were outlined in the Liquidation Analysis.

122 For the purpose of the Liquidation Analysis, the Monitor did not consider other airlines as comparable for evaluation purposes, as the Monitor's valuation was performed on a distressed sale basis. The Monitor further assumed that without CAIL's national and international network to feed traffic into and a source of standby financing, and considering the inevitable negative publicity which a failure of CAIL would produce, CRAL would immediately stop operations as well.

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123 Mr. Peterson testified that CRAL was worth $260 million to Air Canada, based on Air Canada being a special buyer who could integrate CRAL, on a going concern basis, into its network. The Liquidation Analysis assumed the windup of each of CRAL and CAIL, a completely different scenario.

124 There is no evidence that there was a potential purchaser for CRAL who would be prepared to acquire CRAL or the operations of CRAL 98 for any significant sum or at all. CRAL has value to CAIL, and in turn, could provide value to Air Canada, but this value is attributable to its ability to feed traffic to and take traffic from the national and international service operated by CAIL. In my view, the Monitor was aware of these features and properly considered these factors in assessing the value of CRAL on a liquidation of CAIL.

125 If CAIL were to cease operations, the evidence is clear that CRAL would be obliged to do so as well immediately. The travelling public, shippers, trade suppliers, and others would make no distinction between CAIL and CRAL and there would be no going concern for Air Canada to acquire.

International Routes

126 The Monitor ascribed no value to Canadian's international routes in the Liquidation Analysis. In discussions with CAIL management and experts available in its aviation group, the Monitor was advised that international routes are unassignable licenses and not property rights. They do not appear as assets in CAIL's financials. Mr. Carty and Mr. Peterson explained that routes and slots are *not* treated as assets by airlines, but rather as rights in the control of the Government of Canada. In the event of bankruptcy/receivership of CAIL, CAIL's trustee/receiver could not sell them and accordingly they are of no value to CAIL.

127 Evidence was led that on June 23, 1999 Air Canada made an offer to purchase CAIL's international routes for $400 million cash plus $125 million for aircraft spares and inventory, along with the assumption of certain debt and lease obligations for the aircraft required for the international routes. CAIL evaluated the Air Canada offer and concluded that the proposed purchase price was insufficient to permit it to continue carrying on business in the absence of its international routes. Mr. Carty testified that something in the range of $2 billion would be required.

128 CAIL was in desperate need of cash in mid December, 1999. CAIL agreed to sell its Toronto — Tokyo route for $25 million. The evidence, however, indicated that the price for the Toronto — Tokyo route was not derived from a valuation, but rather was what CAIL asked for, based on its then-current cash flow requirements. Air Canada and CAIL obtained Government approval for the transfer on December 21, 2000.

129 Resurgence complained that despite this evidence of offers for purchase and actual sales of international routes and other evidence of sales of slots, the Monitor did not include Canadian's international routes in the Liquidation Analysis and only attributed a total of $66 million for all intangibles of Canadian. There is some evidence that slots at some foreign airports may be bought or sold in some fashion. However, there is insufficient evidence to attribute any value to other slots which CAIL has at foreign airports. It would appear given the regulation of the airline industry, in particular, the *Aeronautics Act* and the *Canada Transportation Act*, that international routes for a Canadian air carrier only have full value to the extent of federal government support for the transfer or sale, and its preparedness to allow the then-current license holder to sell rather than act unilaterally to change the designation. The federal government was prepared to allow CAIL to sell its Toronto — Tokyo route to Air Canada in light of CAIL's severe financial difficulty and the certainty of cessation of operations during the Christmas holiday season in the absence of such a sale.

130 Further, statements made by CAIL in mid-1999 as to the value of its international routes and operations in response to an offer by Air Canada, reflected the amount CAIL needed to sustain liquidity without its international routes and was not a representation of market value of what could realistically be obtained from an arms length purchaser. The Monitor concluded on its investigation that CAIL's Narida and Heathrow slots had a realizable value of $66 million, which it included in the Liquidation Analysis. I find that this conclusion is supportable and that the Monitor properly concluded that there were no other rights which ought to have been assigned value.

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Tax Pools

131 There are four tax pools identified by Resurgence and the Minority Shareholders that are material: capital losses at the CAC level, undepreciated capital cost pools, operating losses incurred by Canadian and potential for losses to be reinstated upon repayment of fuel tax rebates by CAIL.

Capital Loss Pools

132 The capital loss pools at CAC will not be available to Air Canada since CAC is to be left out of the corporate reorganization and will be severed from CAIL. Those capital losses can essentially only be used to absorb a portion of the debt forgiveness liability associated with the restructuring. CAC, who has virtually all of its senior debt compromised in the plan, receives compensation for this small advantage, which cost them nothing.

Undepreciated capital cost ("UCC")

133 There is no benefit to Air Canada in the pools of UCC unless it were established that the UCC pools are in excess of the fair market value of the relevant assets, since Air Canada could create the same pools by simply buying the assets on a liquidation at fair market value. Mr. Peterson understood this pool of UCC to be approximately $700 million. There is no evidence that the UCC pool, however, could be considered to be a source of benefit. There is no evidence that this amount is any greater than fair market value.

Operating Losses

134 The third tax pool complained of is the operating losses. The debt forgiven as a result of the Plan will erase any operating losses from prior years to the extent of such forgiven debt.

Fuel tax rebates

135 The fourth tax pool relates to the fuel tax rebates system taken advantage of by CAIL in past years. The evidence is that on a consolidated basis the total potential amount of this pool is $297 million. According to Mr. Carty's testimony, CAIL has not been taxable in his ten years as Chief Financial Officer. The losses which it has generated for tax purposes have been sold on a 10 - 1 basis to the government in order to receive rebates of excise tax paid for fuel. The losses can be restored retroactively if the rebates are repaid, but the losses can only be carried forward for a maximum of seven years. The evidence of Mr. Peterson indicates that Air Canada has no plan to use those alleged losses and in order for them to be useful to Air Canada, Air Canada would have to complete a legal merger with CAIL, which is not provided for in the plan and is not contemplated by Air Canada until some uncertain future date. In my view, the Monitor's conclusion that there was no value to any tax pools in the Liquidation Analysis is sound.

136 Those opposed to the Plan have raised the spectre that there may be value unaccounted for in this liquidation analysis or otherwise. Given the findings above, this is merely speculation and is unsupported by any concrete evidence.

c. Alternatives to the Plan

137 When presented with a plan, affected stakeholders must weigh their options in the light of commercial reality. Those options are typically liquidation measured against the plan proposed. If not put forward, a hope for a different or more favourable plan is not an option and no basis upon which to assess fairness. On a purposive approach to the CCAA, what is fair and reasonable must be assessed against the effect of the Plan on the creditors and their various claims, in the context of their response to the plan. Stakeholders are expected to decide their fate based on realistic, commercially viable alternatives (generally seen as the prime motivating factor in any business decision) and not on speculative desires or hope for the future. As Farley J. stated in *T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 6:

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> One has to be cognizant of the function of a balancing of their prejudices. Positions must be realistically assessed and weighed, all in the light of what an alternative to a successful plan would be. Wishes are not a firm foundation on which to build a plan; nor are ransom demands.

138 The evidence is overwhelming that all other options have been exhausted and have resulted in failure. The concern of those opposed suggests that there is a better plan that Air Canada can put forward. I note that significant enhancements were made to the plan during the process. In any case, this is the Plan that has been voted on. The evidence makes it clear that there is not another plan forthcoming. As noted by Farley J. in *T. Eaton Co.*, *supra*, "no one presented an alternative plan for the interested parties to vote on" (para. 8).

d. Oppression

Oppression and the CCAA

139 Resurgence and the Minority Shareholders originally claimed that the Plan proponents, CAC and CAIL and the Plan supporters 853350 and Air Canada had oppressed, unfairly disregarded or unfairly prejudiced their interests, under Section 234 of the ABCA. The Minority Shareholders (for reasons that will appear obvious) have abandoned that position.

140 Section 234 gives the court wide discretion to remedy corporate conduct that is unfair. As remedial legislation, it attempts to balance the interests of shareholders, creditors and management to ensure adequate investor protection and maximum management flexibility. The Act requires the court to judge the conduct of the company and the majority in the context of equity and fairness: *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.). Equity and fairness are measured against or considered in the context of the rights, interests or reasonable expectations of the complainants: *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 (B.C. S.C.).

141 The starting point in any determination of oppression requires an understanding as to what the rights, interests, and reasonable expectations are and what the damaging or detrimental effect is on them. MacDonald J. stated in *First Edmonton Place*, *supra* at 57:

> In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected in general commercial practice should all be material. More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: The protection of the underlying expectation of a creditor in the arrangement with the corporation, the extent to which the acts complained of were unforeseeable where the creditor could not reasonably have protected itself from such acts and the detriment to the interests of the creditor.

142 While expectations vary considerably with the size, structure, and value of the corporation, all expectations must be reasonably and objectively assessed: *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.).

143 Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: *Royal Oak Mines Ltd.*, *supra*, para. 4., *Re Cadillac Fairview Inc.* (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), and *T. Eaton Company*, *supra*.

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144 To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.

145 It is through the lens of insolvency legislation that the rights and interests of both shareholders and creditors must be considered. The reduction or elimination of rights of both groups is a function of the insolvency and not of oppressive conduct in the operation of the CCAA. The antithesis of oppression is fairness, the guiding test for judicial sanction. If a plan unfairly disregards or is unfairly prejudicial it will not be approved. However, the court retains the power to compromise or prejudice rights to effect a broader purpose, the restructuring of an insolvent company, provided that the plan does so in a fair manner.

Oppression allegations by Resurgence

146 Resurgence alleges that it has been oppressed or had its rights disregarded because the Petitioners and Air Canada disregarded the specific provisions of their trust indenture, that Air Canada and 853350 dealt with other creditors outside of the CCAA, refusing to negotiate with Resurgence and that they are generally being treated inequitably under the Plan.

147 The trust indenture under which the Unsecured Notes were issued required that upon a "change of control", 101% of the principal owing thereunder, plus interest would be immediately due and payable. Resurgence alleges that Air Canada, through 853350, caused CAC and CAIL to purposely fail to honour this term. Canadian acknowledges that the trust indenture was breached. On February 1, 2000, Canadian announced a moratorium on payments to lessors and lenders, including the Unsecured Noteholders. As a result of this moratorium, Canadian defaulted on the payments due under its various credit facilities and aircraft leases.

148 The moratorium was not directed solely at the Unsecured Noteholders. It had the same impact on other creditors, secured and unsecured. Canadian, as a result of the moratorium, breached other contractual relationships with various creditors. The breach of contract is not sufficient to found a claim for oppression in this case. Given Canadian's insolvency, which Resurgence recognized, it cannot be said that there was a reasonable expectation that it would be paid in full under the terms of the trust indenture, particularly when Canadian had ceased making payments to other creditors as well.

149 It is asserted that because the Plan proponents engaged in a restructuring of Canadian's debt before the filing under the CCAA, that its use of the Act for only a small group of creditors, which includes Resurgence is somehow oppressive.

150 At the outset, it cannot be overlooked that the CCAA does not require that a compromise be proposed to *all* creditors of an insolvent company. The CCAA is a flexible, remedial statute which recognizes the unique circumstances that lead to and away from insolvency.

151 Next, Air Canada made it clear beginning in the fall of 1999 that Canadian would have to complete a financial restructuring so as to permit Air Canada to acquire CAIL on a financially sound basis and as a wholly owned subsidiary. Following the implementation of the moratorium, absent which Canadian could not have continued to operate, Canadian and Air Canada commenced efforts to restructure significant obligations by consent. They perceived that further damage to public confidence that a CCAA filing could produce, required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection. Before the Petitioners started the CCAA proceedings on March 24, 2000, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

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152 The purpose of the CCAA is to create an environment for negotiations and compromise. Often it is the stay of proceedings that creates the necessary stability for that process to unfold. Negotiations with certain key creditors in advance of the CCAA filing, rather than being oppressive or conspiratorial, are to be encouraged as a matter of principle if their impact is to provide a firm foundation for a restructuring. Certainly in this case, they were of critical importance, staving off liquidation, preserving cash flow and allowing the Plan to proceed. Rather than being detrimental or prejudicial to the interests of the other stakeholders, including Resurgence, it was beneficial to Canadian and all of its stakeholders.

153 Resurgence complained that certain transfers of assets to Air Canada and its actions in consolidating the operations of the two entities prior to the initiation of the CCAA proceedings were unfairly prejudicial to it.

154 The evidence demonstrates that the sales of the Toronto — Tokyo route, the Dash 8s and the simulators were at the suggestion of Canadian, who was in desperate need of operating cash. Air Canada paid what Canadian asked, based on its cash flow requirements. The evidence established that absent the injection of cash at that critical juncture, Canadian would have ceased operations. It is for that reason that the Government of Canada willingly provided the approval for the transfer on December 21, 2000.

155 Similarly, the renegotiation of CAIL's aircraft leases to reflect market rates supported by Air Canada covenant or guarantee has been previously dealt with by this court and found to have been in the best interest of Canadian, not to its detriment. The evidence establishes that the financial support and corporate integration that has been provided by Air Canada was not only in Canadian's best interest, but its only option for survival. The suggestion that the renegotiations of these leases, various sales and the operational realignment represents an assumption of a benefit by Air Canada to the detriment of Canadian is not supported by the evidence.

156 I find the transactions predating the CCAA proceedings, were in fact Canadian's life blood in ensuring some degree of liquidity and stability within which to conduct an orderly restructuring of its debt. There was no detriment to Canadian or to its creditors, including its unsecured creditors. That Air Canada and Canadian were so successful in negotiating agreements with their major creditors, including aircraft financiers, without resorting to a stay under the CCAA underscores the serious distress Canadian was in and its lenders recognition of the viability of the proposed Plan.

157 Resurgence complained that other significant groups held negotiations with Canadian. The evidence indicates that a meeting was held with Mr. Symington, Managing Director of Resurgence, in Toronto in March 2000. It was made clear to Resurgence that the pool of unsecured creditors would be somewhere between $500 and $700 million and that Resurgence would be included within that class. To the extent that the versions of this meeting differ, I prefer and accept the evidence of Mr. Carty. Resurgence wished to play a significant role in the debt restructuring and indicated it was prepared to utilize the litigation process to achieve a satisfactory result for itself. It is therefore understandable that no further negotiations took place. Nevertheless, the original offer to affected unsecured creditors has been enhanced since the filing of the plan on April 25, 2000. The enhancements to unsecured claims involved the removal of the cap on the unsecured pool and an increase from 12 to 14 cents on the dollar.

158 The findings of the Commissioner of Competition establishes beyond doubt that absent the financial support provided by Air Canada, Canadian would have failed in December 1999. I am unable to find on the evidence that Resurgence has been oppressed. The complaint that Air Canada has plundered Canadian and robbed it of its assets is not supported but contradicted by the evidence. As described above, the alternative is liquidation and in that event the Unsecured Noteholders would receive between one and three cents on the dollar. The Monitor's conclusions in this regard are supportable and I accept them.

e. Unfairness to Shareholders

159 The Minority Shareholders essentially complained that they were being unfairly stripped of their only asset in CAC — the shares of CAIL. They suggested they were being squeezed out by the new CAC majority shareholder 853350,

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without any compensation or any vote. When the reorganization is completed as contemplated by the Plan, their shares will remain in CAC but CAC will be a bare shell.

160 They further submitted that Air Canada's cash infusion, the covenants and guarantees it has offered to aircraft financiers, and the operational changes (including integration of schedules, "quick win" strategies, and code sharing) have all added significant value to CAIL to the benefit of its stakeholders, including the Minority Shareholders. They argued that they should be entitled to continue to participate into the future and that such an expectation is legitimate and consistent with the statements and actions of Air Canada in regard to integration. By acting to realign the airlines before a corporate reorganization, the Minority Shareholders asserted that Air Canada has created the expectation that it is prepared to consolidate the airlines with the participation of a minority. The Minority Shareholders take no position with respect to the debt restructuring under the CCAA, but ask the court to sever the corporate reorganization provisions contained in the Plan.

161 Finally, they asserted that CAIL has increased in value due to Air Canada's financial contributions and operational changes and that accordingly, before authorizing the transfer of the CAIL shares to 853350, the current holders of the CAIL Preferred Shares, the court must have evidence before it to justify a transfer of 100% of the equity of CAIL to the Preferred Shares.

162 That CAC will have its shareholding in CAIL extinguished and emerge a bare shell is acknowledged. However, the evidence makes it abundantly clear that those shares, CAC's "only asset", have no value. That the Minority Shareholders are content to have the debt restructuring proceed suggests by implication that they do not dispute the insolvency of both Petitioners, CAC and CAIL.

163 The Minority Shareholders base their expectation to remain as shareholders on the actions of Air Canada in acquiring only 82% of the CAC shares before integrating certain of the airlines' operations. Mr. Baker (who purchased *after* the Plan was filed with the Court and almost six months after the take over bid by Air Canada) suggested that the contents of the bid circular misrepresented Air Canada's future intentions to its shareholders. The two dollar price offered and paid per share in the bid must be viewed somewhat skeptically and in the context in which the bid arose. It does not support the speculative view that some shareholders hold, that somehow, despite insolvency, their shares have some value on a going concern basis. In any event, any claim for misrepresentation that Minority Shareholders might have arising from the take over bid circular against Air Canada or 853350, if any, is unaffected by the Plan and may be pursued after the stay is lifted.

164 In considering Resurgence's claim of oppression I have already found that the financial support of Air Canada during this restructuring period has benefited Canadian and its stakeholders. Air Canada's financial support and the integration of the two airlines has been critical to keeping Canadian afloat. The evidence makes it abundantly clear that without this support Canadian would have ceased operations. However it has not transformed CAIL or CAC into solvent companies.

165 The Minority Shareholders raise concerns about assets that are ascribed limited or no value in the Monitor's report as does Resurgence (although to support an opposite proposition). Considerable argument was directed to the future operational savings and profitability forecasted for Air Canada, its subsidiaries and CAIL and its subsidiaries. Mr. Peterson estimated it to be in the order of $650 to $800 million on an annual basis, commencing in 2001. The Minority Shareholders point to the tax pools of a restructured company that they submit will be of great value once CAIL becomes profitable as anticipated. They point to a pension surplus that at the very least has value by virtue of the contribution holidays that it affords. They also look to the value of the compromised claims of the restructuring itself which they submit are in the order of $449 million. They submit these cumulative benefits add value, currently or at least realizable in the future. In sharp contrast to the Resurgence position that these acts constitute oppressive behaviour, the Minority Shareholders view them as enhancing the value of their shares. They go so far as to suggest that there may well be a current going concern value of the CAC shares that has been conveniently ignored or unquantified and that the Petitioners must put evidence before the court as to what that value is.

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166 These arguments overlook several important facts, the most significant being that CAC and CAIL are insolvent and will remain insolvent until the debt restructuring is fully implemented. These companies are not just technically or temporarily insolvent, they are massively insolvent. Air Canada will have invested upward of $3 billion to complete the restructuring, while the Minority Shareholders have contributed nothing. Further, it was a fundamental condition of Air Canada's support of this Plan that it become the sole owner of CAIL. It has been suggested by some that Air Canada's share purchase at two dollars per share in December 1999 was unfairly prejudicial to CAC and CAIL's creditors. Objectively, any expectation by Minority Shareholders that they should be able to participate in a restructured CAIL is not reasonable.

167 The Minority Shareholders asserted the plan is unfair because the effect of the reorganization is to extinguish the common shares of CAIL held by CAC and to convert the voting and non-voting Preferred Shares of CAIL into common shares of CAIL. They submit there is no expert valuation or other evidence to justify the transfer of CAIL's equity to the Preferred Shares. There is no equity in the CAIL shares to transfer. The year end financials show CAIL's shareholder equity at a deficit of $790 million. The Preferred Shares have a liquidation preference of $347 million. There is no evidence to suggest that Air Canada's interim support has rendered either of these companies solvent, it has simply permitted operations to continue. In fact, the unaudited consolidated financial statements of CAC for the quarter ended March 31, 2000 show total shareholders equity went from a deficit of $790 million to a deficit of $1.214 million, an erosion of $424 million.

168 The Minority Shareholders' submission attempts to compare and contrast the rights and expectations of the CAIL preferred shares as against the CAC common shares. This is not a meaningful exercise; the Petitioners are not submitting that the Preferred Shares have value and the evidence demonstrates unequivocally that they do not. The Preferred Shares are merely being utilized as a corporate vehicle to allow CAIL to become a wholly owned subsidiary of Air Canada. For example, the same result could have been achieved by issuing new shares rather than changing the designation of 853350's Preferred Shares in CAIL.

169 The Minority Shareholders have asked the court to sever the reorganization from the debt restructuring, to permit them to participate in whatever future benefit might be derived from the restructured CAIL. However, a fundamental condition of this Plan and the expressed intention of Air Canada on numerous occasions is that CAIL become a wholly owned subsidiary. To suggest the court ought to sever this reorganization from the debt restructuring fails to account for the fact that it is not two plans but an integral part of a single plan. To accede to this request would create an injustice to creditors whose claims are being seriously compromised, and doom the entire Plan to failure. Quite simply, the Plan's funder will not support a severed plan.

170 Finally, the future profits to be derived by Air Canada are not a relevant consideration. While the object of any plan under the CCAA is to create a viable emerging entity, the germane issue is what a prospective purchaser is prepared to pay in the circumstances. Here, we have the one and only offer on the table, Canadian's last and only chance. The evidence demonstrates this offer is preferable to those who have a remaining interest to a liquidation. Where secured creditors have compromised their claims and unsecured creditors are accepting 14 cents on the dollar in a potential pool of unsecured claims totalling possibly in excess of $1 billion, it is not unfair that shareholders receive nothing.

e. The Public Interest

171 In this case, the court cannot limit its assessment of fairness to how the Plan affects the direct participants. The business of the Petitioners as a national and international airline employing over 16,000 people must be taken into account.

172 In his often cited article, *Reorganizations Under the Companies' Creditors Arrangement Act* (1947), 25 Can.Bar R.ev. 587 at 593 Stanley Edwards stated:

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> Another reason which is usually operative in favour of reorganization is the interest of the public in the continuation of the enterprise, particularly if the company supplies commodities or services that are necessary or desirable to large numbers of consumers, or if it employs large numbers of workers who would be thrown out of employment by its liquidation. This public interest may be reflected in the decisions of the creditors and shareholders of the company and is undoubtedly a factor which a court would wish to consider in deciding whether to sanction an arrangement under the C.C.A.A.

173 In *Re Repap British Columbia Inc.* (1998), 1 C.B.R. (4th) 49 (B.C. S.C.) the court noted that the fairness of the plan must be measured against the overall economic and business environment and against the interests of the citizens of British Columbia who are affected as "shareholders" of the company, and creditors, of suppliers, employees and competitors of the company. The court approved the plan even though it was unable to conclude that it was necessarily fair and reasonable. In *Re Quintette Coal Ltd.*, *supra*, Thackray J. acknowledged the significance of the coal mine to the British Columbia economy, its importance to the people who lived and worked in the region and to the employees of the company and their families. Other cases in which the court considered the public interest in determining whether to sanction a plan under the CCAA include *Re Canadian Red Cross Society / Société Canadienne de la Croix-Rouge* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) and *Algoma Steel Corp. v. Royal Bank* (April 16, 1992), Doc. Toronto B62/91-A (Ont. Gen. Div.)

174 The economic and social impacts of a plan are important and legitimate considerations. Even in insolvency, companies are more than just assets and liabilities. The fate of a company is inextricably tied to those who depend on it in various ways. It is difficult to imagine a case where the economic and social impacts of a liquidation could be more catastrophic. It would undoubtedly be felt by Canadian air travellers across the country. The effect would not be a mere ripple, but more akin to a tidal wave from coast to coast that would result in chaos to the Canadian transportation system.

175 More than sixteen thousand unionized employees of CAIL and CRAL appeared through counsel. The unions and their membership strongly support the Plan. The unions represented included the Airline Pilots Association International, the International Association of Machinists and Aerospace Workers, Transportation District 104, Canadian Union of Public Employees, and the Canadian Auto Workers Union. They represent pilots, ground workers and cabin personnel. The unions submit that it is essential that the employee protections arising from the current restructuring of Canadian not be jeopardized by a bankruptcy, receivership or other liquidation. Liquidation would be devastating to the employees and also to the local and national economies. The unions emphasize that the Plan safeguards the employment and job dignity protection negotiated by the unions for their members. Further, the court was reminded that the unions and their members have played a key role over the last fifteen years or more in working with Canadian and responsible governments to ensure that Canadian survived and jobs were maintained.

176 The Calgary and Edmonton Airport authorities, which are not for profit corporations, also supported the Plan. CAIL's obligations to the airport authorities are not being compromised under the Plan. However, in a liquidation scenario, the airport authorities submitted that a liquidation would have severe financial consequences to them and have potential for severe disruption in the operation of the airports.

177 The representations of the Government of Canada are also compelling. Approximately one year ago, CAIL approached the Transport Department to inquire as to what solution could be found to salvage their ailing company. The Government saw fit to issue an order in council, pursuant to section 47 of the *Transportation Act*, which allowed an opportunity for CAIL to approach other entities to see if a permanent solution could be found. A standing committee in the House of Commons reviewed a framework for the restructuring of the airline industry, recommendations were made and undertakings were given by Air Canada. The Government was driven by a mandate to protect consumers and promote competition. It submitted that the Plan is a major component of the industry restructuring. Bill C-26, which addresses the restructuring of the industry, has passed through the House of Commons and is presently before the Senate. The Competition Bureau has accepted that Air Canada has the only offer on the table and has worked very closely with the parties to ensure that the interests of consumers, employees, small carriers, and smaller communities will be protected.

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178 In summary, in assessing whether a plan is fair and reasonable, courts have emphasized that perfection is not required: see for example *Re Wandlyn Inns Ltd.* (1992), 15 C.B.R. (3d) 316 (N.B. Q.B.), *Quintette Coal*, *supra* and *Repap*, *supra*. Rather, various rights and remedies must be sacrificed to varying degrees to result in a reasonable, viable compromise for all concerned. The court is required to view the "big picture" of the plan and assess its impact as a whole. I return to *Algoma Steel v. Royal Bank*, *supra* at 9 in which Farley J. endorsed this approach:

> What might appear on the surface to be unfair to one party when viewed in relation to all other parties may be considered to be quite appropriate.

179 Fairness and reasonableness are not abstract notions, but must be measured against the available commercial alternatives. The triggering of the statute, namely insolvency, recognizes a fundamental flaw within the company. In these imperfect circumstances there can never be a perfect plan, but rather only one that is supportable. As stated in *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 173:

> 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.

180 I find that in all the circumstances, the Plan is fair and reasonable.

IV. Conclusion

181 The Plan has obtained the support of many affected creditors, including virtually all aircraft financiers, holders of executory contracts, AMR, Loyalty Group and the Senior Secured Noteholders.

182 Use of these proceedings has avoided triggering more than $1.2 billion of incremental claims. These include claims of passengers with pre-paid tickets, employees, landlords and other parties with ongoing executory contracts, trade creditors and suppliers.

183 This Plan represents a solid chance for the continued existence of Canadian. It preserves CAIL as a business entity. It maintains over 16,000 jobs. Suppliers and trade creditors are kept whole. It protects consumers and preserves the integrity of our national transportation system while we move towards a new regulatory framework. The extensive efforts by Canadian and Air Canada, the compromises made by stakeholders both within and without the proceedings and the commitment of the Government of Canada inspire confidence in a positive result.

184 I agree with the opposing parties that the Plan is not perfect, but it is neither illegal nor oppressive. Beyond its fair and reasonable balancing of interests, the Plan is a result of bona fide efforts by all concerned and indeed is the only alternative to bankruptcy as ten years of struggle and creative attempts at restructuring by Canadian clearly demonstrate. This Plan is one step toward a new era of airline profitability that hopefully will protect consumers by promoting affordable and accessible air travel to all Canadians.

185 The Plan deserves the sanction of this court and it is hereby granted. The application pursuant to section 185 of the ABCA is granted. The application for declarations sought by Resurgence are dismissed. The application of the Minority Shareholders is dismissed.

Application granted; counter-applications dismissed.

Footnotes

* Leave to appeal refused 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, [2000] 10 W.W.R. 314, 2000 ABCA 238, 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]).

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2000 ABCA 238
Alberta Court of Appeal [In Chambers]

Canadian Airlines Corp., Re

2000 CarswellAlta 919, 2000 ABCA 238, [2000] 10 W.W.R. 314, [2000] A.W.L.D. 655, [2000] A.J. No. 1028, 20 C.B.R. (4th) 46, 228 W.A.C. 131, 266 A.R. 131, 84 Alta. L.R. (3d) 52, 99 A.C.W.S. (3d) 533, 9 B.L.R. (3d) 86

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

And In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c. B-15, as amended, Section 185;

And In the Matter of Canadian Airlines Corporation and Canadian Airlines International Ltd.; Resurgence Asset Management LLC (Applicant) and Canadian Airlines Corporation and Canadian Airlines International Ltd. (Respondents)

Wittmann J.A.

Heard: August 3, 2000
Judgment: August 29, 2000
Docket: Calgary Appeal 00-08901

Proceedings: refused leave to appeal *Canadian Airlines Corp., Re* (2000), 2000 CarswellAlta 662, 2000 ABQB 442, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201 (Alta. Q.B.); affirmed (2000), 2000 CarswellAlta 1556, 2001 ABCA 9, [2001] 3 W.W.R. 1 (Alta. C.A.)

Counsel: *D.R. Haigh*, *Q.C.*, *D.S. Nishimura*, and *A.Z.A. Campbell*, for Applicant.
H.M. Kay, *Q.C.*, *A.L. Friend*, *Q.C.*, and *L.A. Goldbach*, for Respondents.
S.F. Dunphy, for Air Canada.
F.R. Foran, *Q.C.*, for Monitor, Pricewaterhouse Coopers.

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

APPLICATION by investment corporation for leave to appeal from judgment reported at 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, [2000] 10 W.W.R. 269, 2000 ABQB 442, 20 C.B.R. (4th) 1 (Alta. Q.B.), approving airline's plan of arrangement under *Companies' Creditors Arrangement Act.*

Wittmann J.A. **[In Chambers]:**

INTRODUCTION

1 This is an application by Resurgence Asset Management LLC ("Resurgence") for leave to appeal the order of Paperny, J., dated June 27, 2000, [reported 84 Alta. L.R. (3d) 9, [2000] 10 W.W.R. 269 (Alta. Q.B.)] pursuant to proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, ("*CCAA*"). The order sanctioned a plan of compromise and arrangement ("the Plan") proposed by Canadian Airlines Corporation ("CAC") and Canadian Airlines International Ltd. ("CAIL") (together, "Canadian") and dismissed an application by Resurgence for a declaration that Resurgence was an unaffected creditor under the Plan.

BACKGROUND

2 Resurgence was the holder of 58.2 per cent of $100,000,000.00 (U.S.) of the unsecured notes issued by CAC.

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3 CAC was a publicly traded Alberta corporation which, prior to the June 27 order of Paperny, J., owned 100 per cent of the common shares of CAIL, the operating company of Canadian Airlines.

4 Air Canada is a publicly traded Canadian corporation. Air Canada owned 10 per cent of the shares of 853350 Alberta Ltd. ("853350"), which prior to the June 27 order of Paperny, J., owned all the preferred shares of CAIL.

5 As described in detail by the learned chambers judge in her reasons, Canadian had been searching for a decade for a solution to its ongoing, significant financial difficulties. By December 1999, it was on the brink of bankruptcy. In a series of transactions including 853350's acquisition of the preferred shares of CAIL, Air Canada infused capital into Canadian and assisted in debt restructuring.

6 Canadian came to the conclusion that it must conclude its debt restructuring to permit the completion of a full merger between Canadian and Air Canada. On February 1, 2000, to secure liquidity to continue operating until debt restructuring was achieved, Canadian announced a moratorium on payments to lessors and lenders. CAIL, Air Canada and lessors of 59 aircraft reached an agreement in principle on a restructuring plan. They also reached agreement with other secured creditors and several major unsecured creditors with respect to restructuring.

7 Canadian still faced threats of proceedings by secured creditors. It commenced proceedings under the *CCAA* on March 24, 2000. Pricewaterhouse Coopers Inc. was appointed as Monitor by court order.

8 Arrangements with various aircraft lessors, lenders and conditional vendors which would benefit Canadian by reducing rates and other terms were approved by court orders dated April 14, 2000 and May 10, 2000.

9 On April 25, 2000, in accordance with the March 24 court order, Canadian filed the Plan which was described as having three principal objectives:

(a) To provide near term liquidity so that Canadian can sustain operations;

(b) To allow for the return of aircraft not required by Canadian; and

(c) To permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset value and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

10 The Plan generally provided for stakeholders by category as follows:

(a) Affected unsecured creditors, which included unsecured noteholders, aircraft claimants, executory contract claimants, tax claimants and various litigation claimants, would receive 12 cents per dollar (later changed to 14 cents per dollar) of approved claims;

(b) Affected secured creditors, the senior secured noteholders, would receive 97 per cent of the principal amount of their claim plus interest and costs in respect of their secured claim, and a deficiency claim as unsecured creditors for the remainder;

(c) Unaffected unsecured creditors, which included Canadian's employees, customers and suppliers of goods and services, would be unaffected by the Plan;

(d) Unaffected secured creditor, the Royal Bank, CAIL's operating lender, would not be affected by the Plan.

11 The Plan also proposed share capital reorganization by having all CAIL common shares held by CAC converted into a single retractable share, which would then be retracted by CAIL for $1.00, and all CAIL preferred shares held by 853350 converted into CAIL common shares. The Plan provided for amendments to CAIL's articles of incorporation to effect the proposed reorganization.

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12 On May 26, 2000, in accordance with the orders and directions of the court, two classes of creditors, the senior secured noteholders and the affected unsecured creditors voted on the Plan as amended. Both classes approved the Plan by the majorities required by ss. 4 and 5 of the *CCAA*.

13 On May 29, 2000, by notice of motion, Canadian sought court sanction of the Plan under s. 6 of the *CCAA* and an order for reorganization pursuant to s. 185 of the *Business Corporations Act* (Alberta), S.A. 1981, c. B-15 as amended ("*ABCA*"). Resurgence was among those who opposed the Plan. Its application, along with that of four shareholders of CAC, was ordered to be tried during a hearing to consider the fairness and reasonableness of the Plan ("the fairness hearing").

14 Resurgence sought declarations that the actions of Canadian, Air Canada and 853350 constitute an amalgamation, consolidation or merger with or into Air Canada or a conveyance or transfer of all or substantially all of Canadian's assets to Air Canada; that any plan of arrangement involving Canadian will not affect Resurgence and directing the repurchase of their notes pursuant to provisions of their trust indenture and that the actions of Canadian, Air Canada and 853350 were oppressive and unfairly prejudicial to it pursuant to s. 234 of the *ABCA*.

15 The fairness hearing lasted two weeks during which *viva voce* evidence of six witnesses was heard, including testimony of the chief financial officers of Canadian and Air Canada. Submissions by counsel were made on behalf of the federal government, the Calgary and Edmonton airport authorities, unions representing employees of Canadian and various creditors of Canadian. The court also received two special reports from the Monitor.

16 As part of assessing the fairness of the Plan, the learned chambers judge received a liquidation analysis of CAIL, prepared by the Monitor, in order to estimate the amounts that might be recovered by CAIL's creditors and shareholders in the event that CAIL's assets were disposed of by a receiver or trustee. The Monitor concluded that liquidation would result in a shortfall to certain secured creditors, that recovery by unsecured creditors would be between one and three cents on the dollar, and that there would be no recovery by shareholders.

17 The learned chambers judge stated that she agreed with the parties opposing the Plan that it was not perfect, but it was neither illegal, nor oppressive, and therefore, dismissed the requested declarations and relief sought by Resurgence. Further, she held that the Plan was the only alternative to bankruptcy as ten years of struggle and failed creative attempts at restructuring clearly demonstrated. She ruled that the Plan was fair and reasonable and deserving of the sanction of the court. She granted the order sanctioning the Plan, and the application pursuant to s. 185 of the *ABCA* to reorganize the corporation.

LEAVE TO APPEAL UNDER THE *CCAA*

18 The *CCAA* provides for appeals to this Court as follows:

> 13. Except in the Yukon Territory, any person dissatisfied with an order or a decision made under this Act may appeal therefrom on obtaining leave of the judge appealed from or of the court or a judge or the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

19 As set out in *Re Canadian Airlines Corp.*, 2000 ABCA 149 (Alta. C.A. [In Chambers]) ("*Resurgence No. 1*"), a decision on a leave application sought earlier in this action, and as conceded by all the parties to this application, the criterion to be applied in an application for leave to appeal is that there must be serious and arguable grounds that are of real and significant interest to the parties. This criterion subsumes four factors to be considered by the court:

(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

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(4) whether the appeal will unduly hinder the progress of the action.

20 The respondents argue that apart from the test for leave, mootness is an additional overriding factor in the present case which is dispositive against the granting of leave to appeal.

MOOTNESS

21 In *Galcor Hotel Managers Ltd. v. Imperial Financial Services Ltd.* (1993), 81 B.C.L.R. (2d) 142 (B.C. C.A.), an order authorizing the distribution of substantially all the assets of a limited partnership had been fully performed. The appellants appealed, seeking to have the order vacated. The appellants had unsuccessfully applied for a stay of the order. In deciding whether to allow the appeal to be presented, Gibbs, J.A., for the court, said there was no merit, substance or prospective benefit that could accrue to the appellants, and that the appeal was therefore moot.

22 In *Borowski v. Canada (Attorney General)*, [1989] 1 S.C.R. 342 (S.C.C.), Sopinka, J. for the court, held that where there is no longer a live controversy or concrete dispute, an appeal is moot.

23 No stay of the June 27 order was obtained or even sought. In reliance on that order, most of the transactions contemplated by the Plan have been completed. According to the Affidavit of Paul Brotto, sworn July 6, 2000, filed July 7, 2000, the following occurred:

> 5. The transactions contemplated by the Plan have been completed in reliance upon the Sanction Order. The completion of the transactions has involved, among other things, the following steps:
>
> > (a) Effective July 4, 2000, all of the depreciable property of CAIL was transferred to a wholly-owned subsidiary of CAIL and leased back from such subsidiary by CAIL;
> >
> > (b) Articles of Reorganization of CAIL, being Schedule "D" to the Plan (which is Exhibit "A" to the Sanction Order), were filed and a Certificate of Amendment and Registration of Restated Articles was issued by the Registrar of Corporations pursuant to the Sanction Order, and in accordance with sections 185 and 255 of the Business Corporations Act (Alberta) (the "Certificate") on July 5, 2000. Pursuant to the Articles of Reorganization, the common shares of CAIL formerly held by CAC were converted to retractable preferred shares and the same were retracted. All preferred shares of CAIL held by 853350 Alberta Ltd. ("853350") were converted into CAIL common shares;
> >
> > (c) The "Section 80.04 Agreement" referred to in the Plan between CAIL and CAC, pursuant to which certain forgiveness of debt obligations under s.80 of the Income Tax Act were transferred from CAIL to CAC, has been entered into as of July 5, 2000;
> >
> > (d) Payment of $185,973,411 (US funds) has been made to the Trustee on behalf of all holders of Senior Secured Notes as provided for in the Plan and 853350 has acquired the Amended Secured Intercompany Note; and
> >
> > (e) Payments have been made to Affected Unsecured Creditors holding Unsecured Proven Claims and further payments will be made upon the resolution of disputed claims by the Claims officer; and
> >
> > (f) It is expected that payment will be made within several days of the date of this Affidavit to the Trustee, on behalf of the Unsecured Notes, in the amount 14 percent of approximately $160,000,000.

24 In *Norcan Oils Ltd. v. Fogler* (1964), [1965] S.C.R. 36 (S.C.C.), it was held that the Alberta Supreme Court Appellate Division could not set aside or revoke a certificate of amalgamation after the registrar of companies had issued the certificate in accordance with a valid court order and the corporations legislation. A notice appealing the order had been served but no stay had been obtained. Absent express legislative authority to reverse the process once the certificate had

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been issued, the majority of the Supreme Court of Canada held the amalgamation could not be unwound and therefore, an appellate court ought not to make an order which could have no effect.

25 Courts following *Norcan Oils Ltd.* have recognized that any right to appeal will be lost if a party does not obtain a stay of the filing of an amalgamation approval order: *Harris v. Universal Explorations Ltd.* (1982), 35 A.R. 71 (Alta. T.D.) and *Gibbex Mines Ltd. v. International Video Cassettes Ltd.*, [1975] 2 W.W.R. 10 (B.C. S.C.).

26 *Norcan* applies to bind this Court in the present action where CAIL's articles of reorganization were filed with the Registrar of Corporations on July 5, 2000 and pursuant to the provisions of the *ABCA*, a certificate amending the articles was issued. The certificate cannot now be rescinded. There is no provision in the ***ABCA*** for reversing a reorganization.

27 The respondents point out that there are other irreversible changes which have occurred since the date of the June 27, 2000 order. They include changes in share structure, changes in management personnel, implementation of a restructuring plan that included a repayment agreement with its principal lender and other creditors and payments to third parties. [Affidavit of Paul Brotto, paras. 6, 7, 8, 9, 10, 11, 12.]

28 The applicant relies on *Re Blue Range Resource Corp.* (1999), 244 A.R. 103 (Alta. C.A.), to argue that leave to appeal can be granted after a *CCAA* plan has been implemented. In that case, as noted by Fruman, J.A. at 106, a plan was in place and an appeal of the issues which were before her would not unduly hinder the progress of restructuring.

29 In this case, however, the proposed appeal by Resurgence would interfere with the restructuring since the remedies it seeks requires that the Plan be set aside. One proposed ground of appeal attacks the fairness and reasonableness of the Plan itself when the Plan has been almost fully implemented. It cannot be said that the proposed appeal would not unduly hinder the progress of restructuring.

30 If the proposed appeal were allowed, this Court cannot rewrite the Plan; nor could it remit the matter back to the *CCAA* supervising judge for such purpose. It must either uphold or set aside the approval of the Plan granted by the court below. In effect, if Resurgence succeeded on appeal, the Plan would be vacated. However, that remedy is no longer possible, at minimum, because the certificate issued by the Registrar cannot be revoked. As stated in *Norcan Oils Ltd.*, an appellate court cannot order a remedy which could have no effect. This Court cannot order that the Plan be undone in its entirety.

31 Similarly, the other ground of Resurgence's proposed appeal, oppression under s. 234 of the *ABCA*, cannot be allowed since that remedy must be granted within the context of the *CCAA* proceedings. As recognized by the learned chambers judge, allegations of oppression were considered in the test for fairness when seeking judicial sanction of the Plan. As she discussed at paragraphs 140-145 of her reasons, the starting point in any determination of oppression under the *ABCA* requires an understanding of the rights, interests and reasonable expectations which must be objectively assessed. In this action, the rights, interests and reasonable expectations of both shareholders and creditors must be considered through the lens of *CCAA* insolvency legislation. The complaints of Resurgence, that its rights under its trust indenture have been ignored or eliminated, are to be seen as the function of the insolvency, and not of oppressive conduct. As a consequence, even if Resurgence were to successfully appeal on the ground of oppression, the remedy would not be to give effect to the terms of the trust indenture. This Court could only hold that the fairness test for the court's sanction was not met and therefore, the approval of the Plan should be set aside. Again, as explained above, reversing the Plan is no longer possible.

32 The applicant was unable to point to any issue where this Court could grant a remedy and yet leave the Plan unaffected. It proposed on appeal to seek a declaration that it be declared an unaffected unsecured creditor. That is not a ground of appeal but is rather a remedy. As the respondents argued, the designation of Resurgence as an affected unsecured creditor was part of the Plan. To declare it an unaffected unsecured creditor requires vacating the Plan. On every ground proposed by the applicant, it appears that the response of this Court can only be to either uphold or set aside the approval of the court below. Setting aside the approval is no longer possible since essential elements of the

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Plan have been implemented and are now irreversible. Thus, the applicant cannot be granted the remedy it seeks. No prospective benefit can accrue to the applicant even if it succeeded on appeal. The appeal, therefore, is moot.

DISCRETION TO HEAR MOOT APPEALS

33 Even if an appeal could provide no benefit to the applicants, should leave be granted?

34 In *Borowski*, *supra*, Sopinka, J. described the doctrine of mootness at 353. He said that, as an aspect of a general policy or practice, a court may decline to decide a case which raises merely a hypothetical or abstract questions and will apply the doctrine when the decision of the court will have no practical effect of resolving some controversy affecting the rights of parties.

35 After discussing the principles involved in deciding whether an issue was moot, Sopinka, J. continued at 358 to describe the second stage of the analysis by examining the basis upon which a court should exercise its discretion either to hear or decline to hear a moot appeal. He examined three underlying factors in the rationale for the exercise of discretion in departing from the usual practice. The first is the requirement of an adversarial context which helps guarantee that issues are well and fully argued when resolving legal disputes. He suggested the presence of collateral consequences may provide the necessary adversarial context. Second is the concern for judicial economy which requires that special circumstances exist in a case to make it worthwhile to apply scare judicial resources to resolve it. Third is the need for the court to demonstrate a measure of awareness of its proper law-making function as the adjudicative branch in the political framework. Judgments in the absence of a dispute may be viewed as intruding into the role of the legislative branch. He concluded at 363:

> In exercising its discretion in an appeal which is moot, the court should consider the extent to which each of the three basic rationalia for enforcement of the mootness doctrine is present. This is not to suggest that it is a mechanical process. The principles identified above may not all support the same conclusion. The presence of one or two of the factors may be overborne by the absence of the third and vice versa.

36 The third factor underlying the rationale does not apply in this case. As for the first criterion, the circumstances of this case do not reveal any collateral consequences, although, it may be assumed that the necessary adversarial context could be present. However, there are no special circumstances making it worthwhile for this Court to ration scarce judicial resources to the resolution of this dispute. This outweighs the other two factors in concluding that the mootness doctrine should be enforced.

37 On the ground of mootness, leave to appeal should not be granted.

38 I am supported in this conclusion by similar cases before the British Columbia Court of Appeal, *Sparling v. Northwest Digital Ltd.* (1991), 47 C.P.C. (2d) 124 (B.C. C.A.) and *Galcor*, *supra*.

39 In *Sparling*, a company sought to restructure its financial basis and called a special meeting of shareholders. A court order permitted the voting of certain shares at the shareholders' meeting. A director sought to appeal that order. On the basis of the initial order, the meeting was held, the shares were voted and some significant changes to the company occurred as a result. Hollinrake, J.A. for the court described these as substantial changes which are irreversible. He found that the appeal was moot because there was no longer a live controversy. After considering *Borowski*, he also concluded that the court should not exercise its discretion to depart from the usual practice of declining to hear moot appeals.

40 In *Galcor*, as stated earlier, an order authorizing the distribution of certain monies to limited partners was appealed. A stay was sought but the application was dismissed. An injunction to restrain the distribution of monies was also sought and refused. The monies were distributed. The B.C. Court of Appeal held there was no merit, no substance and no prospective benefit to the appellants nor could they find any merit in the argument that there would be a collateral advantage if the appeal were heard and allowed. None of the criteria in *Borowski* were of assistance as there was no issue

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of public importance and no precedent value to other cases. Gibbs, J.A. was of the opinion it would not be prudent to use judicial time to hear a moot case as the rationing of scarce judicial resources was of importance and concern to the court.

APPLICATION OF THE CRITERIA FOR LEAVE

41 In any event, consideration of the usual factors in granting leave to appeal does not result in the granting of leave.

42 In particular, the applicant has not established *prima facie* meritorious grounds. The issue in the proposed appeal must be whether the learned chambers judge erred in determining that the Plan was fair and reasonable. As discussed in *Resurgence No. 1*, regard must be given to the standard of review this Court would apply on appeal when considering a leave application. The applicant has been unable to point to an error on a question of law, or an overriding and palpable error in the findings of fact, or an error in the learned chambers judge's exercise of discretion.

43 Resurgence submits that serious and arguable grounds surround the following issues: (a) Should Resurgence be treated as an unaffected creditor under the Plan? and (b) Should the Plan have been sanctioned under s. 6 of the *CCAA*? The applicant cannot show that either issue is based on an appealable error.

44 On the second issue, the main argument of the applicant is that the learned chambers judge failed to appreciate that the vote in favour of the Plan was not fair. At bottom, most of the submissions Resurgence made on this issue are directed at the learned chambers judge's conclusion that shareholders and creditors of Canadian would not be better off in bankruptcy than under the Plan. To appeal this conclusion, based on the findings of fact and exercise of discretion, Resurgence must establish that it has a *prima facie* meritorious argument that the learned chambers judge's error was overriding and palpable, or created an unreasonable result. This, it has not done.

45 Resurgence also argues that the acceptance of the valuations given by the Monitor to certain assets, in particular, Canadian Regional Airlines Limited ("CRAL"), the pension surplus and the international routes was in error. The Monitor did not attribute value to these assets when it prepared the liquidation analysis. Resurgence argued that the learned chambers judge erred when she held that the Monitor was justified in making these omissions.

46 Resurgence argued that CRAL was worth as much as $260 million to Air Canada. The Monitor valued CRAL on a distressed sale basis. It assumed that without CAIL's national and international network to feed traffic and considering the negative publicity which the failure of CAIL would cause, CRAL would immediately stop operations.

47 The learned chambers judge found that there was no evidence of a potential purchaser for CRAL. She held that CRAL had a value to CAIL and could provide value of Air Canada, but this was attributable to CRAL's ability to feed traffic to and take traffic from the national and international service of CAIL. She held that the Monitor properly considered these factors. The $260 million dollar value was based on CRAL as a going concern which was a completely different scenario than a liquidation analysis. She accepted the liquidation analysis on the basis that if CAIL were to cease operations, CRAL would be obliged to do so as well and that would leave no going concern for Air Canada to acquire.

48 CRAL may have some value, but even assuming that, Resurgence has not shown that it has a *prima facie* meritorious argument that the learned chambers judge committed an overriding and palpable error in finding that the Monitor was justified in concluding CRAL would not have any value assuming a windup of CAIL. She found that there was no evidence of a market for CRAL as a going concern. Her preference for the liquidation analysis was a proper exercise of her discretion and cannot be said to have been unreasonable.

49 Resurgence also argued that the pension plan surplus must be given value and included in the liquidation analysis because the surplus may revert to the company depending upon the terms of the plan. There was some evidence that in the two pension plans, with assets over $2 billion, there may be a surplus of $40 million. The Monitor attributed no value because of concerns about contingent liabilities which made the true amount of any available surplus indefinite and also because of the uncertainty of the entitlement of Canadian to any such amount.

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50 The learned chambers judge found that no basis had been established for any surplus being available to be withdrawn from an ongoing pension plan. She also found that the evidence showed the potential for significant contingencies. Upon termination of the plan, further reductions for contingent benefits payable in accordance with the plans, any wind up costs, contribution holidays and litigation costs would affect a determination of whether there was a true surplus. The evidence before the learned chambers judge included that of the unionized employees who expected to dispute all the calculations of the pension plan surplus and the entitlement to the surplus. The learned chambers judge observed also that the surplus could quickly disappear with relatively minor changes in the market value of the securities held or in the calculation of liabilities. She concluded that given all variables, the existence of any surplus was doubtful at best and held that ascribing a zero value was reasonable in the circumstances.

51 In addition to the evidence upon which the learned chambers judge based her conclusion, she is also supported by the case law which demonstrates that even if a pension surplus existed and was accessible, entitlement is a complex question: *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611 (S.C.C.).

52 Resurgence argued that the international routes of Canadian should have been treated as valuable assets. The Monitor took the position that the international routes were unassignable licences in control of the Government of Canada and not property rights to be treated as assets by the airlines. Resurgence argues that the Monitor's conclusion was wrong because there was evidence that the international routes had value. In December 1999, CAIL sold its Toronto - Tokyo route to Air Canada for $25 million. Resurgence also pointed to statements made by Canadian's former president and CEO in mid-1999 that the value of its international routes was $2 billion. It further noted that in the United States, where the government similarly grants licences to airlines for international routes, many are bought and sold.

53 The learned chambers judge found the evidence indicated that the $25 million paid for the Toronto-Tokyo route was not an amount derived from a valuation but was the amount CAIL needed for its cash flow requirements at the time of the transaction in order to survive. She found that the statements that CAIL's international routes were worth $2 billion reflected the amount CAIL needed to sustain liquidity without its international routes and was not the market value of what could realistically be obtained from an arm's length purchaser. She found there was no evidence of the existence of an arm's length purchaser. As the respondents pointed out, the Canadian market cannot be compared to the United States. Here in Canada, there is no other airline which would purchase international routes, except Air Canada. Air Canada argued that it is pure speculation to suggest it would have paid for the routes when it could have obtained the routes in any event if Canadian went into liquidation.

54 Even accepting Resurgence's argument that those assets should have been given some value, the applicant has not established a *prima facie* meritorious argument that the learned chambers judge was unreasonable to have accepted the valuations based on a liquidation analysis rather than a market value or going concern analysis nor that she lacked any evidence upon which to base her conclusions. She found that the evidence was overwhelming that all other options had been exhausted and have resulted in failure. As described above, she had evidence upon which to accept the Monitor's valuations of the disputed assets. It is not the role of this Court to review the evidence and substitute its opinion for that of the learned chambers judge. She properly exercised her discretion and she had evidence upon which to support her conclusions. The applicant, therefore, has not established that its appeal is *prima facie* meritorious.

55 On the first issue, Resurgence argues that it should be an unaffected creditor to pursue its oppression remedy. As discussed above, the oppression remedy cannot be considered outside the context of the *CCAA* proceedings. The learned chambers judge concluded that the complaints of Resurgence were the result of the insolvency of Canadian and not from any oppressive conduct. The applicant has not established any *prima facie* error committed by the learned chambers judge in reaching that conclusion.

56 Thus, were this appeal not moot, leave would not be granted as the applicant has not met the threshold for leave to appeal.

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CONCLUSION

57 The application for leave to appeal is dismissed because it is moot, and in any event, no serious and arguable grounds have been established upon which to found the basis for granting leave.

Application dismissed.

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2001 CarswellAlta 888
Supreme Court of Canada

Canadian Airlines Corp., Re

2001 CarswellAlta 888, 2001 CarswellAlta 889, [2001] S.C.C.A. No. 60, 257 W.A.C. 351 (note), 275 N.R. 386 (note), 293 A.R. 351 (note)

Resurgence Asset Management LLC v. Canadian Airlines Corporation and Canadian Airlines International Ltd.

Bastarache J., Iacobucci J., McLachlin C.J.C.

Judgment: July 13, 2001
Docket: 28388

Proceedings: Leave to appeal refused (2000), 2001 ABCA 9, 2000 CarswellAlta 1556, [2001] 3 W.W.R. 1, 277 A.R. 179, 242 W.A.C. 179 (Alta. C.A.); Affirmed 2000 ABCA 238, 2000 CarswellAlta 919, [2000] 10 W.W.R. 314, 20 C.B.R. (4th) 46, 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, 266 A.R. 131, 228 W.A.C. 131 (Alta. C.A. [In Chambers]); Leave to appeal refused 2000 ABQB 442, 2000 CarswellAlta 662, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201 (Alta. Q.B.)

Counsel: None given.

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

***Bastarache J.*, *Iacobucci J.*, *McLachlin C.J.C.*:**

1 The application for leave to appeal is dismissed with costs.

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3

2015 ONSC 622
Ontario Superior Court of Justice

Cline Mining Corp., Re

2015 CarswellOnt 3285, 2015 ONSC 622, 23 C.B.R. (6th) 194, 252 A.C.W.S. (3d) 8

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

In the Matter of a Plan of Compromise and Arrangement of Cline Mining Corporation, New ELK Coal Company LLC and North Central Energy Company

G.B. Morawetz R.S.J.

Heard: January 27, 2015
Judgment: January 30, 2015
Docket: CV-14-10781-00CL

Counsel: Robert J. Chadwick, Logan Willis for Applicants, Cline Mining Corporation et al.
Michael DeLellis, David Rosenblatt for FTI Consulting Canada Inc., Monitor of the Applicants
Jay Swartz for Secured Noteholders

Subject: Insolvency

MOTION by insolvent companies for approval or plan of arrangement and other relief.

***G.B. Morawetz R.S.J.*:**

1 Cline Mining Corporation, New Elk Coal Company LLC and North Central Energy Company (collectively, the "Applicants") seek an order (the "Sanction Order"), among other things:

> a. sanctioning the Applicants' Amended and Restated Plan of Compromise and Arrangement dated January 20, 2015 (the "Plan") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA"); and
>
> b. extending the stay, as defined in the Initial Order granted December 3, 2014 (the "Initial Order"), to and including April 1, 2015.

2 Counsel to the Applicants submits that the Recapitalization is the result of significant efforts by the Applicants to achieve a resolution of their financial challenges and, if implemented, the Recapitalization will maintain the Applicants as a unified corporate enterprise and result in an improved capital structure that will enable the Applicants to better withstand prolonged weakness in the global market for metallurgical coal.

3 Counsel submits that the Applicants believe that the Recapitalization achieves the best available outcome for the Applicants and their stakeholders in the circumstances and achieves results that are not attainable under any other bankruptcy, sale or debt enforcement scenario.

4 The position of the Applicants is supported by the Monitor, and by Marret, on behalf of the Secured Noteholders.

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5 The Plan has the unanimous support from the creditors of the Applicants. The Plan was approved by 100% in number and 100% in value of creditors voting in each of the Secured Noteholders Class, the Affected Unsecured Creditors Class and the WARN Act Plaintiffs Class.

6 The background giving rise to (i) the insolvency of the Applicants; (ii) the decision to file under the CCAA; (iii) the finding made that the court had the jurisdiction under the CCAA to accept the filing; (iv) the finding of insolvency; and (v) the basis for granting the Initial Order and the Claims Procedure Order was addressed in *Cline Mining Corp., Re*, 2014 ONSC 6998 (Ont. S.C.J.) and need not be repeated.

7 The Applicants report that counsel to the WARN Act Plaintiffs in the class action proceedings (the "Class Action Counsel") submitted a class proof of claim on behalf of the 307 WARN Act Plaintiffs in the aggregate amount of U.S. $3.7 million. Class Action Counsel indicated that the WARN Act Plaintiffs were not prepared to vote in favour of the Plan dated December 3, 2014 (the "Original Plan") without an enhancement of the recovery. The Applicants report that after further discussions, agreement was reached with Class Action Counsel on the form of a resolution that provides for an enhanced recovery for the WARN Act Plaintiffs Class of $210,000 (with $90,000 paid on the Plan implementation date) as opposed to the recovery offered in the Original Plan of $100,000 payable in eight years from the Plan implementation date.

8 As a result of reaching this resolution, the Original Plan was amended to reflect the terms of the WARN Act resolution.

9 The Applicants served the Amended Plan on the Service List on January 20, 2015.

10 The Plan provides for a full and final release and discharge of the Affected Claims and Released Claims, a settlement of, and consideration for, all Allowed Affected Claims and a recapitalization of the Applicants.

11 Equity claimants will not receive any consideration or distributions under the Plan.

12 The Plan provides for the release of certain parties (the "Released Parties"), including:

> (i) the Applicants, the Directors and Officers and employees of contractors of the Applicants; and
>
> (ii) the Monitor, the Indenture Trustee and Marret and their respective legal counsel, the financial and legal advisors to the Applicants and other parties employed by or associated with the parties listed in sub-paragraph (ii), in each case in respect of claims that constitute or relate to, *inter alia*, any Claims, any Directors/Officer Claims and any claims arising from or connected to the Plan, the Recapitalization, the CCAA Proceedings, the Chapter 15 Proceedings, the business or affairs of the Applicants or certain other related matter (collectively, the "Released Claims").

13 The Plan does not release:

> (i) the right to enforce the Applicants' obligations under the Plan;
>
> (ii) the Applicants from or in respect of any Unaffected Claim or any Claim that is not permitted to be released pursuant to section 19(2) of the CCAA; or
>
> (iii) any Director or Officer from any Director/Officer Claim that is not permitted to be released pursuant to section 5.1(2) of the CCAA.

14 The Plan does not release Insured Claims, provided that any recourse in respect of such claims is limited to proceeds, if any, of the Applicants' applicable Insurance Policies.

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15 The Meetings Order authorized the Applicants to convene a meeting of the Secured Noteholders, a meeting of Affected Unsecured Creditors and a meeting of WARN Act Plaintiffs to consider and vote on the Plan.

16 The Meetings were held on January 21, 2015. At the Meetings, the resolution to approve the Plan was passed unanimously in each of the three classes of creditors.

17 None of the persons with Disputed Claims voted at the Meetings, in person or by proxy. Consequently, the results of the votes taken would not change based on the inclusion or exclusion of the Disputed Claims in the voting results.

18 Pursuant to section 6(1) of the CCAA, the court has the discretion to sanction a plan of compromise or arrangement where the requisite double-majority of creditors has approved the plan. The effect of the court's approval is to bind the company and its creditors.

19 The general requirements for court approval of the CCAA Plan are well established:

a. there must be strict compliance with all statutory requirements;

b. all materials filed and procedures carried out must be examined to determine if anything has been done or purported to have been done, which is not authorized by the CCAA; and

c. the plan must be fair and reasonable.

(see *SkyLink Aviation Inc., Re*, 2013 ONSC 2519 (Ont. S.C.J. [Commercial List]))

20 Having reviewed the record and hearing submissions, I am satisfied that the foregoing test for approval has been met in this case.

21 In arriving at my conclusion that the Plan is fair and reasonable in the circumstances, I have taken into account the following:

a. the Plan represents a compromise among the Applicants and the Affected Creditors resulting from discussions among the Applicants and their creditors, with the support of the Monitor;

b. the classification of the Applicants' creditors into three voting classes was previously approved by the court and the classification was not opposed at any time;

c. the results of the Sale Process indicate that the Secured Noteholders would suffer a significant shortfall and there would be no residual value for subordinate interests;

d. the Recapitalization provides a limited recovery for unsecured creditors and the WARN Act Plaintiffs;

e. all Affected Creditors that voted on the Plan voted for its approval;

f. the Plan treats Affected Creditors fairly and provides for the same distribution among the creditors within each of the Secured Noteholders Class, the Affected Unsecured Creditors Class and the WARN Act Plaintiffs Class;

g. Unaffected Claims, which include, *inter alia*, government and employee priority claims, claims not permitted to be compromised pursuant to sections 19(2) and 5.1(2) of the CCAA and prior ranking secured claims, will not be affected by the Plan;

h. the treatment of Equity Claims under the Plan is consistent with the provisions of the CCAA; and

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i. the Plan is supported by the Applicants (Marret, on behalf of the Secured Noteholders), the Monitor and the creditors who voted in favor of the Plan at the Meetings.

22 The CCAA permits the inclusion of third party releases in a plan of compromise or arrangement where those releases are reasonably connected to the proposed restructuring (see: *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 (Ont. C.A.) ("*ATB Financial*"); *SkyLink*, *supra;* and *Sino-Forest Corp., Re*, 2012 ONSC 7050 (Ont. S.C.J. [Commercial List]), leave to appeal denied, 2013 ONCA 456 (Ont. C.A.)).

23 The court has the jurisdiction to sanction a plan containing third party releases where the factual circumstances indicate that the third party releases are appropriate. In this case, the record establishes that the releases were negotiated as part of the overall framework of the compromises in the Plan, and these releases facilitate a successful completion of the Plan and the Recapitalization. The releases cover parties that could have claims of indemnification or contribution against the Applicants in relation to the Recapitalization, the Plan and other related matters, whose rights against the Applicants have been discharged in the Plan.

24 I am satisfied that the releases are therefore rationally related to the purpose of the Plan and are necessary for the successful restructuring of the Applicants.

25 Further, the releases provided for in the Plan were contained in the Original Plan filed with the court on December 3, 2014 and attached to the Meetings Order. Counsel to the Applicants submits that the Applicants are not aware of any objections to the releases provided for in the Plan.

26 The Applicants also contend that the releases of the released Directors/Officers are appropriate in the circumstances, given that the released Directors and Officers, in the absence of the Plan releases, could have claims for indemnification or contribution against the Applicants and the release avoids contingent claims for such indemnification or contribution against the Applicants. Further, the releases were negotiated as part of the overall framework of compromises in the Plan. I also note that no Director/Officer Claims were asserted in the Claims Procedure.

27 The Monitor supports the Applicants' request for the sanction of the Plan, including the releases contained therein.

28 I am satisfied that in these circumstances, it is appropriate to grant the releases.

29 The Plan provides for certain alterations to the Cline Articles in order to effectuate certain corporate steps required to implement the Plan, including the consolidation of shares and the cancellation of fractional interests of the Cline Common Shares. I am satisfied that these amendments are necessary in order to effect the provisions of the Plan and that it is appropriate to grant the amendments as part of the approval of the Plan.

30 The Applicants also request an extension of the stay until April 1, 2015. This request is made pursuant to section 11.02(2) of the CCAA. The court must be satisfied that:

(i) circumstances exist that make the order appropriate; and

(ii) the applicant has acted, and is acting in good faith and with due diligence.

31 The record establishes that the Applicants have made substantial progress toward the completion of the Recapitalization, but further time is required to implement same. I am satisfied that the test pursuant to section 11.02(2) has been met and it is appropriate to extend the stay until April 1, 2015.

32 Finally, the Monitor requests approval of its activities and conduct to date and also approval of its Pre-Filing Report, the First Report dated December 16, 2014 and the Second Report together with the activities described therein. No objection was raised with respect to the Monitor's request, which is granted.

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33 For the foregoing reasons, the motion is granted and an order shall issue in the form requested, approving the Plan and providing certain ancillary relief.

Motion granted.

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2009 CarswellOnt 146
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re.

2009 CarswellOnt 146, [2009] O.J. No. 154, 174 A.C.W.S. (3d) 332, 50 C.B.R. (5th) 77

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: January 14, 2009
Oral reasons: January 14, 2009
Docket: 09-CL-7950

Counsel: Derrick Tay, Mario Forte, Jennifer Stam for Nortel Networks Corporation, et al
Edmond Lamek, Aubrey Kauffman for Export Development Canada
Michael Barrack, Rachelle Moncur for Flextronics Corporation
Edward A. Sellers for Directors of Nortel Networks Corporation, Nortel Networks Limited
Jay Carfagnini for Monitor, Ernst & Young Inc.

Subject: Insolvency; Corporate and Commercial

APPLICATION by debtor for protection under *Companies' Creditors Arrangement Act.*

***Morawetz J.*:**

1 Nortel Networks Corporation ("NNC"), Nortel Networks Limited ("NNL"), Nortel Networks International Corporation ("NNIC"), Nortel Networks Global Corporation ("NNGC"), Nortel Networks International Corporation ("NNIC") and Nortel Networks Technology Corporation ("NNTC") bring this application under the *Companies' Creditors Arrangement Act* ("*CCAA*").

2 NNC is a Canadian corporation and is the direct or indirect parent of 143 subsidiaries including the other applicants. NNC, NNL, NNIC, NNGC and NNTC are referred to as the "Applicants".

3 In addition, NNC is party to eight joint ventures operating worldwide. References to "Nortel" or the "Nortel Companies" are references to the global enterprise as a whole. References to a "Nortel Company" are references to a single entity within the Nortel Companies.

4 NNC's and NNL's principal executive offices are in Toronto, Ontario. NNTC's principal executive offices are in Ottawa, Ontario. NNL also has offices in Montreal and Ottawa with sales and support offices throughout Western and Central Canada, Quebec and Atlantic Canada. NNIC and NNGC have their registered offices in Toronto, Ontario, but apparently have no operations.

5 The Applicants seek protection under the *CCAA* to facilitate the re-organization of the Nortel Companies for the benefit of all creditors. In addition, certain of NNC's direct and indirect U.S. subsidiaries have filed voluntary petitions

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(the "Chapter 11 proceedings") pursuant to Chapter 11 of the United States Bankruptcy Code (the "Code"), and the directors of certain of NNL's active subsidiaries in Europe, Middle East and Africa (collectively referred to as the "ENEA Entities") and ("ENEA"), are expected to apply to the English court for administration orders for each of the ENEA Entities and (the "Administration Proceedings") pursuant to the *Insolvency Act* 1986 ("IA86"). The Applicants are also seeking this court's authorization to apply for recognition of the *CCAA* proceedings as "foreign main proceedings" under Chapter 15 of the Code. Counsel has also indicated that Nortel Networks Inc. ("NNI") and the other scheduled Chapter 11 applicants are making an application to this court pursuant to s.18.6 of the *CCAA* to recognize the Chapter 11 proceedings as "foreign proceedings" in Canada and to give effect to the stay thereunder.

6 The name Nortel is known throughout the world for leadership in the networking and communication industries, delivering cutting-edge hardware and software solutions and related services.

7 In his affidavit filed in support of this application, Mr. John Doolittle, Treasurer of NNC and NNL stated that at their peak in 2000, the Nortel companies generated approximately $30 billion of annual revenue, employed nearly 93,000 employees and had a market capitalization of over U.S. $250 billion. He also stated that with the burst of the high-tech bubble in early 2001 and the resulting significant downturn in both the telecommunications industry and the economic environment, the Nortel companies began to face an increasingly difficult competitive environment.

8 A number of steps have been taken to restructure the affairs of Nortel since 2001, but as Mr. Doolittle explains in his affidavit these measures have not provided adequate relief from the significant pressures Nortel is experiencing. The Applicants are of the view that the action which presents the greatest potential for the survival and recovery of Nortel is a comprehensive business and financial restructuring which can only be accomplished through a *CCAA* process coordinated with the Chapter 11 proceedings and the Administration Proceedings.

9 The Canadian corporate structure, the U.S. corporate structure and the European corporate structure are detailed in the affidavit of Mr. Doolittle as is the Applicants' capital structure.

10 As at January 9, 2009, Nortel's debt structure consisted of the following unsecured obligations:

Nortel Networks Corporation

- $575 million, 1.75 percent convertible notes due 2012
- $575 million, 2.125 percent convertible notes due 2014

Nortel Networks Limited and Nortel Networks Inc.

- $1 billion Libor + 4.25 percent senior notes due 2011
- $550 million, 10.125 percent senior notes due 2013
- $1.125 billion, 10.75 percent senior notes due 2016
- $200 million, 6.875 percent senior notes due 2023 (no NNI guarantee)

Nortel Networks Capital Corporation

- $150 million, 7.875 percent senior notes due 2026
- Notes do not carry NNI guarantee but are fully and unconditionally guaranteed by NNL

11 Mr. Doolittle also stated that the operation of the Nortel business is a highly complex integrated structure designed to accommodate the global nature of their business and, although many of Nortel's primary contractual external

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relationships with vendors are through NNL, products are ordered, delivered and paid for pursuant to internal sub-agreements with vendors and Nortel regional entities.

12 As a result of the complex structure, Mr. Doolittle states that there are frequent inter-company receivables arising among the operating subsidiaries and, occasionally, when such receivables are not settled on a short timeframe, such receivables may be converted into an inter-company loan. These loans are typically repaid in the normal course.

13 Further, as a result of the inter-connectivity of the Nortel Companies, Nortel employs a complex arrangement to deal with cash management and inter-company payments and the allocation of revenues, and costs among the Nortel Companies. By way of summary, Mr. Doolittle noted that the Applicants have a total of 39 Canadian $ and U.S. $ bank accounts, which are maintained on an entity-by-entity basis.

14 Again, according to Mr. Doolittle, the Nortel business is highly integrated with several key Nortel Companies acting as purchasing hubs for Nortel Companies around the world which results in high levels of inter-company receivables and payables, which necessitate the complex transfer pricing and inter-company settling methods employed by Nortel.

15 Mr. Doolittle goes on to explain that the inter-company sales and receivables system is highly complex and essential for the ongoing fulfillment of customer orders.

16 Accordingly, the Applicants propose to continue their buying and selling arrangements consistent with the transfer pricing model post filing. In anticipating of these insolvency proceedings, the Chapter 11 proceedings in the U.S. and the Administration in England, Mr. Doolittle stated that the Applicants have entered into discussions with NNI in the U.S. and NNUK (the head of ENEA) along with Ernst & Young LLP (UK) as proposed administrator (the "Administrator") and have reached a 30-day agreement with respect to the terms on which these arrangements would continue were proceedings to be commenced in all three jurisdictions.

17 In addition, the Applicants have critical relationships with two entities.

18 First, the Applicants rely heavily on Flextronics Telecom Systems Ltd. to supply approximately 75 percent of Nortel's products. In anticipation of this filing, and in recognition of the importance of Flextronics' continuing compliance during the proceedings, Nortel and Flextronics negotiated the terms of an agreement that will ensure ongoing supply upon filing. A copy of the agreement is contained at Exhibit B to the affidavit of Mr. Doolittle. The agreement is subject to Canadian court approval. The Monitor recommends that this court approve this amending agreement.

19 Second, Export Development Canada ("EDC") provides a support facility to Nortel. Nortel is of the view that this facility is a key component of the ability of Nortel to continue its business. EDC has agreed to provide a 30-day waiver of default and has agreed to provide up to U.S. $30 million of additional support during the 30-day waiver period, to allow EDC and Nortel to work together to see if a longer-term arrangement can be reached. The EDC waiver is subject to the condition that any support granted by EDC post-filing will be secured by a charge on the assets of Nortel (the "EDC Charge"). Nortel is agreeable to the granting of the charge and the Monitor has recommended that the EDC Charge be granted.

20 Copies of NNC's audited Consolidated Financial Statements for 2007 as well its Unconsolidated Financial Statements for the first three fiscal quarters of 2008 are filed in the Record.

21 As of September 30, 2008, the Applicants had total current assets of U.S. $21.153 billion and total current liabilities of U.S. $22.355 billion.

22 The Applicants do not have any senior secured obligations. Other than leased equipment, capital leases, sale lease arrangements related to the real estate properties and certain letters of credit which are cash collateralized, the remainder of their obligations are apparently unsecured obligations.

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23 Nortel also has significant pension and post-retirement plan liabilities. Mr. Doolittle states that an upcoming valuation will reflect a significant decline in the value of the assets held in Nortel pension plans due to the recent adverse conditions in the financial markets globally. As a result, Nortel anticipates that its pension plan funding requirements in 2009 will increase in a very substantial and material manner.

24 Mr. Doolittle also states that the Applicants have third-party trade debt of approximately U.S. $160 million. He also indicated that the Applicants are defendants in various legal proceedings for which the Applicants are unable to ascertain the ultimate aggregate amount of liability. Further, the Applicants have other debt of approximately $414 million relating to various contractual commitments.

25 The Applicants have acknowledged that they are insolvent. In addition to the information referenced above, the Chapter 11 applicants are seeking protection pursuant to Chapter 11 of the Code, which is a default under the high-yield notes. Mr. Doolittle has acknowledged that NNL and NNC do not have sufficient funds to pay any accelerated amounts on the high-yield notes and defaults under the high-yield notes lead to a default under support facility provided by EDC as well as other convertible notes.

26 Further, Mr. Doolittle acknowledges that the Applicants are cognizant of the significant pension deficits in England (the contributions to which have been guaranteed by NNL) and Canada, which, if accelerated they would not be able to fulfill.

27 Ernst & Young Inc. ("E&Y") was retained by the Applicants on September 26, 2008 to advise as to the financial status of the Applicants.

28 E&Y has consented to act as the Monitor (the "Monitor") of the Applicants in the *CCAA* proceedings.

29 E&Y has filed a report in its capacity as proposed Monitor (the "Report"). The Report provides additional detail as to the current financial status of Nortel and as well it contains the recommendations of the Monitor in respect of the proposed form of *CCAA* order.

30 The Record filed in support of the application also contains the required cash-flow forecast, which in this case is a 13-week cash-flow forecast that estimates the Applicants' financing requirements.

31 The proposed form of order provides for a number of charges and financial thresholds which are described in both the affidavit of Mr. Doolittle and in the Report.

32 These charges include an Administrative Charge, a Directors' and Officers' Charge, and Inter-Company Charge, and a Carling Facility Charge to support cash loans from NNI to NNL.

33 With respect to the Carling Facility Charge, Mr. Doolittle states that, at the present time, most of Nortel's cash in North America is with NNI. NNL requires access to $200 million of that cash to ensure that NNL has access to adequate funding for this process. It is therefore contemplated that as part of its first-day hearings, NNI will seek U.S. Bankruptcy Court approval to advance up to U.S. $200 million on a revolving basis to NNL (the "NNI Loan") which will be secured by the Carling Facility Charge.

34 The Applicants have also disclosed that the directors in the past have elected to receive remuneration by way of allocation of share units. The proposed Monitor has been advised by the Applicants that, in the future, all directors will be remunerated by way of cash payments (at current cash-equivalent levels, less $25,000), subject to court approval.

35 In its report, the Monitor has recommended that the Applicants be granted the benefit of protection under the *CCAA* and, as well, the Monitor is supportive of the charges and financial thresholds proposed in the draft order. The priority of the various charges is specified in the order.

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36 Having reviewed the record and having heard submissions, I am satisfied that the Applicants qualify as debtor corporations within the meaning of the *CCAA*.

37 The Applicants clearly have obligations in excess of the qualifying limit and have acknowledged that they are insolvent.

38 The jurisdiction of this court to receive the *CCAA* application has been established.

39 The Applicants seek an initial order under s.11 of the *CCAA*. The required Statement of Projected Cash Flow and the other financial documents required under s.11(2) have been filed. The application was not opposed by any party appearing.

40 Counsel to Flextronics, EDC and the Board of Directors all expressed their support for the granting of the requested relief. The Monitor expressed its approval to the requested form of order.

41 I am satisfied that it is appropriate that the Applicants be granted protection under the *CCAA* and an order shall issue to that effect, which order also approves the amending agreement with Flextronics and the granting of the EDC Charge. The draft order is based on the Model Order and the modifications as proposed are acceptable.

42 Although none of the Applicants have filed for Chapter 11 protection in the United States, and none of the Chapter 11 entities have filed as debtor companies under the *CCAA*, it is recognized that Nortel's operations are connected in many ways such that, in my view, it is desirable to implement a cross-border insolvency protocol. The initial order seeks approval of such a protocol which establishes the basis for communication and cooperation between the Canadian and U.S. courts, while confirming their independence. The form of protocol is acceptable to this court and is, accordingly, approved. However, this cross-border insolvency protocol cannot be implemented without the approval of the U.S. court.

43 The Applicants have also requested that the Monitor be directed to commence proceedings under Chapter 15 of the Code to have the *CCAA* proceedings recognized as "foreign main proceedings". The effect of the Chapter 15 proceedings would be to give effect to this initial order in the United States. The Applicants anticipate that the Monitor will be appointed as the Applicants' foreign representative in respect of such Chapter 15 proceedings.

44 The Monitor is of the view that the Applicants should be authorized to seek such recognition. I am in agreement with these submissions and the Monitor is accordingly authorized to seek such recognition under Chapter 15 of the Code.

45 In considering whether these *CCAA* proceedings should be recognized as "foreign main proceedings", Mr. Doolittle at paragraph 189 of his affidavit provides comprehensive reasons for the basis for his conclusion that the Applicants' centre of main interest ("COMI") is in Toronto, Ontario.

46 An order shall issue to give effect to the foregoing.

47 I would like to express my appreciation to all parties involved in this process. It is clear that significant effort was expended by all concerned in the preparation of the materials. The detail contained in the affidavit of Mr. Doolittle as well as the proposed Monitor's report was of great assistance to the court.

Application granted.

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2016 CarswellOnt 4213
Ontario Superior Court of Justice [Commercial List]

Nortel Communications Inc., Re

2016 CarswellOnt 4213

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Communications Inc., Architel Systems Corporation and Northern Telecom Canada Limited (the "New Applicants")
Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

Newbould J.

Judgment: March 18, 2016
Docket: CV-16-11312-00CL

Counsel: Counsel — not provided

Subject: Insolvency

***Newbould J.*:**

1 *THIS APPLICATION*, made by the New Applicants, pursuant to the *Companies ' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "*CCAA*") was heard this date at 330 University Avenue, Toronto, Ontario.

2 *ON READING* the One Hundred and Twenty Seventh Report of the Ernst & Young Inc. ("*EYI*") in its capacity as court-appointed monitor (the "*Monitor*") of the Canadian Debtors (as defined below) dated March 9, 2016 (the "*Report*") filed in the CCAA proceedings of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks Technology Corporation and Nortel Networks International Corporation (collectively, the "*Canadian Debtors*") (Court File No. 09-CL-7950) (the "*CCAA Proceedings*"), and on hearing submissions of counsel for the Monitor, and counsel for those other parties present, no one appearing for any other person on the service list although duly served as appears from the affidavit of Christopher G. Armstrong sworn March 9, 2016, filed, and on reading the consent of EYI to act as the Monitor of the New Applicants.

Service

3 1. *THIS COURT ORDERS* that the time for the service of the Notice of Application and the Application Record is hereby abridged and validated so that this Application is properly returnable today and hereby dispenses with further service thereof.

New Applicants

4 *2. THIS COURT ORDERS AND DECLARES* that the New Applicants are companies to which the CCAA applies.

5 3. *THIS COURT ORDERS* that, from and after the making of this Order, each of the New Applicants shall be deemed to be an "Applicant" (as defined in the Initial Order of this Court granted in the CCAA Proceedings dated January 14, 2009, as amended and restated (the "*Initial Order*")) in the CCAA Proceedings, entitled to all of the rights, benefits and protections granted by, and otherwise subject to: (i) the Initial Order; (ii) the Order of this Court dated August 14, 2009 granted in the CCAA Proceedings (the "*First Expansion of Powers Order*"); and (iii) the Order (Monitor's Expansion

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of Power Order # 2) of this Court dated October 3, 2012 granted in the CCAA Proceedings (the "*Second Expansion of Powers Order*" and with the Initial Order and the First Expansion of Powers Order, the "*Orders*") [1] as if it were an Applicant thereunder. Without limiting the generality of the foregoing:

(a) the New Applicants shall have the benefit of the stay of proceedings and other protections granted in paragraphs 14, 15 and 16 of the Initial Order;

(b) EYI is hereby appointed pursuant to the CCAA as the monitor of the New Applicants on the same terms and with the same powers, obligations and protections as provided by the CCAA and granted in the Orders with respect to its role as Monitor of the Canadian Debtors in the CCAA Proceedings, including, without limitation, the stay of proceedings granted in paragraphs 14 and 15 of the Initial Order and the protections granted in: (i) paragraphs 26, 27, 28 and 29 of the Initial Order; (ii) paragraphs 6, 7, 8 and 9 of the First Expansion of Powers Order; and (iii) paragraphs 6, 7, 8 and 9 of the Second Expansion of Powers Order; and

(c) the Monitor is authorized and empowered, but not obligated, to exercise any powers which may be properly exercised by a board of directors of any of the New Applicants and to designate any person or persons as the Monitor shall determine from time to time as evidenced by the filing of a Monitor's Certificate with this Court as an "Authorized Representative" (as such term is defined in the Second Expansion of Powers Order) of the New Applicants and in such role the Monitor and any Authorized Representative of the New Applicants shall have all of the protections and benefits provided by the CCAA and granted in the Orders, including, without limitation, pursuant to paragraphs 6, 7, 8 and 9 of the Second Expansion of Powers Order.

6 4. *THIS COURT ORDERS* that the within application shall be procedurally consolidated with the CCAA Proceedings and that from and after the date hereof all motions, actions, steps or other matters in respect of the within application shall be taken in the CCAA Proceedings.

7 5. *THIS COURT ORDERS* that the requirement for the Monitor to publish a notice in respect of this Order pursuant to Section 23(a)(i) of the CCAA is hereby dispensed with such that the Monitor shall have no obligation to publish any such notice.

Miscellaneous

8 6. *THIS COURT ORDERS* that the Monitor is hereby authorized, but not required, to apply for recognition of these proceedings in respect of the New Applicants as "Foreign Main Proceedings" in the United States pursuant to chapter 15 of the U.S. Bankruptcy Code.

9 7. *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 New 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 New 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 New Applicants and the Monitor and their respective agents in carrying out the terms of this Order.

10 8. *THIS COURT ORDERS* that this Order and all of its provisions are effective as of 12:01 a.m. Toronto time on the date of this Order.

Schedule "A"

[ATTACHED]

Court File No. 09-CL-7950

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Ontario Superior Court of Justice

THE HONOURABLE	)	WEDNESDAY, THE 14{TH}
	)	
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.

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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 diburseements 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 the Order;

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(c) with the written appoval 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;

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(g) payment of any indebtedness of NNL to EDC under he 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

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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

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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.

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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, reasserted, 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 h accordance with paragraph 20 of this Order

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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;

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(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 if 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 Jaw 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

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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 intercompany 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, "Intercompany 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 an;,' disposition of the Property, the business operations, or the reorganization of a Beneficiary Applicant. An Intercompany 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 Intercompany 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 Intercompany 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,

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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, BOB d 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-

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(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 provide 1 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 off 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,

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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 statue 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

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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.

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Graphic 1

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*"),[2] 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, 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,

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the "*Canadian Debtors*")[3] 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.

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 a 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 (he 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' credited 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

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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. Cooperation

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.

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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 tie 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.

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(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 tile 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

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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 terras 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 h 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

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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 de Sued 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 tail 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 Parries 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

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(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 he 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. Effectiveness; Modification

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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. Procedure for Resolving Disputes Under this Protocol

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) fender 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.

Appendix

Court File No.: 09-CL-7950

Ontario Superior Court of Justice Commercial List

THE HONOURABLE MR.	)	FRIDAY, THE 14{th}
	)	

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JUSTICE MORAWETZ) DAY OF AUGUST, 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 Application Under The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, As Amended

Order

THIS MOTION, made by Nortel Networks Corporation ("NNC"), Nortel Networks Limited ("NNL"), Nortel Networks Technology Corporation, Nortel Networks Global Corporation and Nortel Networks International Corporation (collectively, the "Applicants") for the relief set out in the Applicants' Notice of Motion dated August 11, 2009 was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the affidavit of Gordon A. Davies sworn August 11, 2009 (the "Davies Affidavit") and the Nineteenth report of Ernst & Young Inc. in its capacity as monitor (the "Monitor") dated August 11, 2009 (the "Nineteenth Report") and on hearing the submissions of counsel for the Applicant, the Monitor and those other parties present, no one appearing for any other person on the service list, although properly served as appears from the affidavit of Katie Legree sworn August 11, 2009, filed:

1. THIS COURT ORDERS that the time for the service of the Notice of Motion, the Nineteenth Report and the Motion Record is hereby abridged so that this Motion is properly returnable today and hereby dispenses with further service thereof.

2. THIS COURT ORDERS that capitalized terms used herein and not otherwise defined shall have the meaning given to them in the Initial Order granted by this Court on January 14, 2009 (as the same has been amended and amended and restated and as the same may be amended or amended and restated further from time to time, the "Initial Order").

3. THIS COURT ORDERS that in addition to the powers and duties set out in the Initial Order but without altering in any way the powers, abilities, limitations and obligations of the Applicants within or as a result of these proceedings, the Monitor be and is hereby authorized and empowered to:

(a) cause the Applicants, or any one or more of them, to exercise rights under paragraph 11 of the Initial Order;

(b) cause the Applicants to perform such other functions or duties as the Monitor considers necessary or desirable in order to facilitate or assist the Applicants in dealing with the Property or their operations, restructuring, wind-down, liquidation or other activities;

(c) conduct, supervise and direct one or more Court-approved sales processes for the Property or the business and any procedure regarding the allocation and/or distribution of proceeds of any sales;

(d) cause the Applicants to administer the Property and operations of the Applicants as the Monitor considers necessary or desirable for the purposes of completing any transaction for the sale of the business or any part of it or for purposes of facilitating a Plan or Plans for all or part of the business;

(e) administer the Applicants' claims process pursuant to the Claims Procedure Order dated July 30, 2009 (the "Claims Procedure Order") and any other claims bar and/or claims resolution process, or protocol as may be approved by Order of this Court within these proceedings;

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(f) propose or cause the Applicants or any one or more of them to propose one or more Plans in respect of the Applicants or any one or more of them;

(g) engage assistants or advisors or cause the Applicants to engage assistants or advisors as the Monitor deems necessary or desirable to carry out the terms of the Initial Order or any other Order made in these proceedings or for the purposes of the Plan and such persons shall be deemed to be "Assistants" under the Initial Order;

(h) apply to this Court for any orders necessary or advisable to carry out its powers and obligations under this Order or any other Order granted by this Court including for advice and directions with respect to any matter;

(i) meet and coordinate with the chief restructuring officer of the Applicants or any person holding any similar position;

(j) meet and consult with the board of directors of the Applicants as it deems necessary or appropriate;

(k) meet with and direct management of the Applicants with respect to any of the foregoing including, without limitation, operational and restructuring matters; and

(l) coordinate with the individual appointed as the principal officer (or such similar title) of Nortel Networks Inc. or any successor or assign of such entity with respect to operational and restructuring matters, provided that the Monitor shall have no supervisory authority or control over such individuals;

provided, however, that the Monitor shall comply with all applicable law and shall not have any authority or power to elect or to cause the election or removal of directors of any of the Applicants or any of their subsidiaries or to take any action to restrict or to transfer to the Monitor any of their powers, duties or obligations.

4. THIS COURT ORDERS that, other than with respect to the Retainers, the Monitor shall not receive or hold any property or funds of the Applicants, including without limitation, any proceeds of dispositions of Property or other cash or cash equivalents.

5. THIS COURT ORDERS that nothing in this Order shall diminish or vary the obligations of the Applicants, or the Monitor when directing the Applicants, where required, either contractually or by Order of the Court, to consult with, obtain the consent of or provide notice to the official committee of unsecured creditors of Nortel Networks Inc., the ad hoc bondholders committee and/or the Joint Administrators (as defined in the Davies Affidavit), prior to taking any action for which consent or notice is required including pursuant to and in accordance with the Orders previously made in these proceedings and in accordance with the applicable provisions of the Amended Cross-Border Protocol dated July 6, 2009 (the "Cross-Border Protocol"), the Interim Funding and Settlement Agreement dated as of June 9, 2009 (the "IFSA") and the Interim GSPA (as the same has been amended and extended from time to time) and provided further that nothing in this Order shall diminish or vary the Applicants' obligations under the Cross-Border Protocol, the IFSA or the Interim GSPA (or any Orders in respect of the Cross-Border Protocol, the IFSA or the Interim GSPA).

6. THIS COURT ORDERS that, without limiting the provisions of the Initial Order, the Applicants shall remain in possession and control of the Property and the Business and that the Monitor shall not take possession of the Property and/or the Business or any part thereof.

7. THIS COURT ORDERS that, without limiting the provisions of the Initial Order, all employees of the Applicants shall remain employees of the Applicants until such time as the Applicants may terminate the employment of such employees. Nothing in this Order shall, in and of itself, cause the Monitor to be liable for any employee-related liabilities or duties, including, without limitation, wages, severance pay, termination pay, vacation pay and pension or benefit amounts.

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8. THIS COURT ORDERS that the Monitor shall continue to have the benefit of all of the protections and priorities as set out in the Initial Order and any such protections and priorities shall apply to the Monitor in fulfilling its duties under this Order or carrying out the provisions of this Order.

9. THIS COURT ORDERS AND DECLARES that nothing in this Order shall constitute or be deemed to constitute the Monitor as a receiver, assignee, liquidator, administrator, receiver-manager, agent of the creditors or legal representative of any of the Applicants within the meaning of any relevant legislation and that any distribution ultimately made to creditors of the Applicants by the Monitor will be deemed to have been made by the Applicants themselves.

10. THIS COURT ORDERS that the Applicants and their advisors shall cooperate fully with the Monitor and any directions it may provide pursuant to this Order and shall provide the Monitor with such assistance as the Monitor may request from time to time to enable the Monitor to carry out its duties and powers as set out in the Initial Order, this Order or any other Order of this Court under the CCAA or applicable law generally.

11. THIS COURT ORDERS that a further hearing shall be held on September 15, 2009 or such alternate date as this Court may fix, at which time this Order may be varied. Materials for such further hearing shall be served upon the Service List for this proceeding by no later than ten days prior to the date schedule for the further hearing save and except in the case of the Monitor and the Applicants, which shall serve their materials (either in response or otherwise), if any, by no later than four days prior to the date scheduled for the further hearing.

Graphic 2

Appendix

Court File No.: 09-CL-7950

Ontario Superior Court Of Justice Commercial List

THE HONOURABLE MR.	)	*WEDNESDAY, THE 3{rd}*
	)	
JUSTICE MORAWETZ	)	*DAY OF OCTOBER, 2012*

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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 Application under the Companies' Creditors Arrangement Act, 7 R.S.C. 1985, c. C-36, As Amended

Order (Monitor's Expansion of Power Order # 2)

THIS MOTION, made by Ernst & Young Inc. in its capacity as monitor in the within proceedings (the "Monitor") for the relief set out in the Monitor's Notice of Motion dated September 26, 2012 was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Eighty-Eighth Report of the Monitor ("Eighty-Eighth Report") and on hearing the submissions of counsel for Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Technology Corporation, Nortel Networks Global Corporation and Nortel Networks International Corporation (collectively, the "Applicants") and counsel for the Monitor and those other parties present, no one appearing for any other person on the service list, although properly served as appears from the affidavit of Christopher G. Armstrong sworn September 27, 2012, filed:

1. THIS COURT ORDERS that the time for the service of the Notice of Motion, the Eighty-Eighth Report and the Motion Record is hereby abridged so that this Motion is properly returnable today and hereby dispenses with further service thereof

2. THIS COURT ORDERS that capitalized terms used herein and not otherwise defined shall have the meaning given to them in the Initial Order granted by this Court on January 14, 2009 (as the same has been amended and amended and restated and as the same may be amended or amended and restated further from time to time, the "Initial Order").

3. THIS COURT ORDERS that, without limiting the provisions of previous Orders granted in these proceedings, including the Initial Order and the Order granted by this Court on August 14, 2009, which, among other things, expanded the powers of the Monitor (the "Monitor Expansion of Powers Order") and in addition to all powers of the Monitor, the Monitor be and is hereby authorized and empowered, but not obligated, to exercise any powers which may be properly exercised by a board of directors of any of the Applicants.

4. THIS COURT ORDERS that, in furtherance of and without in any way limiting the powers set out in the Initial Order, those set out in the Monitor Expansion of Powers Order or any other Order of this Court, those set out herein or under the CCAA or applicable law generally, the Monitor is authorized and directed to take the following actions:

a) cause the Applicants to retain the services of Allan Bifield and Anna Ventresca as employees of NNL under the supervision and direction of the Monitor on the same terms in respect of their 2012 remuneration as currently in place and thereafter on terms as agreed with the Monitor; and

b) designate each of Allan Bifield and Anna Ventresca, and/or such other person or persons as the Monitor shall determine from time to time as evidenced by the filing of a Monitor's Certificate with this Court as an authorized representative of each of the Applicants (each, in such capacity, an "Authorized Representative") whose sole responsibility shall be to act, on behalf of the Applicants, solely as the Monitor may direct in the exercise of its rights, powers and authorities granted by the Initial Order, the Monitor Expansion of Powers Order, and any other Order of this Court, and, without limiting the generality of the foregoing, each of the Authorized Representatives shall have sole authority to sign such agreements, instruments and other documents on behalf of each of the Applicants as the Monitor may direct, but no authority to direct the management and policies of the Applicants or any entity affiliated with any of the Applicants by reason of having been designated as an Authorized Representative pursuant to this Order.

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5. THIS COURT ORDERS that, other than with respect to the Retainers, the Monitor shall not receive or hold any property or funds of the Applicants, including without limitation, any proceeds of dispositions of Property or other cash or cash equivalents.

6. THIS COURT ORDERS that, without limiting the provisions of the Initial Order, the Applicants shall remain in possession and control of the Property and the Business and that the Monitor shall not take possession of the Property and/or the Business or any part thereof.

7. THIS COURT ORDERS that, without limiting the provisions of the Initial Order, all employees of the Applicants shall remain employees of the Applicants until such time as the Applicants may terminate the employment of such employees. Nothing in this Order shall, in and of itself, cause the Monitor to be liable for any employee-related liabilities or duties, including, without limitation, wages, severance pay, termination pay, vacation pay and pension or benefit amounts.

8. THIS COURT ORDERS that the Monitor shall continue to have the benefit of all of the indemnities, charges, protections and priorities as set out in the Initial Order, the Monitor Expansion of Powers Order and any other Order of this Court and all such indemnities, charges, protections and priorities shall apply and extend to the Monitor in the fulfilment of its duties or the carrying out of the provisions of this Order and shall extend to any Authorized Representative acting upon the direction of the Monitor. For the avoidance of doubt, no Authorized Representative shall be deemed to be an officer or director of any of the Applicants, or of any entity affiliated with any of the Applicants, under applicable law by reason of having been designated as an Authorized Representative pursuant to this Order and/or having acted in such capacity at the direction of the Monitor.

9. THIS COURT ORDERS AND DECLARES that nothing in this Order shall constitute or be deemed to constitute the Monitor as a receiver, assignee, liquidator, administrator, receiver manager, agent of the creditors or legal representative of any of the Applicants within the meaning of any relevant legislation and that any distribution ultimately made to creditors of the Applicants by the Monitor will be deemed to have been made by the Applicants themselves.

10. THIS COURT ORDERS that the Applicants and their advisors shall cooperate fully with the Monitor and any directions it may provide pursuant to this Order and shall provide the Monitor with such assistance as the Monitor may request from time to time to enable the Monitor to carry out its duties and powers as set out in the Initial Order, the Monitor Expansion of Powers Order, this Order or any other Order of this Court under the CCAA or applicable law generally.

11. THIS COURT ORDERS that references to "directors" and "officers" in paragraphs 20, 21, 21A and 22 of the Initial Order are understood to mean directors and officers, respectively, that served in such capacity at any time on or after January 14, 2009 and that the reference to "counsel to directors" in paragraph 30 of the Initial Order is understood to mean Osier, Hoskin & Harcourt LLP as counsel to certain former directors and officers.

12. THIS COURT ORDERS that, except as may be necessary to give effect to this Order, the Initial Order and the Monitor Expansion of Powers Order remain in full force and effect and in the event of a conflict between the terms of this Order and those of the Initial Order or the Monitor Expansion of Powers Order, the provisions of this Order shall govern.

13. THIS COURT ORDERS that Confidential Appendix "B" to the Eighty- Eighth Report be and is hereby sealed pending further Order of the Court.

14. THIS COURT HEREBY REQUESTS the aid and recognition of any court or administrative body in any province of Canada, the Federal Court of Canada, any administrative tribunal or other court constituted pursuant to the Parliament of Canada or any of its provinces or territories and any federal or state court or administrative

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body in the United States of America or any other foreign courts to act in aid of and to be complimentary to this Court in carrying out the terms of this Order.

Graphic 3

Footnotes

1 Copies of each of the Orders are attached at Schedule "A" hereto.

2 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.

3 The Canadian Debtors include the following entities: NNC, NNL, Nortel Networks Technology Corporation, Nortel Networks Global Corporation and Nortel Networks International Corporation.

End of Document

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2012 ONCA 816
Ontario Court of Appeal

Sino-Forest Corp., Re

2012 CarswellOnt 14701, 2012 ONCA 816, 114 O.R. (3d) 304,
225 A.C.W.S. (3d) 601, 299 O.A.C. 107, 98 C.B.R. (5th) 20

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 Sino-Forest Corporation

S.T. Goudge, Alexandra Hoy, S.E. Pepall JJ.A.

Heard: November 13, 2012
Judgment: November 23, 2012
Docket: C56115, C56118, C56125

Proceedings: affirming *Sino-Forest Corp., Re* (2012), 92 C.B.R. (5th) 99, 2012 CarswellOnt 9430, 2012 ONSC 4377 (Ont. S.C.J. [Commercial List])

Counsel: Peter H. Griffin, Peter J. Osborne, Shara Roy for Appellant, Ernst & Young LLP
Sheila Block, David Bish for Appellants, Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC
Kenneth Dekker for Appellant, BDO Limited
Robert W. Staley, Derek J. Bell, Jonathan Bell for Respondent, Sino-Forest Corporation
Benjamin Zarnett, Robert Chadwick, Julie Rosenthal for Respondent, Ad Hoc Committee of Noteholders
Clifton Prophet for Monitor, FTI Consulting Canada Inc.
Kirk M. Baert, A. Dimitri Lascaris, Massimo Starnino for Respondent, Ad Hoc Committee of Purchasers
Emily Cole for Respondent, Allen Chan
Erin Pleet for Respondent, David Horsley
David Gadsden for Respondent, Pöyry (Beijing)
Larry Lowenstein, Edward A. Sellers for Respondent, Board of Directors

Subject: Insolvency

APPEAL by auditors and underwriters from judgment reported at *Sino-Forest Corp., Re* (2012), 92 C.B.R. (5th) 99, 2012 CarswellOnt 9430, 2012 ONSC 4377 (Ont. S.C.J. [Commercial List]) granting application by corporation for order that auditors' and underwriters' claims were equity claims under statute.

***Per curiam*:**

I Overview

1 In 2009, the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA"), was amended to expressly provide that general creditors are to be paid in full before an equity claim is paid.

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2 This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor, Sino-Forest Corporation ("Sino-Forest"), for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation.

3 The appellants argue that the supervising judge erred in concluding that the claims at issue are equity claims within the meaning of the CCAA and in determining the issue before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

4 For the reasons that follow, we conclude that the supervising judge did not err and accordingly dismiss this appeal.

II The Background

(a) The Parties

5 Sino-Forest is a Canadian public holding company that holds the shares of numerous subsidiaries, which in turn own, directly or indirectly, forestry assets located principally in the People's Republic of China. Its common shares are listed on the Toronto Stock Exchange. Sino-Forest also issued approximately $1.8 billion of unsecured notes, in four series. Trading in Sino-Forest shares ceased on August 26, 2011, as a result of a cease-trade order made by the Ontario Securities Commission.

6 The appellant underwriters [1] provided underwriting services in connection with three separate Sino-Forest equity offerings in June 2007, June 2009 and December 2009, and four separate Sino-Forest note offerings in July 2008, June 2009, December 2009 and October 2010. Certain underwriters entered into agreements with Sino-Forest in which Sino-Forest agreed to indemnify the underwriters in connection with an array of matters that could arise from their participation in these offerings.

7 The appellant BDO Limited ("BDO") is a Hong Kong-based accounting firm that served as Sino-Forest's auditor between 2005 and August 2007 and audited its annual financial statements for the years ended December 31, 2005 and December 31, 2006.

8 The engagement agreements governing BDO's audits of Sino-Forest provided that the company's management bore the primary responsibility for preparing its financial statements in accordance with Generally Accepted Accounting Principles ("GAAP") and implementing internal controls to prevent and detect fraud and error in relation to its financial reporting.

9 BDO's Audit Report for 2006 was incorporated by reference into a June 2007 prospectus issued by Sino-Forest regarding the offering of its shares to the public. This use by Sino-Forest was governed by an engagement agreement dated May 23, 2007, in which Sino-Forest agreed to indemnify BDO in respect of any claims by the underwriters or any third party that arose as a result of the further steps taken by BDO in relation to the issuance of the June 2007 prospectus.

10 The appellant Ernst & Young LLP ("E&Y") served as Sino-Forest's auditor for the years 2007 to 2012 and delivered Auditors' Reports with respect to the consolidated financial statements of Sino-Forest for fiscal years ended December 31, 2007 to 2010, inclusive. In each year for which it prepared a report, E&Y entered into an audit engagement letter with Sino-Forest in which Sino-Forest undertook to prepare its financial statements in accordance with GAAP, design and implement internal controls to prevent and detect fraud and error, and provide E&Y with its complete financial records and related information. Some of these letters contained an indemnity in favour of E&Y.

11 The respondent Ad Hoc Committee of Noteholders consists of noteholders owning approximately one-half of Sino-Forest's total noteholder debt. [2] They are creditors who have debt claims against Sino-Forest; they are not equity claimants.

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12 Sino-Forest has insufficient assets to satisfy all the claims against it. To the extent that the appellants' claims are accepted and are treated as debt claims rather than equity claims, the noteholders' recovery will be diminished.

(b) The Class Actions

13 In 2011 and January of 2012, proposed class actions were commenced in Ontario, Quebec, Saskatchewan and New York State against, amongst others, Sino-Forest, certain of its officers, directors and employees, BDO, E&Y and the underwriters. Sino-Forest is sued in all actions. [3]

14 The proposed representative plaintiffs in the class actions are shareholders of Sino-Forest. They allege that: Sino-Forest repeatedly misrepresented its assets and financial situation and its compliance with GAAP in its public disclosure; the appellant auditors and underwriters failed to detect these misrepresentations; and the appellant auditors misrepresented that their audit reports were prepared in accordance with generally accepted auditing standards ("GAAS"). The representative plaintiffs claim that these misrepresentations artificially inflated the price of Sino-Forest's shares and that proposed class members suffered damages when the shares fell after the truth was revealed in 2011.

15 The representative plaintiffs in the Ontario class action seek approximately $9.2 billion in damages. The Quebec, Saskatchewan and New York class actions do not specify the quantum of damages sought.

16 To date, none of the proposed class actions has been certified.

(c) CCAA Protection and Proofs of Claim

17 On March 30, 2012, Sino-Forest sought protection pursuant to the provisions of the CCAA. Morawetz J. granted the initial order which, among other things, appointed FTI Consulting Canada Inc. as the Monitor and stayed the class actions as against Sino-Forest. Since that time, Morawetz J. has been the supervising judge of the CCAA proceedings. The initial stay of the class actions was extended and broadened by order dated May 8, 2012.

18 On May 14, 2012, the supervising judge granted an unopposed claims procedure order which established a procedure to file and determine claims against Sino-Forest.

19 Thereafter, all of the appellants filed individual proofs of claim against Sino-Forest seeking contribution and indemnity for, among other things, any amounts that they are ordered to pay as damages to the plaintiffs in the class actions. Their proofs of claim advance several different legal bases for Sino-Forest's alleged obligation of contribution and indemnity, including breach of contract, contractual terms of indemnity, negligent and fraudulent misrepresentation in tort, and the provisions of the *Negligence Act*, R.S.O. 1990, c. N.1.

(d) Order under Appeal

20 Sino-Forest then applied for an order that the following claims are equity claims under the CCAA: claims against Sino-Forest arising from the ownership, purchase or sale of an equity interest in the company, including shareholder claims ("Shareholder Claims"); and any indemnification claims against Sino-Forest related to or arising from the Shareholder Claims, including the appellants' claims for contribution or indemnity ("Related Indemnity Claims").

21 The motion was supported by the Ad Hoc Committee of Noteholders.

22 On July 27, 2012, the supervising judge granted the order sought by Sino-Forest and released a comprehensive endorsement.

23 He concluded that it was not premature to determine the equity claims issue. It had been clear from the outset of Sino-Forest's CCAA proceedings that this issue would have to be decided and that the expected proceeds arising from

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any sales process would be insufficient to satisfy the claims of creditors. Furthermore, the issue could be determined independently of the claims procedure and without prejudice being suffered by any party.

24 He also concluded that both the Shareholder Claims and the Related Indemnity Claims should be characterized as equity claims. In summary, he reasoned that:

• The characterization of claims for indemnity turns on the characterization of the underlying primary claims. The Shareholder Claims are clearly equity claims and they led to and underlie the Related Indemnity Claims;

• The plain language of the CCAA, which focuses on the nature of the claim rather than the identity of the claimant, dictates that both Shareholder Claims and Related Indemnity Claims constitute equity claims;

• The definition of "equity claim" added to the CCAA in 2009 broadened the scope of equity claims established by pre-amendment jurisprudence;

• This holding is consistent with the analysis in *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, 2011 ONSC 5018, 83 C.B.R. (5th) 123 (Ont. S.C.J. [Commercial List]), which dealt with contractual indemnification claims of officers and directors. Leave to appeal was denied by this court, 2012 ONCA 10, 90 C.B.R. (5th) 141 (Ont. C.A.); and

• "It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of shareholders cannot achieve the same status" (para. 82). To hold otherwise would run counter to the scheme established by the CCAA and would permit an indirect remedy to the shareholders when a direct remedy is unavailable.

25 The supervising judge did not characterize the full amount of the claims of the auditors and underwriters as equity claims. He excluded the claims for defence costs on the basis that while it was arguable that they constituted claims for indemnity, they were not necessarily in respect of an equity claim. That determination is not appealed.

III Interpretation of "Equity Claim"

(a) Relevant Statutory Provisions

26 As part of a broad reform of Canadian insolvency legislation, various amendments to the CCAA were proclaimed in force as of September 18, 2009.

27 They included the addition of s. 6(8):

> No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1, which provides that creditors with equity claims may not vote at any meeting unless the court orders otherwise, was also added.

28 Related definitions of "claim", "equity claim", and "equity interest" were added to s. 2(1) of the CCAA:

> In this Act,
>
> . . . . .
>
> "claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> . . . . .
>
> "equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

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(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d); [Emphasis added.]

"equity interest" means

(a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

29 Section 2 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") defines a "claim provable in bankruptcy". Section 121 of the BIA in turn specifies that claims provable in bankruptcy are those to which the bankrupt is subject.

2. "claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;

121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act. [Emphasis added.]

(b) The Legal Framework Before the 2009 Amendments

30 Even before the 2009 amendments to the CCAA codified the treatment of equity claims, the courts subordinated shareholder equity claims to general creditors' claims in an insolvency. As the supervising judge described:

[23] Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise.

[24] The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential.

[25] As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement. [Citations omitted.] [4]

(c) The Appellants' Submissions

31 The appellants essentially advance three arguments.

32 First, they argue that on a plain reading of s. 2(1), their claims are excluded. They focus on the opening words of the definition of "equity claim" and argue that their claims against Sino-Forest are not claims that are "in respect of an equity interest" because they do not have an equity interest in Sino-Forest. Their relationships with Sino-Forest were purely

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contractual and they were arm's-length creditors, not shareholders with the risks and rewards attendant to that position. The policy rationale behind ranking shareholders below creditors is not furthered by characterizing the appellants' claims as equity claims. They were service providers with a contractual right to an indemnity from Sino-Forest.

33 Second, the appellants focus on the term "claim" in paragraph (e) of the definition of "equity claim", and argue that the claims in respect of which they seek contribution and indemnity are the shareholders' claims against them in court proceedings for damages, which are not "claims" against Sino-Forest provable within the meaning of the BIA, and, therefore, not "claims" within s. 2(1). They submit that the supervising judge erred in focusing on the characterization of the underlying primary claims.

34 Third, the appellants submit that the definition of "equity claim" is not sufficiently clear to have changed the existing law. It is assumed that the legislature does not intend to change the common law without "expressing its intentions to do so with irresistible clearness": *Parry Sound (District) Welfare Administration Board v. O.P.S.E.U., Local 324*, 2003 SCC 42, [2003] 2 S.C.R. 157 (S.C.C.), at para. 39, citing *Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co.*, [1956] S.C.R. 610 (S.C.C.), at p. 614. The appellants argue that the supervising judge's interpretation of "equity claim" dramatically alters the common law as reflected in *National Bank of Canada v. Merit Energy Ltd.*, 2001 ABQB 583, 294 A.R. 15 (Alta. Q.B.) , aff'd 2002 ABCA 5, 299 A.R. 200 (Alta. C.A.). There the court determined that in an insolvency, claims of auditors and underwriters for indemnification are not to be treated in the same manner as claims by shareholders. Furthermore, the Senate debates that preceded the enactment of the amendments did not specifically comment on the effect of the amendments on claims by auditors and underwriters. The amendments should be interpreted as codifying the pre-existing common law as reflected in *National Bank of Canada v. Merit Energy Ltd.*

35 The appellants argue that the decision of *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* is distinguishable because it dealt with the characterization of claims for damages by an equity investor against officers and directors, and it predated the 2009 amendments. In any event, this court confirmed that its decision denying leave to appeal should not be read as a judicial precedent for the interpretation of the meaning of "equity claim" in s. 2(1) of the CCAA.

(d) Analysis

(i) Introduction

36 The exercise before this court is one of statutory interpretation. We are therefore guided by the following oft-cited principle from Elmer A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), at p. 87:

> [T]he words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

37 We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

38 The appellants' arguments do not give effect to the expansive language adopted by Parliament in defining "equity claim" and read in language not incorporated by Parliament. Their interpretation would render paragraph (e) of the definition meaningless and defies the logic of the section.

(ii) The expansive language used

39 The definition incorporates two expansive terms.

40 First, Parliament employed the phrase "*in respect of*" twice in defining equity claim: in the opening portion of the definition, it refers to an equity claim as a "claim that is *in respect of* an equity interest", and in paragraph (e) it refers to "contribution or indemnity *in respect of* a claim referred to in any of paragraphs (a) to (d)" (emphasis added).

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41 The Supreme Court of Canada has repeatedly held that the words "in respect of" are "of the widest possible scope", conveying some link or connection between two related subjects. In *CanadianOxy Chemicals Ltd. v. Canada (Attorney General)*, [1999] 1 S.C.R. 743 (S.C.C.), at para. 16, citing *Nowegijick v. R.*, [1983] 1 S.C.R. 29 (S.C.C.), at p. 39, the Supreme Court held as follows:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters. [Emphasis added in *CanadianOxy*.]

That court also stated as follows in *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94 (S.C.C.), at para. 26:

> The words "in respect of" have been held by this Court to be words of the broadest scope that convey some link between two subject matters. [Citations omitted.]

42 It is conceded that the Shareholder Claims against Sino-Forest are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest", within the meaning of paragraph (d) of the definition of "equity claim". There is an obvious link between the appellants' claims against Sino-Forest for contribution and indemnity and the shareholders' claims against Sino-Forest. The legal proceedings brought by the shareholders asserted their claims against Sino-Forest together with their claims against the appellants, which gave rise to these claims for contribution and indemnity. The causes of action asserted depend largely on common facts and seek recovery of the same loss.

43 The appellants' claims for contribution or indemnity against Sino-Forest are therefore clearly connected to or "in respect of" a claim referred to in paragraph (d), namely the shareholders' claims against Sino-Forest. They are claims in respect of equity claims by shareholders and are provable in bankruptcy against Sino-Forest.

44 Second, Parliament also defined equity claim as "including a claim for, among others", the claims described in paragraphs (a) to (e). The Supreme Court has held that this phrase "including" indicates that the preceding words - "a claim that is in respect of an equity interest" - should be given an expansive interpretation, and include matters which might not otherwise be within the meaning of the term, as stated in *National Bank of Greece (Canada) c. Katsikonouris*, [1990] 2 S.C.R. 1029 (S.C.C.), at p. 1041:

> [T]hese words are terms of extension, designed to enlarge the meaning of preceding words, and not to limit them.
>
> ... [T]he natural inference is that the drafter will provide a specific illustration of a subset of a given category of things in order to make it clear that that category extends to things that might otherwise be expected to fall outside it.

45 Accordingly, the appellants' claims, which clearly fall within paragraph (e), are included within the meaning of the phrase a "claim that is in respect of an equity interest".

(iii) What Parliament did not say

46 "Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of an equity interest. Parliament could have, but did not, include language in paragraph (e) restricting claims for contribution or indemnity to those made by shareholders.

(iv) An interpretation that avoids surplusage

47 A claim for contribution arises when the claimant for contribution has been sued. Section 2 of the *Negligence Act* provides that a tortfeasor may recover contribution or indemnity from any other tortfeasor who is, or would if sued have been, liable in respect of the damage to any person suffering damage as a result of a tort. The securities legislation of the various provinces provides that an issuer, its underwriters, and, if they consented to the disclosure of information

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in the prospectus, its auditors, among others, are jointly and severally liable for a misrepresentation in the prospectus, and provides for rights of contribution. [5]

48 Counsel for the appellants were unable to provide a satisfactory example of when a holder of an equity interest in a debtor company would seek contribution under paragraph (e) against the debtor in respect of a claim referred to in any of paragraphs (a) to (d). In our view, this indicates that paragraph (e) was drafted with claims for contribution or indemnity by non-shareholders rather than shareholders in mind.

49 If the appellants' interpretation prevailed, and only a person with an equity interest could assert such a claim, paragraph (e) would be rendered meaningless, and as Lamer C.J. wrote in *R. v. Proulx*, 2000 SCC 5, [2000] 1 S.C.R. 61 (S.C.C.), at para. 28:

> It is a well accepted principle of statutory interpretation that no legislative provision should be interpreted so as to render it mere surplusage.

(v) The scheme and logic of the section

50 Moreover, looking at s. 2(1) as a whole, it would appear that the remedies available to shareholders are all addressed by ss. 2(1)(a) to (d). The logic of ss. 2(1)(a) to (e) therefore also supports the notion that paragraph (e) refers to claims for contribution or indemnity not by shareholders, but by others.

(vi) The legislative history of the 2009 amendments

51 The appellants and the respondents each argue that the legislative history of the amendments supports their respective interpretation of the term "equity claim". We have carefully considered the legislative history. The limited commentary is brief and imprecise. The clause by clause analysis of Bill C-12 comments that "[a]n equity claim is defined to include any claim that is related to an equity interest". [6] While, as the appellants submit, there was no specific reference to the position of auditors and underwriters, the desirability of greater conformity with United States insolvency law to avoid forum shopping by debtors was highlighted in 2003, some four years before the definition of "equity claim" was included in Bill C-12.

52 In this instance the legislative history ultimately provided very little insight into the intended meaning of the amendments. We have been guided by the plain words used by Parliament in reaching our conclusion.

(vii) Intent to change the common law

53 In our view the definition of "equity claim" is sufficiently clear to alter the pre-existing common law. *National Bank of Canada v. Merit Energy Ltd.*, an Alberta decision, was the single case referred to by the appellants that addressed the treatment of auditors' and underwriters' claims for contribution and indemnity in an insolvency before the definition was enacted. As the supervising judge noted, in a more recent decision, *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, the courts of this province adopted a more expansive approach, holding that contractual indemnification claims of directors and officers were equity claims.

54 We are not persuaded that the practical effect of the change to the law implemented by the enactment of the definition of "equity claim" is as dramatic as the appellants suggest. The operations of many auditors and underwriters extend to the United States, where contingent claims for reimbursement or contribution by entities "liable with the debtor" are disallowed pursuant to § 502(e)(1)(B) of the U.S. Bankruptcy Code, 11 U.S.C.S. [7]

(viii) The purpose of the legislation

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55 The supervising judge indicated that if the claims of auditors and underwriters for contribution and indemnity were not included within the meaning of "equity claim", the CCAA would permit an indirect remedy to the shareholders when a direct remedy is not available. We would express this concept differently.

56 In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest *not* diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity.

IV Prematurity

57 We are not persuaded that the supervising judge erred by determining that the appellants' claims were equity claims before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

58 The supervising judge noted at para. 7 of his endorsement that from the outset, Sino-Forest, supported by the Monitor, had taken the position that it was important that these proceedings be completed as soon as possible. The need to address the characterization of the appellants' claims had also been clear from the outset. The appellants have not identified any prejudice that arises from the determination of the issue at this stage. There was no additional information that the appellants have identified that was not before the supervising judge. The Monitor, a court-appointed officer, supported the motion procedure. The supervising judge was well positioned to determine whether the procedure proposed was premature and, in our view, there is no basis on which to interfere with the exercise of his discretion.

V Summary

59 In conclusion, we agree with the supervising judge that the appellants' claims for contribution or indemnity are equity claims within s. 2(1)(e) of the CCAA.

60 We reach this conclusion because of what we have said about the expansive language used by Parliament, the language Parliament did not use, the avoidance of surplusage, the logic of the section, and what, from the foregoing, we conclude is the purpose of the 2009 amendments as they relate to these proceedings.

61 We see no basis to interfere with the supervising judge's decision to consider whether the appellants' claims were equity claims before the completion of the claims procedure.

VI Disposition

62 This appeal is accordingly dismissed. As agreed, there will be no costs.

Appeal dismissed.

Footnotes

1 Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC.

2 Noteholders holding in excess of $1.296 billion, or 72%, of Sino-Forest's approximately $1.8 billion in noteholders' debt have executed written support agreements in favour of the Sino-Forest CCAA plan as of March 30, 2012. These include noteholders represented by the Ad Hoc Committee of Noteholders.

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3 None of the appellants are sued in Saskatchewan and all are sued in Ontario. E&Y is also sued in Quebec and New York and the appellant underwriters are also sued in New York.

4 The supervising judge cited the following cases as authority for these propositions: *Blue Range Resource Corp., Re*, 2000 ABQB 4, 259 A.R. 30 (Alta. Q.B.); *Stelco Inc., Re* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.J. [Commercial List]); *Central Capital Corp. (Re)* (1996), 27 O.R. (3d) 494 (Ont. C.A.); *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 71 C.B.R. (5th) 153 (Ont. S.C.J. [Commercial List]); *EarthFirst Canada Inc., Re*, 2009 ABQB 316, 56 C.B.R. (5th) 102 (Alta. Q.B.).

5 *Securities Act*, R.S.O. 1990, c. S.5, s. 130(1), (8); *Securities Act*, R.S.A. 2000, c. S-4, s. 203(1), (10); *Securities Act*, R.S.B.C. 1996, c. 418, s. 131(1), (11); *The Securities Act*, C.C.S.M. c. S50, s. 141(1), (11); *Securities Act*, S.N.B. 2004, c. S-5.5, s. 149(1), (9); *Securities Act*, R.S.N.L. 1990, c. S-13, s. 130(1), (8); *Securities Act*, R.S.N.S. 1989, c. 418, s. 137(1), (8); *Securities Act*, S.Nu. 2009, c. 12, s. 111(1), (12); *Securities Act*, S.N.W.T. 2008, c. 10, s. 111(1), (12); *Securities Act*, R.S.P.E.I. 1988, c. S-3.1, s. 111(1), (12); *Securities Act*, R.S.Q. c. V-1.1, ss. 218, 219, 221; *The Securities Act, 1988*, S.S. 1988-89, c. S-42.2, s. 137(1), (9); *Securities Act*, S.Y. 2007, c. 16, s. 111(1), (13).

6 We understand that this analysis was before the Standing Senate Committee on Banking, Trade and Commerce in 2007.

7 The United States Bankruptcy Court for the District of Delaware in *In Re: Mid-American Waste Systems, Inc.* 228 B.R. 816 (1999), indicated that this provision applies to underwriters' claims, and reflects the policy rationale that such stakeholders are in a better position to evaluate the risks associated with the issuance of stock than are general creditors.

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2010 ONSC 6229
Ontario Superior Court of Justice [Commercial List]

Nelson Financial Group Ltd., Re

2010 CarswellOnt 8655, 2010 ONSC 6229, 195 A.C.W.S. (3d) 319, 71 C.B.R. (5th) 153, 75 B.L.R. (4th) 302

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON FINANCIAL GROUP LTD.

Pepall J.

Judgment: November 16, 2010
Docket: 10-8630-00CL

Counsel: Richard B. Jones, Douglas Turner, Q.C. for Noteholders / Moving Party
J.H. Grout, S. Aggarwal for Monitor
Pamela Foy for Ontario Securities Commission
Frank Lamie for Nelson Financial Group Ltd.
Robert Benjamin Mills, Harold Van Winssen for Respondents, Clifford Styles, Jackie Styles, Play Investments Ltd.
Michael Beardsley, Respondent for himself
Clifford Holland, Respondent for himself
Arnold Bolliger, Respondent for himself
John McVey, Respondent for himself
Joan Frederick, Respondent for herself
Rakesh Sharma, Respondent for himself
Larry Debono, Respondent for himself
Keith McClear, Respondent for himself

Subject: Corporate and Commercial; Insolvency

MOTION by promissory note holders to determine whether certain claims of preferred shareholders constitute equity claims for purposes of *Companies' Creditors Arrangement Act*.

***Pepall J.*:**

1 This motion addresses the legal characterization of claims of holders of preferred shares in the capital stock of the applicant, Nelson Financial Group Ltd. ("Nelson"). The issue before me is to determine whether such claims constitute equity claims for the purposes of sections 6(8) and 22.1 of the *Companies' Creditors Arrangement Act* ("*CCAA*").

Background Facts

2 Nelson was incorporated pursuant to the *Business Corporations Act* of Ontario in September, 1990. Nelson raised money from investors and then used those funds to extend credit to customers in vendor assisted financing programmes. It raised money in two ways. It issued promissory notes bearing a rate of return of 12% per annum and also issued preference shares typically with an annual dividend of 10%. [1] The funds were then lent out at significantly higher rates of interest.

3 The Monitor reported that Nelson placed ads in selected publications. The ads outlined the nature of the various investment options. Term sheets for the promissory notes or the preferred shares were then provided to the investors

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by Nelson together with an outline of the proposed tax treatment for the investment. No funds have been raised from investors since January 29, 2010.

(a) Noteholders

4 As of the date of the *CCAA* filing on March 23, 2010, Nelson had issued 685 promissory notes in the aggregate principal amount of $36,583,422.89. The notes are held by approximately 321 people.

(b) Preferred Shareholders

5 Nelson was authorized to issue two classes of common shares and 2,800,000 Series A preferred shares and 2,000,000 Series B preferred shares, each with a stated capital of $25.00. The president and sole director of Nelson, Marc Boutet, is the owner of all of the issued and outstanding common shares. By July 31, 2007, Nelson had issued to investors 176,675 Series A preferred shares for an aggregate consideration of $4,416,925. During the subsequent fiscal year ended July 31, 2008, Nelson issued a further 172,545 Series A preferred shares and 27,080 Series B preferred shares. These shares were issued for an aggregate consideration of $4,672,383 net of share issue costs.

6 The preferred shares are non-voting and take priority over the common shares. The company's articles of amendment provide that the preferred shareholders are entitled to receive fixed preferential cumulative cash dividends at the rate of 10% per annum. Nelson had the unilateral right to redeem the shares on payment of the purchase price plus accrued dividends. At least one investor negotiated a right of redemption. Two redemption requests were outstanding as of the *CCAA* filing date.

7 As of the *CCAA* filing date of March 23, 2010, Nelson had issued and outstanding 585,916.6 Series A and Series B preferred shares with an aggregate stated capital of $14,647,914. The preferred shares are held by approximately 82 people. As of the date of filing of these *CCAA* proceedings, there were approximately $53,632 of declared but unpaid dividends outstanding with respect to the preferred shares and $73,652.51 of accumulated dividends.

8 Investors subscribing for preferred shares entered into subscription agreements described as term sheets. These were executed by the investor and by Nelson. Nelson issued share certificates to the investors and maintained a share register recording the name of each preferred shareholder and the number of shares held by each shareholder.

9 As reported by the Monitor, notwithstanding that Nelson issued two different series of preferred shares, the principal terms of the term sheets signed by the investors were almost identical and generally provided as follows:

- the issuer was Nelson;
- the par value was fixed at $25.00;
- the purpose was to finance Nelson's business operations;
- the dividend was 10% per annum, payable monthly, commencing one month after the investment was made;
- preferred shareholders were eligible for a dividend tax credit;
- Nelson issued annual T-3 slips on account of dividend income to the preferred shareholders;
- the preferred shares were non-voting (except where voting as a class was required), redeemable at the option of Nelson and ranked ahead of common shares; and
- dividends were cumulative and no dividends were to be paid on common shares if preferred share dividends were in arrears.

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10 In addition, the Series B term sheet provided that the monthly dividend could be reinvested pursuant to a Dividend Reinvestment Plan ("DRIP").

11 The preferred shareholders were entered on the share register and received share certificates. They were treated as equity in the company's financial statements. Dividends were received by the preferred shareholders and they took the benefit of the advantageous tax treatment.

(c) Insolvency

12 Mr. Boutet knew that Nelson was insolvent since at least its financial year ended July 31, 2007. Nelson did not provide financial statements to any of the preferred shareholders prior to, or subsequent to, the making of the investment.

(d) Ontario Securities Commission

13 On May 12, 2010, the Ontario Securities Commission ("OSC") issued a Notice of Hearing and Statement of Allegations alleging that Nelson and its affiliate, Nelson Investment Group Ltd., and various officers and directors of those corporations committed breaches of the *Ontario Securities Act* in the course of selling preferred shares. The allegations include noncompliance with the prospectus requirements, the sale of shares in reliance upon exemptions that were inapplicable, the sale of shares to persons who were not accredited investors, and fraudulent and negligent misrepresentations made in the course of the sale of shares. The OSC hearing has been scheduled for the end of February, 2011.

(e) Legal Opinion

14 Based on the Monitor's review, the preferred shareholders were documented as equity on Nelson's books and records and financial statements. Pursuant to court order, the Monitor retained Stikeman Elliott LLP as independent counsel to provide an opinion on the characterization of the claims and potential claims of the preferred shareholders. The opinion concluded that the claims were equity claims. The Monitor posted the opinion on its website and also advised the preferred shareholders of the opinion and conclusions by letter. The opinion was not to constitute evidence, issue estoppel or res judicata with respect to any matters of fact or law referred to therein. The opinion, at least in part, informed Nelson's position which was supported by the Monitor, that independent counsel for the preferred shareholders was unwarranted in the circumstances.

(f) Development of Plan

15 The Monitor reported in its Eighth Report that a plan is in the process of being developed and that preferred shareholders would have their existing preference shares cancelled and would then be able to claim a tax loss on their investment or be given a new form of preference shares with rights to be determined.

Motion

16 The holders of promissory notes are represented by Representative Counsel appointed pursuant to my order of June 15, 2010. Representative Counsel wishes to have some clarity as to the characterization of the preferred shareholders' claims. Accordingly, Representative Counsel has brought a motion for an order that all claims and potential claims of the preferred shareholders against Nelson be classified as equity claims within the meaning of the *CCAA*. In addition, Representative Counsel requests that the unsecured creditors, which include the noteholders, be entitled to be paid in full before any claim of a preferred shareholder and that the preferred shareholders form a separate class that is not entitled to vote at any meeting of creditors. Nelson and the Monitor support the position of Representative Counsel. The OSC is unopposed.

17 On the return of the motion, some preferred shareholders were represented by counsel from Templeman Menninga LLP and some were self-represented. It was agreed that the letters and affidavits of preferred shareholders that were

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filed with the court would constitute their evidence. Oral submissions were made by legal counsel and by approximately eight individuals. They had many complaints. Their allegations against Nelson and Mr. Boutet range from theft, fraud, misrepresentation including promises that their funds would be secured, operation of a Ponzi scheme, breach of trust, dividend payments to some that exceeded the rate set forth in Nelson's articles, conversion of notes into preferred shares at a time when Nelson was insolvent, non-disclosure, absence of a prospectus or offering memorandum disclosure, oppression, violation of section 23(3) of the *OBCA* and of the *Securities Act* such that the issuance of the preferred shares was a nullity, and breach of fiduciary duties.

18 The stories described by the investors are most unfortunate. Many are seniors and pensioners who have invested their savings with Nelson. Some investors had notes that were rolled over and replaced with preference shares. Mr. McVey alleges that he made an original promissory note investment which was then converted arbitrarily and without his knowledge into preference shares. He alleges that the documents effecting the conversion did not contain his authentic signature.

19 Mr. Styles states that he and his company invested approximately $4.5 million in Nelson. He states that Mr. Boutet persuaded him to convert his promissory notes into preference shares by promising a 13.75% dividend rate, assuring him that the obligation of Nelson to repay would be treated the same or better than the promissory notes, and that they would have the same or a priority position to the promissory notes. He then received dividends at the 13.75% rate contrary to the 10% rate found in the company's articles. In addition, at the time of the conversion, Nelson was insolvent.

20 In brief, Mr. Styles submits that:

> (a) the investment transactions were void because there was no prospectus contrary to the provisions of the *Securities Act* and the Styles were not accredited investors; the preferred shares were issued contrary to section 23(3) of the *OBCA* in that Nelson was insolvent at the relevant time and as such, the issuance was a nullity; and the conduct of the company and its principal was oppressive contrary to section 248 of the *OBCA*; and that
>
> (b) the Styles' claim is in respect of an undisputed agreement relating to the conversion of their promissory notes into preferred shares which agreement is enforceable separate and apart from any claim relating to the preferred shares.

The Issue

21 Are any of the claims advanced by the preferred shareholders equity claims within section 2 of the *CCAA* such that they are to be placed in a separate class and are subordinated to the full recovery of all other creditors?

The Law

22 The relevant provisions of the *CCAA* are as follows.

Section 2 of the *CCAA* states:

> In this Act,
>
> "Claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> "Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> (a) a dividend or similar payment,
>
> (b) a return of capital,
>
> (c) a redemption or retraction obligation,

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(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);"

"Equity Interest" means

(a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

Section 6(8) states:

No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1 states:

Despite subsection 22(1) creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

23 Section 2 of the *Bankruptcy and Insolvency Act* ("*BIA*") which is referenced in section 2 of the *CCAA* provides that a claim provable includes any claim or liability provable in proceedings under the Act by a creditor. Creditor is then defined as a person having a claim provable as a claim under the Act.

24 Section 121(1) of the *BIA* describes claims provable. It states:

All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

25 Historically, the claims and rights of shareholders were not treated as provable claims and ranked after creditors of an insolvent corporation in a liquidation. As noted by Laskin J.A. in *Central Capital Corp., Re*[2], on the insolvency of a company, the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. This principle is premised on the notion that shareholders are understood to be higher risk participants who have chosen to tie their investment to the fortunes of the corporation. In contrast, creditors choose a lower level of exposure, the assumption being that they will rank ahead of shareholders in an insolvency. Put differently, amongst other things, equity investors bear the risk relating to the integrity and character of management.

26 This treatment also has been held to encompass fraudulent misrepresentation claims advanced by a shareholder seeking to recover his investment: *Blue Range Resource Corp., Re*[3] In that case, Romaine J. held that the alleged loss derived from and was inextricably intertwined with the shareholder interest. Similarly, in the United States, the Second Circuit Court of Appeal in *Matter of Stirling Homex Corp.*[4] concluded that shareholders, including those who had allegedly been defrauded, were subordinate to the general creditors when the company was insolvent. The Court stated that "the real party against which [the shareholders] are seeking relief is the body of general creditors of their corporation. Whatever relief may be granted to them in this case will reduce the percentage which the general creditors will ultimately

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realize upon their claims." *National Bank of Canada v. Merit Energy Ltd.* [5] and *EarthFirst Canada Inc., Re* [6] both treated claims relating to agreements that were collateral to equity claims as equity claims. These cases dealt with separate indemnification agreements and the issuance of flow through shares. The separate agreements and the ensuing claims were treated as part of one integrated transaction in respect of an equity interest. The case law has also recognized the complications and delay that would ensue if *CCAA* proceedings were mired in shareholder claims.

27 The amendments to the *CCAA* came into force on September 18, 2009. It is clear that the amendments incorporated the historical treatment of equity claims. The language of section 2 is clear and broad. Equity claim means a claim in respect of an equity interest and includes, amongst other things, a claim for rescission of a purchase or sale of an equity interest. Pursuant to sections 6(8) and 22.1, equity claims are rendered subordinate to those of creditors.

28 The Nelson filing took place after the amendments and therefore the new provisions apply to this case. Therefore, if the claims of the preferred shareholders are properly characterized as equity claims, the relief requested by Representative Counsel in his notice of motion should be granted.

29 Guidance on the appropriate approach to the issue of characterization was provided by the Ontario Court of Appeal in *Central Capital Corp., Re* [7]. Central Capital was insolvent and sought protection pursuant to the provisions of the *CCAA*. The appellants held preferred shares of Central Capital. The shares each contained a right of retraction, that is, a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. One shareholder exercised his right of retraction and the other shareholder did not but both filed proofs of claim in the *CCAA* proceedings. In considering whether the two shareholders had provable debt claims, Laskin J.A. considered the substance of the relationship between the company and the shareholders. If the governing instrument contained features of both debt and equity, that is, it was hybrid in character, the court must determine the substance of the relationship between the company and the holder of the certificate. The Court examined the parties' intentions.

30 In *Central Capital*, Laskin J.A. looked to the share purchase agreements, the conditions attaching to the shares, the articles of incorporation and the treatment given to the shares in the company's financial statements to ascertain the parties' intentions and determined that the claims were equity and not debt claims.

31 In this case, there are characteristics that are suggestive of a debt claim and of an equity claim. That said, in my view, the preferred shareholders are, as their description implies, shareholders of Nelson and not creditors. In this regard, I note the following.

(a) Investors were given the option of investing in promissory notes or preference shares and opted to invest in shares. Had they taken promissory notes, they obviously would have been creditors. The preference shares carried many attractions including income tax advantages.

(b) The investors had the right to receive dividends, a well recognized right of a shareholder.

(c) The preference share conditions provided that on a liquidation, dissolution or winding up, the preferred shareholders ranked ahead of common shareholders. As in *Central Capital Corp.*, it is implicit that they therefore would rank behind creditors.

(d) Although I acknowledge that the preferred shareholders did not receive copies of the financial statements, nonetheless, the shares were treated as equity in Nelson's financial statements and in its books and records.

32 The substance of the arrangement between the preferred shareholders and Nelson was a relationship based on equity and not debt. Having said that, as I observed in *I. Waxman & Sons Ltd., Re* [8], there is support in the case law for the proposition that equity may become debt. For instance, in that case, I held that a judgment obtained at the suit of a shareholder constituted debt. An analysis of the nature of the claims is therefore required. If the claims fall within the parameters of section 2 of the *CCAA*, clearly they are to be treated as equity claims and not as debt claims.

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33 In this case, in essence the claims of the preferred shareholders are for one or a combination of the following:

(a) declared but unpaid dividends;

(b) unperformed requests for redemption;

(c) compensatory damages for the loss resulting in the purchased preferred shares now being worthless and claimed to have been caused by the negligent or fraudulent misrepresentation of Nelson or of persons for whom Nelson is legally responsible; and

(d) payment of the amounts due upon the rescission or annulment of the purchase or subscription for preferred shares.

34 In my view, all of these claims fall within the ambit of section 2, are governed by sections 6(8) and 22.1 of the *CCAA*, and therefore do not constitute a claim provable for the purposes of the statute. The language of section 2 is clear and unambiguous and equity claims include "a claim that is in respect of an equity interest" and a claim for a dividend or similar payment and a claim for rescission. This encompasses the claims of all of the preferred shareholders including the Styles whose claim largely amounts to a request for rescission or is in respect of an equity interest. The case of *National Bank of Canada v Merit Energy Ltd.* [9] is applicable in regard to the latter. In substance, the Styles' claim is for an equity obligation. At a minimum, it is a claim in respect of an equity interest as described in section 2 of the CCAA. Parliament's intention is clear and the types of claims advanced in this case by the preferred shareholders are captured by the language of the amended statute. While some, and most notably Professor Janis Sarra [10], advocated a statutory amendment that provided for some judicial flexibility in cases involving damages arising from egregious conduct on the part of a debtor corporation and its officers, Parliament opted not to include such a provision. Sections 6(8) and 22.1 allow for little if any flexibility. That said, they do provide for greater certainty in the appropriate treatment to be accorded equity claims.

35 There are two possible exceptions. Mr. McVey claims that his promissory note should never have been converted into preference shares, the conversion was unauthorized and that the signatures on the term sheets are not his own. If Mr. McVey's evidence is accepted, his claim would be qua creditor and not preferred shareholder. Secondly, it is possible that monthly dividends that may have been lent to Nelson by Larry Debono constitute debt claims. The factual record on these two possible exceptions is incomplete. The Monitor is to investigate both scenarios, consider a resolution of same, and report back to the court on notice to any affected parties.

36 Additionally, the claims procedure will have to be amended. The Monitor should consider an appropriate approach and make a recommendation to the court to accommodate the needs of the stakeholders. The relief requested in the notice of motion is therefore granted subject to the two aforesaid possible exceptions.

Motion granted.

Footnotes

1 The Monitor is aware of six preferred shareholders with dividends that ranged from 10.5% to 13.75% per annum.

2 (1996), 38 C.B.R. (3d) 1 (Ont. C.A.).

3 (2000), 15 C.B.R. (4th) 169 (Alta. Q.B.).

4 (1978), 579 F.2d 206 (U.S. 2nd Cir. N.Y.).

5 2001 CarswellAlta 913 (Alta. Q.B.), aff'd 2002 CarswellAlta 23 (Alta. C.A.).

6 2009 CarswellAlta 1069 (Alta. Q.B.).

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7 Supra, note 2.

8 2008 CarswellOnt 1245 (Ont. S.C.J. [Commercial List]).

9 Supra, note 5.

10 "From Subordination to Parity: An International Comparison of Equity Securities Law Claims in Insolvency Proceedings" (2007) 16 Int. Insolv. Re., 181.

End of Document

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2011 ONSC 5018
Ontario Superior Court of Justice [Commercial List]

Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.

2011 CarswellOnt 8590, 2011 ONSC 5018, 206 A.C.W.S. (3d) 464, 83 C.B.R. (5th) 123

Return on Innovation Capital Ltd. as agent for Roi Fund Inc, Roi Sceptre Canadian Retirement Fund, Roi Global Retirement Fund and Roi High Yield Private Placement Fund and Any Other Fund Managed By Roi from time to time (Applicants) and Gandi Innovations Limited, Gandi Innovations Holdings LLC, Gandi Innovations LLC, Gandi Innovations Hold Co and Gandi Special Holdings LLC. (Respondents)

Newbould J.

Heard: August 18, 2011
Judgment: August 25, 2011 *
Docket: 09-CL-8172

Counsel: Harvey Chaiton, Maya Poliak for Monitor, BDO Canada Limited
Mathew Halpin, Evan Cobb for TA Associates Inc.
Christopher J. Cosgriffe for Harry Gandy, James Gandy, Trent Garmoe

Subject: Corporate and Commercial; Insolvency

MOTION by monitor for advice and directions in connection with indemnity claims made by creditors.

***Newbould J.*:**

1 This is a motion brought by BDO Canada Limited in its capacity as the Court-appointed Monitor of Gandi Innovations Limited, Gandi Innovations Holdings LLC, Gandi Innovations LLC, Gandi Innovations Hold Co, and Gandi Special Holdings LLC (the "Gandi Group") for advice and directions, and particularly to determine preliminary issues in connection with the indemnity claims made by Hary Gandy, James Gandy and Trent Garmoe (the "Claimants") against all of the Gandi Group.

2 The Gandi Group is under CCAA protection. The Monitor was appointed in the Initial Order on May 8, 2009.

3 The business and assets of the Gandi Group have been sold with court approval. The proceeds from the sale are being held by the Monitor for eventual distribution to unsecured creditors pursuant to a plan of compromise and arrangement.

Arbitration proceedings and indemnity claims

4 Gandi Innovations Holdings LLC ("Gandi Holdings") was incorporated pursuant to the laws of the State of Delaware on August 24, 2007. On September 12, 2007, the Gandi Group re-organized their business structure so that Gandi Holdings became the direct or indirect parent of the other various entities comprising the Gandi Group.

5 TA Associates Inc. is a general partner for a number of TA partners. In conjunction with the reorganization of Gandi Holdings, it advanced approximately US $75 million on September 12, 2007 by way of debt and equity to the Gandi Group. The advance consisted of:

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(i) an equity investment in the amount of US $50 million made pursuant to the terms of a Membership Interest Purchase Agreement in respect of Gandi Holdings dated as of September 12, 2007 made between, among others, Gandi Holdings, TA Associates and the Claimants in their personal capacities; and

(ii) an unsecured loan in the amount of US $25 million which amount was guaranteed by other members of the Gandi Group.

6 In January 2009, TA Associates commenced an arbitration proceeding against the Claimants. In the arbitration TA Associates claim damages against the Claimants in an amount of US $75 million with interest, being the total amount of TA Associates' investment in the Gandi Group. The arbitration has not yet been heard on its merits.

7 On December 20, 2010, the Monitor received proofs of claim of Hary Gandy and James Gandy against the Gandi Group in the approximate amount of $76 million and a proof of claim of Trent Garmoe against the Gandi Group in an approximate amount of $88 million. The Claimants assert an entitlement to indemnification by the Gandi Group in respect of any award of damages which may be made against them in the arbitration together with all legal fees incurred by the Claimants in defending the arbitration.

8 The proofs of claim filed by the Claimants rely on indemnity provisions set out in the Amended and Restated Limited Liability Company Agreement of Gandi Holdings and a separate Indemnification Agreement made by Gandi Holdings entered into in connection with the Membership Agreement made at the time of the TA Associates investment with Gandi Holdings. Gandi Holdings is the only Gandi entity that is a party to these indemnity agreements.

9 On March 11, 2011 the Monitor disallowed the indemnity claims and advised the Claimants that based on the evidence filed in support of the indemnity claims, any indemnity claim would be solely against Gandi Holdings.

10 The Claimants have served notices of dispute and have provided to the Monitor a memorandum of articles of Association of Gandi Canada which provides an indemnity in favour of directors and officers of Gandi Canada in certain circumstances.

11 There is also an indemnity of Gandi Innovations Hold Co ("Gandi Hold Co"). At the relevant times James Gandy was the sole director of the company.

12 There has been an extensive search for corporate documents. The Monitor made inquiries of Jaffe Raitt Heuer & Weiss Inc., former corporate counsel of the Gandi Group, and learned that all of corporate governance documents of the Gandi Group, at Hary Gandy's request, had been sent to Stikeman Elliot LLP, insolvency counsel for the Gandi Group, following the CCAA filing date. Counsel for the Monitor attended at the offices of Stikeman Elliott and reviewed the corporate governance documents in its possession.

13 In addition the Monitor contacted counsel for Agfa, the purchaser of the assets of the Gandi Group, to inquire if it has in its possession copies of the Gandi Group's corporate governance records. The Monitor was advised by counsel for Agfa that Agfa was not able to find any corporate governance documents of the Gandi Group entities.

14 The Monitor also reviewed the books and records of the Gandi Group in storage. In addition, the Monitor advised the Claimants that should they wish to undertake a review of the Gandi Group's records in storage, the Claimants were invited to contact the Monitor and arrange for such review. The review was arranged and conducted by the Claimants on June 3, 2011.

15 It is a fact that there are not in existence documents that support the Claimants all being entitled to indemnities from each corporate entity in the Gaudi Group.

Issues

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16 Whether the Claimants will ever be with held liable in the arbitration is not yet known. However, whether the Claimants have rights to indemnification against all of the Gandi Group or against only Gandi Holdings and Gandi Hold Co will assist the Monitor in determining whether to proceed with a consolidated plan of arrangement or file an alternative plan excluding Gandi Holdings and/or Gandi Hold Co which would enable the Monitor to make a meaningful distribution to unsecured creditors prior to the completion of the arbitration.

17 There is another preliminary issue. In the arbitration, TA Associates seeks to recover against the Claimants their equity investment of US $50 million, for which the Claimants in turn have sought indemnification from the Gandi Group. The Monitor seeks a preliminary determination as to whether these claims for indemnification relating to the claim by TA Associates for its equity investment constitute "equity claims" under the CCAA. A determination of this issue will assist the Monitor in determining the maximum amount which can be claimed by the Claimants and may facilitate an earlier distribution of funds available to unsecured creditors.

Discussion

(a) Indemnity agreements

18 An Amended and Restated Limited Liability Company Agreement of Gandi Holdings dated September 12, 2007 provides for an indemnity by Gandi Holdings in section 6.8(a) for board members and officers. There is no dispute that the Claimants were officers and board members of Gandi Holdings. It also contains in section 7.6 an indemnity for Members as follows:

> (a) Without limitation of any other provision of this Agreement executed in connection herewith, the Company agrees to defend, indemnify and hold each Member, its affiliates and their respective direct and indirect partners (including partners of partners and stockholders and members of partners), members, stockholders, directors, officers, employees and agents and each person who controls any of them...

19 Superwide Limited Partnership is a Member and the Claimants are partners of Superwide. Thus the Claimants are indemnified by Gandi Holdings by that provision as well.

20 There is a form on indemnity agreement made between Gandi Holdings and indemnitees. The form in the record is an unsigned copy dated September 11, 2007. Neither the monitor nor any of the parties have been able to locate any of these agreements signed in favour of the Claimants. Hary Gandi, who swore an affidavit for the Claimants, said that a copy of this agreement was signed between Gandi Holdings and each of the Claimants on September 12, 2007. It contains the following:

> WHEREAS, the Company desires to provide Indemnitee with specific contractual assurance of Indemnitee's rights to full indemnification against litigation risks and related expenses (regardless, among other things, of any amendment to or revocation of the Company's LLC Agreement or any change in the ownership of the Company or the composition of its Board of Managers) ...
>
> . . .
>
> 3. Agreement to indemnify... if Indemnitee was or is a party or is threatened to be made a party to any Proceeding by reason of Indemnitee's Corporate Status, Indemnitee shall be indemnified by the Company against all Expenses and Liabilities incurred ...."

21 Assuming that this form of indemnity agreement was signed by Gandi Holdings and the Claimants, they would be covered by it.

22 The Claimants contend that each of the corporate entities in the Gandi Group signed an indemnity in favour of each of them. This is based on a statement in the affidavit of Hary Gandy that Gandi Holdings and the other CCAA

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Respondents provided additional indemnities to him, James Gandy and Trent Garmoe dated September 12, 2007. He attached to his affidavit a form of the indemnification agreement to be signed by Gandi Holdings. No affidavit was filed from James Gandy or Trent Garmoe.

23 There is no form of indemnity agreement in existence which names an indemnifier other than Gandi Holdings.

24 The date of September 12, 2007, said to be the date that all of the entities in the Gandi Group signed indemnities in favour of each of the claimants, was the date of the investment by TA Associates in which it purchased a membership interest in Gandi Holdings only. Representatives of TA Associates received identical indemnities from Gandi Holdings. There is no evidence that any indemnities from any of the other Gandi Group entities were made at that time. To the contrary, the Membership Interest Purchase Agreement under which TA Associates purchased its membership interest in Gandi Holdings contained as a condition to closing a requirement that Gandi Holdings sign an indemnification agreement. The indemnification was only to be given by Gandi Holdings. There was no requirement for an indemnity to be given by any other entity in the Gandi Group,.

25 I do not accept the bald statement of Hary Gandy that all of the entities in the Gandi Group gave indemnities at the time. The only indemnities that were given were by Gaudi Holdings.

(b) Memorandum and articles of Gandi Hold Co

26 In the course of its investigation, the Monitor did locate an indemnity granted by Gandi Hold Co in its Memorandum and Articles in favour of its directors and officers. Those articles contain an indemnity in the same terms as the indemnity in the Gandi Innovations Limited articles, as discussed below. As the Monitor does not seek a determination regarding indemnities given by Gandi Hold Co, I need not discuss whether one or more of the Claimants is entitled to be indemnified by these articles.

(c) Articles of Association of Gandi Innovations Limited (Gandi Canada)

27 The articles of this company contain an indemnity as follows:

> Every director or officer, former director or officer, or person who acts or acted at the Company's request, as a director or officer of the Company, a body corporate, partnership or other association of which the Company is or was a shareholder, partner, member or creditor and the heirs and legal representatives of such person, in absence of any dishonesty on the part of such persons shall be indemnified by the Company...in respect of any claim made against such person ... by reason of being or having been a director or officer of the Company. [emphasis added]

28 The corporate records sent to the Monitor by the corporate solicitors who incorporated the company name James Gandy as the president, treasurer and secretary and as the sole director. Hary Gandy stated at the outset of his affidavit filed on behalf of the claimants that he was the president and chief executive officer and chairman of the board of the companies that made up the Gandi Group. There are no corporate records that support that assertion and on his cross-examination he acknowledged he had no documents, including board resolutions, contracts or appointment letters to show that he was ever a director or officer of Gandi Innovations Limited. He said that he was directing the business of all of the entities. On his cross-examination, he said that as far as he was concerned, James Handy and Trent Garmoe were directors and officers of the company.

29 James Gandy did not file any affidavit to say that he was not the president, treasurer and secretary of the company, as shown in the corporate records. Trent Garmoe did not file any affidavit. I think it fair to draw an adverse inference that their evidence would not have been helpful to their case.

30 The affidavit of Bruce Johnston filed on behalf of TA Associates states that Hary Gandy and Trent Garmoe were not directors or officers of Gandi Innovations Limited and that a document printed from the Nova Scotia Registry of

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Joint Stock Companies which was included in the closing documents for TA Associates' investment showed that James Gandy was the only director and officer of Gandi Innovations Limited.

31 There has been an extensive search for corporate documents but none have been found that would support Hary Gundy or Trent Garmoe as being an officer or director of Gandi Innovations Limited.

32 It is argued that the indemnity in the articles of Gandi Innovations Limited is in favour not only of officers and directors, but also "persons who acted at the Company's request as a director or officer of the Company", and that Hary Gandy and Trent Garmoe acted as directors and officers at the Company's request. There is certainly no documentary evidence of that. Presumably the request would have had to come from James Gandy, who is the sole officer and director according to the corporate records. There is no evidence from any of the Claimants that any request was made to Hary Gandy or Trent Garmoe to act as an officer or director of Gandi Innovations Limited, which one would have expected if the assertion was to be made.

33 It is also argued that the board of managers (the Delaware concept of a board of directors) of Gandi Holdings operated the subsidiaries as if they were officers and directors of the subsidiaries. Again, there is no documentary evidence of that and no evidence from any of the Claimants to support the assertion. While Hary Gandy may have operated the business in a functional sense, that does not mean that he was acting as an officer or director of any subsidiary in the corporate sense. This is not mere semantics. TA Associates made a large investment, and one of the corporate documents provided on closing was the Nova Scotia Registry of Joint Stock Companies that showed only James Gandy as an officer and director. If all of the Claimants are entitled to be indemnified by Gandi Innovations Limited, it will impact the claim of TA Associates in the CCAA proceedings.

34 In the circumstances, I find that the only person entitled to indemnification from Gandi Innovations Limited is James Gandy.

35 However, in connection with the financing provided by TA Associates, James Gandy executed a Subordination Agreement dated as of September, 12, 2007 under which he agreed that any liability or obligations of Gandi Canada to him, present or in the future, would be deferred, postponed and subordinated in all respects to the repayment in full by Gandi Innovations of all indebtedness, liabilities and obligations owing to TA Associates in connection with the purchase by TA Associates of US $25million in notes. Until that obligation to pay the notes in full with interest has been fulfilled, any claim by James Gandy under the indemnity from Gandi Innovations Limited is subordinated to the claim of TA Associates.

36 The debt claim of TA Associates of $46,733,145 has been accepted by the Monitor. Assuming that the purchase price on the sale of the assets to Agfa is received in full, the monitor expects a distribution to unsecured creditors of approximately 27% of the value of their claims. In such circumstances, James Gundy will have no right to receive any payment from Gandi Innovations Limited in respect of his indemnity claim.

(d) Other Gaudi Group entities

37 It was asserted by the Claimants that because the Gandi companies operated essentially as one integrated company, it should be inferred that the constating documents of the other entities in the Gandi Group contained the same indemnity as contained in the bylaws of Gandi Innovations Limited and Gandi Hold Co. I do not agree.

38 Gandi Innovations LLC is a Texas company. Its Amended and Restated Operating Agreement contains the types of things normally contained in a general bylaw of an Ontario corporation. It contains no provision for indemnities. It was argued that as no articles were obtained from Texas, it could be assumed that the articles contained an indemnity provision similar to that contained in the bylaws of Gandi Innovations Limited and Gandi Hold Co. I asked counsel to obtain whatever documentation was available in Texas, and subsequently the Monitor received from its US counsel, Vinson & Elkins LLP, a copy of articles of organization for Gandi Innovations LLC dated August 2, 2004. There is nothing in these articles dealing with indemnities. Vinson & Elkins LLP advised that these articles, together with

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amending articles already in the possession of the Monitor, are the only corporate governance documents on file with the State of Texas.

39 Gandi Special Holdings LLC is a Delaware corporation. The Limited Liability Company Agreement of Gandi Special Holdings LLC, like the Texas company, contains the types of things normally contained in a general bylaw of an Ontario corporation. It contains no provision for indemnities. Following the hearing, the Monitor obtained through Vinson & Elkins LLP a Delaware Certificate of Formation of Gandi Special Holdings LLC. This document contains no provision for indemnities. A certificate of the Secretary of State of Delaware confirms that there were no other relevant documents on file and this was confirmed by Vinson & Elkins LLP.

40 I find that there is no indemnity in favour of the Claimants in the corporate documentation of Gandi Innovations LLC and Gandi Special Holdings LLC.

41 It is also argued on behalf of the Claimants that the Gandi Group have acknowledged an obligation to indemnify the Claimants and it is said that this arises from a meeting of the board of Gandi Holdings. It is argued that the Gandi Group through the Monitor is thus estopped from denying an indemnity for all of the Gandi Group companies. A document said to be minutes of a meeting of the board of managers of Gandi Holdings held on March 4, 2009 is relied on. That document contains the following paragraph:

> The next item on the agenda was the indemnification of the officers. It was generally agreed that all parties would follow the Purchase Agreement between Gandi Innovations and TA Resources dated September 12, 2007: Counsel for TA had previously expressed the opinion that indemnification was not allowed under the purchase agreement. Counsel for James Gandy, Hary Gandy and Trent Garmoe together with the Corporate Counsel, Matthew Murphy had previously expressed verbal opinions that the indemnification of the officers was permitted under the Purchase Agreement. Lydia Garay, as the only member not involved in the dispute between TA and the key holders, voted to follow the advice of Corporate Counsel, Matthew Murphy. To avoid any misunderstanding, Corporate Counsel would be requested to express that opinion in writing.

42 I do not see this paragraph in the informal minutes as assisting the Claimants. It is a meeting of the board of Gandi Holdings. It says that it was generally agreed that all parties would follow the purchase agreement between Gandi Holdings and TA resources dated September 12, 2007. That purchase agreement provides for an indemnity by only Gandi Holdings. Assuming that the minutes reflect a desire of some board members to indemnify officers of subsidiary corporations, and assuming that the Claimants thought they were officers of all of the subsidiary corporations, it is quite clear from the paragraph that there was a difference of view. The minute states that counsel for TA Associates had previously expressed the opinion that indemnification was not allowed under the purchase agreement and that counsel for the Claimants together with corporate counsel, Matthew Murphy, expressed the opposite opinion. The minute states that Lydia Garay, the only member not involved in the dispute between TA Associates and the key holders, voted to follow the advice of Corporate Counsel Terry Murphy and to avoid any misunderstanding, corporate counsel would be requested to express that opinion in writing.

43 The affidavit of Bruce Johnston on behalf of TA Associates, who attended that meeting of the board of managers of Gandi Holdings swears that the Claimants voted to place Lydia Garay, a longtime employee and officer of Gandi Holdings, on the board despite a verbal agreement that he had with the Claimants to leave that board seat vacant and to work with him to appoint an outside independent board member. He stated Ms. Garay was completely reliant on the Gandy family for her job security and compensation.

44 Mr. Johnston also states in his affidavit that the indemnification of the Claimants was discussed and that he and Mr. Taylor took the position that indemnification was not permitted. He said the Claimants took the position that indemnification was permitted, despite the language of the purchase agreement, and took the position that corporate counsel for Gandi Holdings had previously given a verbal opinion that indemnification was permitted under the purchase agreement. After hearing that, and during the meeting, Mr. Johnston sent an e-mail to Mr. Murphy who two minutes

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later responded that he had not advised on the question of an indemnity under the purchase agreement. Mr. Johnson states that he then read that e-mail at the meeting. I accept his evidence on this.

45 Whether or not Ms. Garay was a disinterested or proper member of the board of management of Gandi Holdings, the minute states that she voted to follow the advice of corporate counsel. At the next board meeting on May 4, 2009, Ms. Garay said that she had sought the written opinion of corporate counsel but had not received it. To date no opinion from Mr. Murphy has surfaced. On the face of those minutes from March 4, 2009, there has been no approval of any indemnities in favour of the Claimants for other corporations. I cannot find on the evidence that there was any agreement that the Claimants would be indemnified by subsidiary corporations, nor is there any evidence that any subsidiary corporation ever enacted any documentation of any kind to provide such indemnities. The opposite is the case, as has been discussed.

46 Finally, the Claimants allege that the Gandi Group has previously acknowledged their liability to indemnify the Claimants for any damage, award or legal costs incurred by the following actions:

> (i) certain Gandi entities made payments of defence costs in connection with the arbitration both pre-and post the CCAA filing; and
>
> (ii) the Monitor allegedly approved payment of post-filing defence costs.

47 Until the sale of the Gandi Group to Agfa was completed, this CCAA proceeding was a debtor in possession restructuring with the business and affairs of the Gandi Group being managed by their officers and directors, specifically Hary Gundy and Trent Garmoe. Payments of legal fees to Langley and Banack Inc., U.S. lawyers for the Gandi Group and the Claimants, were made by or on authorization of Trent Garmoe.

48 Pursuant to the terms of the Initial Order, the Monitor was required to approve all expenditures over $10,000 before payment was made. The Monitor approved payment of legal fees to counsel for the Gandi Group on the general understanding that such fees were incurred by the Gandi Group in connection with the Gandi Group's insolvency proceeding and for general corporate work for the Gandi Group.

49 I accept the statement of the Monitor that it did not knowingly approve the payment of the Claimants' defence costs in connection with the arbitration.

50 Subsequent to the completion of the sale to Agfa, the Monitor learned that a nominal amount of the legal fees approved by the Monitor was subsequently allocated to cover the costs of the arbitration. I accept the statement of the Monitor that it had no input, knowledge or control over such allocation, and had it been consulted, would have been opposed to such allocation as it did not involve any member of the Gandi Group.

51 In the circumstances there is no basis for the assertion that the Monitor is somehow estopped by reason of the payment of legal fees from denying that there are other indemnities in favour of the Claimants.

(e) Are the Claimants claims debt or equity claims?

52 This involves the application of provisions of the CCAA to the claims asserted by TA Associates in the arbitration.

53 Section 6(8) of the CCAA provides:

> No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

54 In s. 2(1) of the CCAA, equity claims are defined as follows:

> "equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

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(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

55 This definition of equity claim came into force on September 18, 2009. Although this provision does not apply to the Gandi Group's CCAA proceedings which commenced shortly prior to the legislative amendments, courts have noted that the amendments codified existing case law relating to the treatment of equity claims in insolvency proceedings. In *Nelson Financial Group Ltd., Re* (2010), 75 B.L.R. (4th) 302 (Ont. S.C.J. [Commercial List]), Pepall J. stated:

> The amendments to the CCAA came into force on September 18, 2009. It is clear that the amendments incorporated the historical treatment of equity claims. The language of section 2 is clear and broad. Equity claim means a claim in respect of an equity interest and includes, amongst other things, a claim for rescission of a purchase or sale of an equity interest. Pursuant to sections 6(8) and 22.1, equity claims are rendered subordinate to those of creditors.

56 If the claims in the arbitration commenced by TA Associates against the Claimants are equity claims, the claims by the Claimants in the CCAA process for contribution or indemnity in respect of those claims would be equity claims. The Claimants contend that the claims in the arbitration are not equity claims.

57 The claims in the arbitration by TA Associates against the creditors include claims for various breaches of contract, fraud, rescission, or in the alternative, recissory damages, negligent misrepresentation, breach of fiduciary duty and tortious interference with advantageous business relationships and prospective economic advantage.

58 In the arbitration TA Associates seeks to recover the investment that it made in Gandi Holdings, including the US $25 million debt secured by promissory notes and the US $50 million equity investment made by way of a membership subscription in Gandi Holdings.

59 The Claimants assert that the claim for US $50 million by TA Associates cannot be an equity claim because it is based on breaches of contract, torts and equity. I do not see that as being the deciding factor. TA Associates seeks the return of its US $50 million equity investment because of various wrongdoings alleged against the Claimants and the fact that the claim is based on these causes of action does not make it any less a claim in equity. The legal tools that are used is not the important thing. It is the fact that they are being used to recover an equity investment that is important.

60 In *Nelson Financial Group Ltd., Re*, *supra*, at Peppall J. stated that historically, the claims and rights of shareholders were not treated as provable claims and ranked after creditors of an insolvent corporation in a liquidation. She also stated:

> This treatment also has been held to encompass fraudulent misrepresentation claims advanced by a shareholder seeking to recover his investment: *Re Blue Range Resource Corp*. In that case, Romaine J. held that the alleged loss derived from and was inextricably intertwined with the shareholder interest. Similarly, in the United States, the Second Circuit Court of Appeal in *Re Stirling Homex Corp*. concluded that shareholders, including those who had allegedly been defrauded, were subordinate to the general creditors when the company was insolvent.

61 As the amendments to the CCAA incorporated the historical treatment of equity claims, in my view the claims of TA Associates in the arbitration to be compensated for the loss of its equity interest of US $50 million is to be treated as

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an equity claim and that the claims of the Claimants for indemnity against that claim is also to be treated as an equity claim in this CCAA proceeding.

Order

62 An order in the form of a declaration shall go in accordance with these reasons.

Order accordingly.

Footnotes

* Additional reasons at *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* (2011), 2011 CarswellOnt 14401, 2011 ONSC 7465 (Ont. S.C.J. [Commercial List]).

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2012 ONCA 10
Ontario Court of Appeal

Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.

2012 CarswellOnt 103, 2012 ONCA 10, 211 A.C.W.S. (3d) 264, 90 C.B.R. (5th) 141

Return on Innovation Capital Ltd. as agent for ROI Fund Inc., ROI Sceptre Canadian Retirement Fund, ROI Global Retirement Fund and ROI high Yield Private Placement Fund and Any Other Fund Managed by ROI from time to time (Applicants/Respondents) and Gandi Innovations Limited, Gandi Innovations Holdings LLC and Gandi Innovations LLC (Respondents/Appellants)

Robert J. Sharpe, R.A. Blair, Paul Rouleau JJ.A.

Heard: January 3, 2012
Judgment: January 9, 2012
Docket: CA M40553

Proceedings: refusing leave to appeal *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* (2011), 2011 CarswellOnt 8590, 2011 ONSC 5018 (Ont. S.C.J. [Commercial List]); additional reasons at *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* (2011), 2011 CarswellOnt 14401, 2011 ONSC 7465 (Ont. S.C.J. [Commercial List])

Counsel: Matthew J. Halpin, Evan Cobb for TA Associates Inc.
Harvey Chaiton, Maya Poliak for Monitor
Christopher J. Cosgriffe, Natasha S. Danson for James Gandy, Hary Gandy, Trent Garmoe

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

MOTION for leave to appeal from judgment reported at *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* (2011), 2011 CarswellOnt 8590, 2011 ONSC 5018 (Ont. S.C.J. [Commercial List]), concerning certain indemnity claims.

***Per curiam*:**

Overview

1 The moving parties (James Gandy, Hary Gandy and Trent Garmoe) are officers, directors and shareholders in the Gandi Group, a series of related companies currently under CCAA protection. In those proceedings they assert indemnity claims in the range of $75 — 80 million against each of the companies in the Gandi Group. The indemnity claims arise out of arbitration proceedings brought against them individually, as officers and directors, by TA Associates, a disgruntled investor in the Gandi Group. TA Associates is the major unsecured creditor in the CCAA proceedings.

2 The assets of the Gandi Group have been sold and what remains to be done in the CCAA process is the finalization of a plan of compromise and arrangement for the distribution of the proceeds among the various creditors. Before settling on the most effective type of plan for such a distribution — a consolidated plan, a partial consolidation plan, or individual corporate plans — the Monitor and the creditors sought to have two preliminary issues determined by the Court:

> a) whether the moving parties (the Claimants) are entitled to indemnity from all of the entities which comprise the Gandi Group, and, if so,
>
> b) whether those indemnification claims are "equity" or "non-equity" claims for purposes of the CCAA (non-equity claims have priority).

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3 On August 25, 2011, Justice Newbould, sitting on the Commercial List, ruled:

> a) that the Claimants were only entitled to indemnity from the direct and indirect parent company, Gandi Holdings (except that the Claimant, James Gandy only was also entitled to indemnification from a second entity in the Group, Gandi Canada);
>
> b) that any claim of James Gandy was subordinated to the claim of TA Associates because of an earlier existing Subordination Agreement; and
>
> c) that the claims for indemnification in respect of the TA Associates claim in the arbitration were equity claims for purposes of the CCAA and therefore subsequent in priority to the claims of unsecured creditors.

4 The Claimants seek leave to appeal from that order.

5 We deny the request.

Analysis

The Test

6 Leave to appeal is granted sparingly in CCAA proceedings and only when there are serious and arguable grounds that are of real and significant interest to the parties. The Court considers four factors:

> (1) Whether the point on the proposed appeal is of significance to the practice;
>
> (2) Whether the point is of significance to the action;
>
> (3) Whether the appeal is prima facie meritorious or frivolous; and
>
> (4) Whether the appeal will unduly hinder the progress of the action.

See *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 24.

7 The Claimants do not meet this stringent test here.

The Indemnification Issue

8 Whether the Claimants are entitled to indemnification from all or just one or some of the entities in the Gandi Group was essentially a factual determination by the motion judge, is of no significance to the practice as a whole, and the proposed appeal on that issue is of doubtful merit in our view. We would not grant leave to appeal on that issue.

The Subordination Issue

9 The same may be said for the Subordination Agreement issue. The Claimants argue that by declaring that the indemnity claim of James Gandy is subordinate to the CCAA claim of TA Associates, the motion judge usurped the role of the pending arbitration. We do not agree. The subordination issue needed to be clarified for purposes of the CCAA proceedings. None of the criteria respecting the granting of leave is met in relation to this proposed ground.

The "Equity Claim" Issue

10 Nor do we see any basis for granting leave to appeal on the equity/non-equity claim issue.

11 "Equity" claims are subsequent in priority to non-equity claims by virtue of s. 6(8) of the CCAA. What constitutes an "equity claim" is defined in s. 2(1) and would appear to encompass the indemnity claims asserted by the Claimants here.

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Those provisions of the Act did not come into force until shortly after the Gandi Group CCAA proceedings commenced, however, and therefore do not apply in this situation. Newbould J. relied upon previous case law suggesting that the new provisions simply incorporated the historical treatment of equity claims in such proceedings: see, for example, *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 75 B.L.R. (4th) 302 (Ont. S.C.J. [Commercial List]), at para. 27 (Pepall J.). He therefore concluded that TA Associates was in substance attempting to reclaim its equity investment in the Gandi Group through the arbitration proceedings and that the Claimants' indemnity claims arising from that claim must be equity claims for CCAA purposes as well.

12 This issue in the proposed appeal is not of significance to the practice since all insolvency proceedings commenced after the new provisions of the CCAA came into effect in September 2009 will be governed by those provisions, not by the prior jurisprudence. The interpretation of sections 6(8) and 2(1) does not come into play on this appeal. To the extent that existing case law continues to govern whatever pre-September 2009 insolvency proceedings are still in the system, those cases will fall to be decided on their own facts. We see no error in the motion judge's analysis of the jurisprudence or in his application of it to the facts of this case, and therefore see no basis for granting leave to appeal from his disposition of the equity issue in these circumstances.

Disposition

13 The motion for leave to appeal is therefore dismissed. Costs to the Monitor and to TA Associates fixed in the amount of $5,000 each, inclusive of disbursements and all applicable taxes.

Motion dismissed.

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2016 ONCA 662
Ontario Court of Appeal

U.S. Steel Canada Inc., Re

2016 CarswellOnt 14104, 2016 ONCA 662, 270 A.C.W.S. (3d) 471, 39 C.B.R. (6th) 173, 402 D.L.R. (4th) 450

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

In the Matter of a Proposed Plan of Compromise or Arrangement with Respect to U.S. Steel Canada Inc.

George R. Strathy C.J.O., P. Lauwers, M.L. Benotto JJ.A.

Heard: March 17, 2016
Judgment: September 9, 2016
Docket: CA C61331

Counsel: Gordon Capern, Kristian Borg-Olivier, Denise Cooney for Appellant, United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union
Andrew Hatnay, Barbara Walancik for SSPO and non-union retirees and active employees of U.S. Steel Canada Inc.
Tamryn Jacobson for Her Majesty the Queen in Right of Ontario and Superintendent of Financial Services (Ontario)
Michael E. Barrack, Jeff Galway, John Mather for Respondent, United States Steel Corporation
Sharon Kour for U.S. Steel Canada Inc.

Subject: Civil Practice and Procedure; Insolvency

APPEAL by union of judgment finding that court had no jurisdiction to apply American doctrine of equitable subordination.

***George R. Strathy C.J.O.*:**

1 U.S. Steel Canada Inc. ("USSC") is in *CCAA* [1] protection. Its former employees claim that its American parent, United States Steel Corporation ("USS"), ran the company into insolvency to further its own interests. An issue arose in the court below as to whether the *CCAA* judge could apply an American legal doctrine called "equitable subordination" to subordinate USS's claims to the appellant's claims.

2 The *CCAA* judge held he had no jurisdiction to do so. For reasons different than the ones he gave, I agree, and would dismiss the appeal.

FACTUAL BACKGROUND

3 USS is one of the largest steel producers in North America. In 2007, it acquired Stelco, which was in *CCAA* protection at the time, and changed its name to USSC.

4 Seven years later, on September 16, 2014, USSC was again granted *CCAA* protection by order of the Superior Court of Justice (Commercial List).

5 The *CCAA* judge made a Claims Process Order on November 13, 2014, establishing a procedure for filing, reviewing and resolving creditors' claims against USSC.

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6 The order set out a separate procedure for resolving claims of approximately $2.2 billion by USS against USSC. Most of the claims arose from USS's acquisition and reorganization of Stelco and from advances of working capital. Those claims were to be determined by the court, rather than by the Monitor.

7 USS filed its proofs of claims. The Monitor recommended they be approved and USS moved for court approval of the claims.

8 Notices of Objection were filed by four parties: (a) the Province of Ontario and the Superintendent of Financial Services in his capacity as administrator of the Pension Benefits Guarantee Fund; (b) the United Steelworkers, Locals 8782 and 1005; (c) Representative Counsel to the Non-USW Active Salaried Employees and Non-USW Salaried Retirees; and (d) Robert Milbourne, a former president of Stelco, and his wife, Sharon Milbourne, both of whom are beneficiaries of a pension agreement with USSC.

9 These objections overlapped to some extent. The *CCAA* judge had to develop a procedure to address the objections. He had to decide whether they should be dealt with within the *CCAA* process, outside it, or not at all.

10 The Province made two allegations. The first was that loans by USS to USSC should be characterized as shareholders' equity, because of the circumstances in which they were made. They should therefore be subordinated to all other claims pursuant to s. 6(8) of the *CCAA* [2] (the "Debt/Equity Objection"). Second, the Province argued that the security for the loans should be invalidated pursuant to provincial and federal fraudulent assignment and fraudulent preference legislation (the "Security Objection"). USS disputed both allegations, but was content to have the issues determined under the Claims Process Order.

11 The Union made objections similar to the Province's, but it added a third based on oppression and breach of fiduciary duty arising out of USS's conduct in relation to the Canadian plants, pensioners, pension plan members and beneficiaries (the "Conduct Objections").

12 The *CCAA* judge described the Conduct Objections as allegations that USS caused USSC to underperform, thereby requiring it to incur significant debt and to be unable to meet its pension obligations. The Union sought, among other things, an order subordinating the USS claims in whole or in part to its claims.

13 The Milbournes' objections were based on USS's alleged conduct and relied primarily on the doctrine of equitable subordination. They asked that the USS claims be dismissed entirely or subordinated to the claims of the other unsecured creditors.

14 The *CCAA* judge scheduled a motion to establish a litigation plan for USS's motion for approval of its claims against USSC. The parties agreed that the Security Objection and the Debt/Equity Objection could be determined pursuant to the Claims Process Order and within the *CCAA* proceedings. [3]

15 The primary disagreement concerned the procedure and timing for the determination of the other objections. The Union argued that the Conduct Objections should be resolved as part of the Claims Process Order and that an evidentiary record was required to do so. USS and USSC took the position that the Conduct Objections should be litigated outside the *CCAA* claims process.

16 The *CCAA* judge found that some of the claims of the Union and the Milbournes could be approached as third party claims against USS for oppression for the purpose of s. 241 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, and for breach of fiduciary duty. He found that neither the Claims Process Order nor the *CCAA* contemplated that such claims would be addressed by or would be relevant to a plan of arrangement or compromise under the *CCAA*. The third party claims fell outside the claims process unless specifically incorporated into the restructuring plan as approved by the parties or otherwise ordered.

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17 The *CCAA*, he said at para. 65, "is directed towards the creation, approval and implementation of a plan of arrangement or compromise proposed between a debtor company and its secured and unsecured creditors". It did not contemplate incorporation of inter-creditor claims into any plan of arrangement or compromise or into the voting process in respect of any proposed plan.

18 He concluded, at para. 84, that under s. 11 the court had authority to order the remaining claims of the Union and the Milbournes, except the claim for equitable subordination, to be "determined by a process within the *CCAA* proceedings, other than the process contemplated by the Claims Process Order, if the Court is of the opinion that, on balance, such action is likely to further the remedial purpose of the *CCAA*." He held that those claims could be determined within the *CCAA* proceedings, rather than in a separate action in the Superior Court, but not under the Claims Process Order. He noted that the court retained jurisdiction to order that the claims be continued outside the *CCAA* if it was determined that pursuing them within the process would no longer further the remedial process of the *CCAA*.

19 He held, however, that he had no jurisdiction under the *CCAA* to apply the doctrine of equitable subordination. Before turning to his reasons, I will explain the doctrine of equitable subordination.

EQUITABLE SUBORDINATION

20 Equitable subordination was developed as an equitable remedy in American insolvency law to subordinate a creditor's claim based on its inequitable conduct. The principles were articulated in *Mobile Steel Co., Re*, 563 F.2d 692 (U.S. C.A. 5th Cir. 1977), which set out a three-part test:

a. the claimant must have engaged in some type of inequitable conduct;

b. the misconduct must have resulted in injury to creditors of the bankrupt or conferred an unfair advantage on the claimant; and

c. equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

21 Paragraph 105(a) of the U.S. *Bankruptcy Code* authorizes bankruptcy courts to use equitable principles to alter the provisions of Title 11 or to prevent an abuse of process. One year after *Mobile Steel*, the *Code* was amended to give legislative effect to equitable subordination: *Bankruptcy Reform Act*, 11 U.S.C. §510(c)(1).

22 The Supreme Court of Canada considered the doctrine on two occasions. In both, the court found it unnecessary to determine whether equitable subordination should be applied, because the underlying facts did not meet the test: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), at p. 609; and *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271 (S.C.C.), at para. 77. This court also found it unnecessary to decide the issue in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 14 O.R. (3d) 1 (Ont. C.A.).

23 The availability of the doctrine has been considered in various Canadian superior courts at the trial level, in various contexts and with inconclusive results: see *General Chemical Canada Ltd., Re*, [2006] O.J. No. 3087 (Ont. S.C.J. [Commercial List]), (in the context of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3); *Christian Brothers of Ireland in Canada, Re* (2004), 69 O.R. (3d) 507 (Ont. S.C.J. [Commercial List]), (in the context of the *Winding-up and Restructuring Act*, R.S.C. 1985, C. W-11, as amended).

24 In *AEVO Co. v. D & A Macleod Co.* (1991), 4 O.R. (3d) 368 (Ont. Bktcy.), Chadwick J. rejected the application of equitable subordination in Canadian law, observing, at p. 372, that to introduce the doctrine would create chaos and would lead to challenges to security agreements based on the conduct of the secured creditor. In *I. Waxman & Sons Ltd., Re* (2008), 89 O.R. (3d) 427 (Ont. S.C.J. [Commercial List]), Pepall J. queried, at para. 33, whether statutory priorities should be upset by a doctrine "divorced from its legal home". This observation was followed, however, with the comment that "a vibrant legal system must be responsive to new developments in the law and the need for reform. Jurisprudence from other jurisdictions often provides the impetus or basis for much needed legal developments."

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25 On the other hand, the Newfoundland and Labrador Supreme Court (Trial Division) applied the doctrine in a bankruptcy case in *Lloyd's Non-Marine Underwriters v. J.J. Lacey Insurance Ltd.*, 2009 NLTD 148, 291 Nfld. & P.E.I.R. 149 (N.L. T.D.).

26 The Supreme Court of Canada's silence on the issue of equitable subordination in *CDIC* and *Indalex* cannot be taken, as the *CCAA* judge appears to have thought, as an outright rejection of the doctrine. In my view, the Supreme Court simply left the issue for another day.

27 It is unnecessary to decide that issue in order to resolve this appeal. The only issue is whether the *CCAA* judge was right in deciding that he had no jurisdiction to grant equitable subordination under the *CCAA*, assuming the remedy is available in Canadian law.

SUBMISSIONS AND ANALYSIS

A. PROCEDURAL OBJECTION

28 The appellant's first submission is procedural. It claims that it was unnecessary for the *CCAA* judge to determine whether he had jurisdiction to grant equitable subordination. The Union essentially says it was blindsided. It says it made no submissions on the doctrine of equitable subordination and the *CCAA* judge did not indicate that he was going to address the issue in the context of the scheduling motion. It was inappropriate and unnecessary for the court to shut the door on a novel and controversial remedy without a full factual record.

29 The respondent acknowledges that equitable subordination was not a central issue in the oral submissions before the *CCAA* judge, but points out that it was raised in some of the factums and memoranda filed before and after the hearing. The *CCAA* judge was required to determine what conduct-based inter-creditor claims would be litigated, either under the Claims Process Order or under the *CCAA*. He was entitled to determine whether he had jurisdiction to grant equitable subordination within the *CCAA*.

30 I do not accept the appellant's submission. The issue of equitable subordination was plainly before the *CCAA* judge in submissions made before and after the hearing. The Milbournes' factum made extensive submissions on equitable subordination and argued that it, along with fiduciary duty and oppression, were "live issues which should be the subject matter of a robust evidentiary record and subject to a fair and thorough due process in this court". The Union's factum suggested that some of USS's unsecured claim could be subordinated to the claims of other creditors "on account of a breach of fiduciary duty, a finding of oppression, *or otherwise*." USSC's factum argued that the Union's claim for equitable subordination should be rejected and that suitable remedies were available outside the Claims Process. In supplementary written submissions, the Union argued, in response to USSC's submissions, that the determination of the issue of equitable subordination should await an evidentiary record.

31 Moreover, the issue before the *CCAA* judge was not simply scheduling. The motion sought directions on the extent and nature of production and discovery with respect to the various objections. The Union argued that the objections had to be resolved before there could be approval of a plan of restructuring, a sale process or a distribution to creditors. The allegations that USS's claims should be re-characterized, invalidated, disallowed or subordinated had to be resolved and the *CCAA* judge had to determine a process for their resolution. Some might be dealt with under the Claims Process Order and some might be dealt with outside that Order but nevertheless in the *CCAA* proceedings. Some might not be dealt with under the *CCAA* at all.

32 The *CCAA* judge was plainly aware that a determination of the inter-creditor claims could have implications for the approval of any subsequent reorganization, sale of the business or credit bid. It was appropriate for him to consider whether the court had jurisdiction to address those claims and, if so, how and when.

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33 An evidentiary record was unnecessary. The *CCAA* judge was not deciding whether equitable subordination applied on the facts of this case. The issue was whether he had jurisdiction to grant equitable subordination under the *CCAA*.

34 I turn now to the question whether the *CCAA* judge correctly held that he had no jurisdiction under the *CCAA* to order equitable subordination of USS's claims.

B. JURISDICTION TO ORDER EQUITABLE SUBORDINATION

35 I will begin by summarizing the *CCAA* judge's reasons on this issue. I will then set out the submissions of the parties, identify the standard of review, describe the methodology I will use and apply that methodology to the legislation.

(1) The CCAA judge's reasons

36 The *CCAA* judge noted that although the *CCAA* gives authority to re-characterize debt as equity and to invalidate a preference or assignment, there is no express provision conferring jurisdiction to grant equitable subordination. He was of the view that any jurisdiction to do so would have to be found in s. 11, which provides that "the court ... may, subject to the restrictions set out in this Act ... make any order that it considers appropriate in the circumstances."

37 He observed that there is no Canadian case law supporting that authority and, when given the occasion to confirm the existence of equitable subordination on two occasions, the Supreme Court of Canada had declined to do so: *Canada Deposit Insurance Corp.*; and *Indalex*. He suggested that one might infer from this that the Supreme Court had rejected the principle of equitable subordination.

38 He found, however, that to the extent the issue remained open, the *CCAA* evidenced an intention to exclude equitable subordination. When Parliament amended the legislation in 2009, it gave authority under s. 6(8) to subordinate debt as being in substance equity, but it did not enact any provision to subordinate a claim based on the conduct of the creditor. Nor had it drafted s. 36.1, which permitted the court to invalidate preferences and assignments, broadly enough to permit the court to make an order for equitable subordination. These provisions, he said, were "restrictions set out in this Act", limiting the court's broad discretion under s. 11. Parliament's failure to include equitable subordination in the remedies introduced in 2009 must be taken as indicative of an intention to exclude the operation of the doctrine under the *CCAA*. This, he said, was a policy decision the court must respect.

(2) The submissions of the parties

39 The appellant submits the *CCAA* judge had jurisdiction to grant equitable subordination pursuant to s. 11 of the *CCAA* in the absence of express "restrictions" on that jurisdiction. He erred in implying restrictions based on Parliament's failure to amend the legislation.

40 The respondent submits that Canadian courts have all the tools they need to assess, review and, where necessary, subordinate or invalidate creditors' claims in a manner consistent with the underlying legislation, without the need for equitable subordination. Some of these tools are the result of the 2009 amendments to the *BIA* and the *CCAA*. Parliament might have expanded those amendments to incorporate equitable subordination or some other conduct-based remedy, but declined to do so. The court should not invoke a controversial doctrine that Parliament declined to adopt when it had the opportunity to do so.

(3) The standard of review

41 The parties agree that the applicable standard of review is correctness: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.), at para. 8; and *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 40.

(4) Framework for analysis

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42 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter Century Services], at paras. 65ff., the Supreme Court of Canada gave guidance on the approach to the scope of statutory remedies under the *CCAA*, and, if need be, under related sources of judicial authority. The court adopted the analysis proposed by Justice Georgina R. Jackson of the Court of Appeal for Saskatchewan and Professor Janis Sarra in an article entitled, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Toronto: Thomson Carswell, 2007), at p. 41. Blair J.A. also approved of this approach in *Metcalfe & Mansfield*, at paras. 48-49.

43 Jackson and Sarra note that the *CCAA* is skeletal legislation and advocate a transparent and consistent methodology as judges define the scope of their jurisdiction under the statute. They propose that the courts should take a hierarchical view of the powers at their disposal, adopting a broad, liberal and purposive interpretation of the statute and applying the principles of statutory interpretation before turning to other tools such as the common law or the exercise of inherent jurisdiction.

44 At para. 66 of *Century Services*, the Supreme Court held that in most cases, the search for jurisdiction under the *CCAA* should be an exercise in statutory interpretation. The starting point is the "big picture" principles of statutory interpretation.

45 Driedger's modern principle is the crucial tool for construing skeletal legislation such as the *CCAA*. A court must go beyond an examination of the wording of the statute and consider the scheme of the Act, its object or the intention of the legislature and the context of the words in issue:

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

See: Jackson and Sarra, at p. 47; Elmer A. Driedger, *The Construction of Statutes*, 2d ed (Toronto: Butterworths, 1983) at p. 87, cited in *Bell ExpressVu Ltd. Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559 (S.C.C.), at para. 26. See also *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at paras. 23, 40.

46 With this in mind, I will apply the framework in *Century Services* to the search for jurisdiction. I turn first to a consideration of the purpose and scheme of the *CCAA*, before considering the language of the statute.

(5) Application of the framework

(i) The purpose of the CCAA

47 There is no dispute about the purpose of the *CCAA*. It describes itself as "An Act to facilitate compromises and arrangements between companies and their creditors". Its purpose is to avoid the devastating social and economic effects of commercial bankruptcies. It permits the debtor to continue to carry on business and allows the court to preserve the status quo while "attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all": *Century Services*, at para. 77.

48 The *CCAA* has proven to be a flexible and successful tool to enable businesses to avoid bankruptcy. As Professor Sarra notes, "[i]t has been the statute of choice for debtor corporations in every major Canadian restructuring in the past quarter century, including national airlines, major steel and forestry companies, telecommunications companies, major retail chains, real estate and development groups, and the national blood delivery system": Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2d ed. (Toronto: Carswell, 2013), at p. 1.

49 The *CCAA* achieves its goals through a summary procedure for the compromise or arrangement of creditors' claims against the company. It was described in *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 36, as:

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> a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders.

50 The process has been effective because it is summary, it is practical, it is supervised by an independent expert monitor and it is managed in real time by an experienced commercial judge.

51 *Century Services* is a good example of how the purpose of the *CCAA* informs the exercise of the court's authority. At issue in that case were the reconciliation of another federal statute with the *CCAA* and the scope of a *CCAA* judge's discretion. At para. 70, the orders of the *CCAA* judge were considered squarely within the context of the purpose of the Act:

> The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.
>
> [emphasis added]

52 The Supreme Court concluded, at para. 75, that the order advanced the underlying purpose of the *CCAA*.

(ii) The scheme of the CCAA

53 The *CCAA* has been described as "skeletal" or "under-inclusive" legislation, (Jackson and Sarra at p. 48) which grants broad powers to the courts in general terms.

54 The Act has five parts. Part I, entitled "Compromises and Arrangements" permits the court to sanction a compromise or arrangement between a company and its secured or unsecured creditors, or both.

55 The powers of the court are found in Part II, entitled "Jurisdiction of Courts". The statute gives the court jurisdiction to receive applications, order stays, approve debtor-in-possession financing and appoint a monitor, among other things. Proceedings are commenced by an application to the Superior Court. The court generally grants an initial stay, appoints a monitor with authority to repudiate leases and other agreements and authorizes debtor in possession financing. A process is established for the identification and review of creditors' claims by the monitor and to deal with disputed claims, with the ultimate purpose of establishing classes of creditors who will vote, by class, on the compromise or arrangement.

56 One possible outcome is the preparation of a plan of arrangement. Creditors vote by class on the plan at a meeting called for that purpose. A majority by number of creditors in each class, together with two-thirds of the creditors in that class by dollar value, must approve the plan. If a class of creditors approves the plan, it is binding on all creditors within the class, subject to the court's approval of the plan. If all classes of creditors approve the plan, the court must then approve the plan as a final step.

57 Part III, entitled "General", deals with such issues as the determination of the amount of creditors' claims, classes of creditors, the duties of monitors, the disclaimer of agreements between the company and third parties and preferences and transfers at undervalue.

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58 Section 19 identifies "claims" that may be dealt with in a compromise or arrangement. Those are claims provable in bankruptcy that relate to debts or liabilities, present or future, to which the *debtor company* is subject or may become subject before the compromise or arrangement is sanctioned. [4]

59 The significance of this definition is that the focus of the plan of arrangement is claims against the *debtor company* that are provable in bankruptcy. The *CCAA* judge identified this significance at para. 59 of his reasons, where he noted that s. 19(1) of the *CCAA* provides, effectively, "that a plan of compromise or arrangement may only deal with claims that relate to debts or liabilities to which a debtor company is subject at the time of commencement of proceedings under the *CCAA*". At para. 61, he noted that neither the Claims Process Order nor the *CCAA* contemplated that inter-creditor claims would be addressed by or be relevant to a plan of arrangement.

60 Section 20 sets out the method for determining the amount of the claim of any secured or unsecured creditors. In most cases, it will be the amount "determined by the court on summary application by the company or by the creditor".

61 Section 22 provides for the establishment of classes of creditors for the purpose of voting on a compromise or arrangement, based on, among other things, the nature of their claims, the nature of the security in respect of their claims and the remedies available to them in relation to their claims. Creditors may be included in the same class "if their interests or rights are sufficiently similar to give them a commonality of interest".

62 Part IV deals with Cross-Border Insolvencies. Its stated purposes are to give mechanisms to provide for the fair and efficient administration of such insolvencies, to promote cooperation with courts of other jurisdictions, to promote "the rescue of financially troubled businesses to protect investment and preserve employment" and to protect the interests of creditors, of other interested persons and of the debtor company. Part V deals with Administration.

63 The *CCAA* was amended in 2009. The amendments were the product of extensive discussion of the *BIA* and the *CCAA* in the Standing Senate Committee on Banking, Trade and Commerce. The Committee recommended amendments to the legislation, including an expanded power to review, invalidate or subordinate creditors' claims under the *CCAA*.

64 These recommendations were reflected in the 2009 amendments in two respects. First, s. 6(8) provides that a compromise or arrangement will not be approved unless it provides that all other claims are to be paid in full before an equity claim is paid.

65 This provision, coupled with the definition of "equity interest" [5] and "equity claim" [6] in s. 2(1), permits the court to determine whether a creditor's claim is in substance a share, warrant or option. This is the underpinning of the Debt/Equity Objection, an objection based on a disagreement as to the proper characterization of the disputed claims.

66 Section 22.1, also added in 2009, provides that all creditors with equity claims are to be in the same class unless the court otherwise orders, and may not, as members of that class, vote at any meeting unless the court otherwise orders.

67 Second, the 2009 amendments harmonized the rules of reviewable transactions under the *BIA* and the *CCAA*. Creditors in a *CCAA* proceeding are now entitled to invoke the provisions of the *BIA* to invalidate security granted by a debtor corporation to a creditor where a fraudulent preference or transfer at undervalue is established. Section 36.1 of the *CCAA* provides that ss. 38 and 95 to 101 of the *BIA* apply, with any required modifications, in respect of a compromise or arrangement, unless the compromise or arrangement provides otherwise.

68 USS says that the 2009 amendments reflected Parliament's decision concerning the extent of the court's jurisdiction over "reviewable transactions" in *CCAA* proceedings and the extent to which a creditor's claim can be subordinated to other claims as a result of its conduct. It says Parliament might have included jurisdiction to rearrange priorities between creditors, for example through equitable subordination, but it declined to do so.

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69 The scheme of the *CCAA* focuses on the determination of the validity of claims of creditors against the company and the determination of classes of claims for the purpose of voting on a compromise or arrangement. Except as contemplated by ss. 2(1), 6(8), 22.1 and 36.1, the statute does not address either conflicts between creditors or the order of priorities of creditors. Priorities are, however, part of the background against which the plan of compromise or arrangement is negotiated.

70 There is nothing in the record before us to indicate that the issue of equitable subordination was given serious consideration at the time of the 2009 amendments or that those amendments were intended to import other remedies.

(iii) Interpreting the particular provisions before the court

71 I now turn to the words of the statute itself, considered in context and having regard to the scheme of the *CCAA*, the object of the act and the intentions of Parliament.

72 As Blair J.A. put it when deciding whether the *CCAA* granted the court the power to sanction the disputed order in *Metcalfe & Mansfield*, at para. 58, "[w]here in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases?" The question before us is "where (if at all) in the words of the statute is the court (implicitly or explicitly) clothed with authority to make an order for equitable subordination of the USS claims?"

(a) Section 11: "The engine that drives the statutory scheme"

73 The parties focussed their arguments on whether the powers granted by s. 11 include the power to grant the remedy of equitable subordination. In order to inform the scope of s. 11, they urge us to consider the treatment of "equity" claims in s. 6(8) of the *CCAA* and the remedies available under s. 36.1.

74 In *Stelco*, at para. 36, Blair J.A. described s. 11 as "the engine that drives this broad and flexible statutory scheme". Section 11 states, in full:

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

75 Prior to amendment in 2005 (S.C. 2005, c. 47, s. 128), the underlined portion above had read "subject to this Act". In *Century Services*, the Supreme Court, at paras. 67-68, interpreted this amendment as being an endorsement of the broad reading of *CCAA* jurisdiction that had been developed in the jurisprudence.

76 The jurisdiction under s. 11 has two express limitations. First, the court must find that the order is "appropriate in the circumstances". Second, even if the court considers the order appropriate in the circumstances, it must consider whether there are "restrictions set out in" the *CCAA* that preclude it.

77 As I have noted, the *CCAA* judge held that s. 11 did not confer jurisdiction to apply the doctrine of equitable subordination. The statute could have provided the authority to subordinate claims on this basis, as it did with equity claims, but it did not. He also held that the definition of "equity claim" and the option to bring proceedings under s. 36.1 were "restrictions" within the meaning of s. 11.

78 In my view, the interpretative process should start with the scope of s. 11 before the restrictions are considered in the analysis. The broad powers exercised by *CCAA* judges evolved in the jurisprudence before the concept of "restrictions" was legislated.

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79 Moreover, it is inconsistent with the anatomy and history of the *CCAA* to maintain that if Parliament had intended that a *CCAA* judge would have the authority to make a certain type of order, it would have said so. The Supreme Court has made it clear that "[t]he general language of the *CCAA* should not be read as being restricted by the availability of more specific orders": *Century Services*, at para. 70.

80 What is apparent from the many creative orders that have been made, before and since the 2009 amendments, is that such orders are made squarely in furtherance of the legislature's objectives. In *Century Services*, at para. 59, the Supreme Court observed that "[j]udicial discretion must of course be exercised in furtherance of the *CCAA*'s purposes", to avoid the devastating social and economic effects of bankruptcy while an attempt is made to organize the affairs of the debtor under court supervision.

81 The words "may ... make any order it considers appropriate in the circumstances" in s. 11 must, in my view, be read as "may ... *in furtherance of the purposes of this act*, make any order it considers appropriate in the circumstances."

82 There is no support for the concept that the phrase "any order" in s. 11 provides an at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors. The orders reflected in the case law have addressed the business at hand: the compromise or arrangement.

83 I turn to the second limit on the court's jurisdiction under s. 11, the "restrictions set out in this Act". The first question is whether such restrictions must be express or can be implied.

84 It bears noting that there are numerous express restrictions on the court's jurisdiction contained within the *CCAA* itself. Some are contained in Part II (Jurisdiction of Courts) and some are actually preceded by the heading "Restriction". In *North American Tungsten Corp. v. Global Tungsten and Powders Corp.*, 2015 BCCA 426, 81 B.C.L.R. (5th) 102 (B.C. C.A.), at para. 34, the British Columbia Court of Appeal observed that "where other provisions of the statute are intended to restrict the powers under ss. 11 and 11.02 of the statute, they do so in unequivocal terms."

85 The *CCAA* judge found that there were "restrictions set out" in the *CCAA* that prevented the court from applying equitable subordination, namely the definition of "equity claim" in s. 2(1) and the provisions of s. 36.1. Essentially, he found that Parliament could have introduced equitable subordination into the *CCAA* when it amended the legislation in 2009, but declined to do so. "The court must respect that policy decision", he said at para. 53. The respondent supports this interpretation.

86 I agree with the appellant that "equity claim" is not a restriction at all, but a definition. Together with s. 6(8), it codifies what was essentially the law before the 2009 amendments. The purpose of this involvement in the priority of claims is to remove shareholders from the process of arriving at a compromise or arrangement, absent permission of the court. It has nothing to do with any wrongdoing by the person with the equity interest. The only "restriction", if any, would be the lack of flexibility to reverse this statutory subordination, as Pepall J. pointed out in *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 75 B.L.R. (4th) 302 (Ont. S.C.J. [Commercial List]), at para. 34. However, this has to do only with subordination flowing from the characterization of a claim and not equitable subordination.

87 I also agree that the plain meaning of the words "subject to the restrictions *set out* in this Act" refers to express restrictions, of which there are a number.

(b) Subsection 6(8): Subordination of "equity claims"

88 In the court below, and in the appellant's submissions in this court, there was a blurring of the distinction between the separate concepts of "equity claim" and the doctrine of "equitable subordination". The *CCAA* judge's reasons referred at times to the "subordination claims" of the Union and the Milbournes as including the equitable subordination claims and the claims for oppression and breach of fiduciary duty.

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89 As explained earlier, s. 6(8) of the *CCAA* effectively subordinates "equity claims", as defined, to the claims of all other creditors. No compromise or arrangement can be approved unless it provides for other claims to be paid, in full, before equity claims are paid.

90 With the exception of environmental claims, ss. 6(8) and 22.1 are the only provisions of the *CCAA* to deal expressly with priorities between creditors. [7] There is a clear rationale for these provisions. In E. Patrick Shea, *BIA, CCAA & WEPPA: A Guide to the New Bankruptcy & Insolvency Regime* (Markham: LexisNexis Group, 2009), at p. 89, the author explains that "[t]he intention of these amendments is to remove the shareholder/creditor from the reorganization process, unless the court orders that they have a seat at the table."

91 "Equitable subordination", on the other hand, refers to the doctrine at issue here: a form of equitable relief to subordinate the claim of a creditor who has engaged in inequitable conduct. Such a claim is not an "equity claim", as defined. If it were, it would be subordinated without the need for intervention by the court.

92 Pepall J. dealt with these different principles and distinguished them clearly in *I. Waxman & Sons Ltd.*, a Commercial List decision that predated the 2009 amendments. There, a trustee in bankruptcy brought a motion for advice and directions as to whether a judgment creditor's claim should be allowed. Other creditors argued that his claim was rooted in equity and was not a debt claim. In the alternative, they argued that even if it was a debt claim, it should be subordinated to their claims pursuant to the doctrine of equitable subordination.

93 Pepall J. addressed the argument that the judgment creditor's claim was an equity claim under the heading "Characterization" (paras. 18-26), because the issue was whether his claim was properly characterized as one of equity or debt, with the attendant priority consequences. Next she considered whether, even though she had found that the claim was a debt claim, it should be subordinated pursuant to the doctrine of equitable subordination (paras. 27-35). She noted, at para. 27, that "[a]s its name suggests, the basis for development of the doctrine is the equitable jurisdiction of the court". She held that even if it applied in Canada, which was not established, there was no evidence on which to apply it in that case.

94 By contrast, the *CCAA* judge in this case disposed of these issues under one heading, "The Authority of the Court to Adjudicate Claims for Debt Re-Characterization and for Equitable Subordination", at paras. 38-53. He found, at para. 51, that the absence of any provision in the *CCAA* that would permit the application of equitable subordination was indicative of an intention to exclude the operation of the doctrine.

95 The *CCAA* judge appears to have treated equitable subordination as akin to equity claims as defined in s. 2(1), the subordination of equity claims in s. 6(8) and the remedies under s. 36.1. He found that because equitable subordination is not mentioned in the context of these remedies, Parliament must have intended to exclude it.

96 The distinction between these terms undermines the argument that equitable subordination does not exist because it was not included as part of the definition of (or together with the subordination of) equity claims. Equity claims are subordinated in order to keep shareholders away from the table while the claims of other creditors are being sorted out. Even prior to being explicitly subordinated by statute in 2009, they generally ranked lower than general creditors: *Sino-Forest Corp., Re*, 2012 ONCA 816, 114 O.R. (3d) 304 (Ont. C.A.), at para. 30. The purpose of the 2009 amendments appears to have been to confirm and clarify the law: see The Report of the Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa, November 2003), at p. 158-59.

(c) Section 36.1: Preferences and Assignments

97 Section 36.1, which was part of the 2009 amendments, incorporates by reference provisions of the *BIA* permitting the court to invalidate prior fraudulent preferences or fraudulent assignments.

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> 36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

98 The respondent argues that the inclusion of these express provisions implies that no other form of equitable remedy was contemplated. Its argument is that, had Parliament wished to invalidate or subordinate claims of creditors who had engaged in inequitable conduct in relation to other creditors, it could have expressly included that remedy.

99 I would not read anything into s. 36.1, one way or the other. Nor would I regard it as a "restriction" set out in the Act within the meaning of s. 11.

(6) Summary

100 The appellant requested "a declaration that the *CCAA* contains no restrictions within the meaning of s. 11 on the court's ability to apply the doctrine of equitable subordination." In my view, this is the wrong inquiry and this is why I reach the same result as the *CCAA* judge, but for different reasons.

101 I would not grant the relief sought because, applying the principles of statutory interpretation, nowhere in the words of the *CCAA* is there authority, express or implied, to apply the doctrine of equitable subordination. Nor does it fall within the scheme of the statute, which focuses on the implementation of a plan of arrangement or compromise. The *CCAA* does not legislate a scheme of priorities or distribution, because these are to be worked out in each plan of compromise or arrangement. The subordination of "equity claims" is directed towards a specific group, shareholders, or those with similar claims. It also has a specific function, consistent with the purpose of the *CCAA*: to facilitate the arrangement or compromise without shareholders' involvement.

102 The success of the *CCAA* in fulfilling its statutory purpose has been in large measure due to the ability of judges to fashion creative solutions, for which there is no express authority, through the exercise of their jurisdiction under s. 11. As Blair J.A. noted in *Metcalfe and Mansfield*, however, the court's powers are not limitless. They are shaped by the purpose and scheme of the *CCAA*. The appellant has not identified how equitable subordination would further the remedial purpose of the *CCAA*.

103 At this stage of the analysis, I am mindful of the Supreme Court's observation in *Century Services* that in most cases the court's jurisdiction in *CCAA* matters will be found through statutory interpretation. I am also mindful of its observation in *Indalex*, at para. 82, that courts should not use an equitable remedy to do what they wish Parliament had done through legislation. In my view, there is no "gap" in the legislative scheme to be filled by equitable subordination through the exercise of discretion, the common law, the court's inherent jurisdiction or by equitable principles.

104 There is no provision in the *CCAA* equivalent to s. 183 of the *BIA* or §105(a) of the U.S. *Bankruptcy Code*. Section 183 invests the bankruptcy court with "such jurisdiction at law and in equity" as will enable it to exercise its bankruptcy jurisdiction. This is significant, because if equitable subordination is to become a part of Canadian law, it would appear that the *BIA* gives the bankruptcy court explicit jurisdiction as a court of equity to ground such a remedy and a legislative purpose that is more relevant to the potential reordering of priorities.

CONCLUSION

105 For these reasons, I would dismiss the appeal. I would order that counsel may make written submissions as to costs, not to exceed five pages in length, excluding costs outlines. I would assume counsel can agree on a timetable for delivery of all costs submissions within 30 days of the release of these reasons.

***P. Lauwers J.A.*:**

I agree

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***M.L. Benotto J.A.*:**

I agree

Appeal dismissed.

Footnotes

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

2 6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

3 In a subsequent ruling, *U.S. Steel Canada Inc., Re*, 2016 ONSC 569 (Ont. S.C.J.), the *CCAA* judge dismissed the Debt/Equity objection, finding that approximately $2 billion of USSC's unsecured claims and $73 million in secured claims were properly characterized as debt rather than equity. He also dismissed the objection that approximately $118 million in secured claims should be invalidated due to lack of consideration or as a fraudulent preference.

4 *CCAA*, s. 2(1): "*claim* means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*." Section 121 of the *BIA* states that claims provable in bankruptcy are those to which the bankrupt is subject: "121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act."

5 "*Equity interest* means (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt."

6 "*Equity claim* means a claim that is in respect of an equity interest, including a claim for, among others, (a) a dividend or similar payment, (b) a return of capital, (c) a redemption or retraction obligation, (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)."

7 Subsection 11.8(8) gives the federal and provincial Crowns priorities for environmental claims against the debtor.

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10

1996 CarswellOnt 316
Ontario Court of Appeal

Central Capital Corp., Re

1996 CarswellOnt 316, [1996] O.J. No. 359, 132 D.L.R. (4th) 223, 26 B.L.R. (2d) 88, 27 O.R. (3d) 494, 38 C.B.R. (3d) 1, 61 A.C.W.S. (3d) 18, 88 O.A.C. 161

Re CENTRAL CAPITAL CORPORATION; Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

Re appeal from disallowance of claims of JAMES W. McCUTCHEON, CENTRAL GUARANTEE TRUST COMPANY, as trustee for Registered Retirement Savings Plan of JAMES W. McCUTCHEON and CONSOLIDATED S.Y.H. CORPORATION by PEAT MARWICK THORNE INC., Administrator of certain assets of CENTRAL CAPITAL CORPORATION

ROYAL BANK OF CANADA, BANCA COMMERCIALE ITALIANA OF CANADA, CREDIT LYONNAIS CANADA, DAI-ICHI KANGYO BANK (CANADA), PRUDENTIAL ASSURANCE COMPANY LIMITED, PRUDENTIAL GLOBAL FUNDING, INC., SANWA BANK CANADA, BANK OF TOKYO CANADA, TORONTO-DOMINION BANK, WESTDEUTSCHE LANDESBANK GIROZENTRALE, BACOB SAVINGS BANK s.c., BANCA NAZIONALE DEL LAVORO OF CANADA, BANCO DI ROMA (LONDON), COMMERZBANK INTERNATIONAL S.A., CREDIT COMMERCIAL DE FRANCE, CREDIT COMMUNAL DE BELGIQUE S.A., CREDIT SUISSE (LUXEMBOURG) S.A., DG BANK LUXEMBOURG S.A., KREDIETBANK NV (BELGIUM), NIPPON TRUST BANK LIMITED, OLFRN INVESTMENT (PANAMA) INC., PAUL REVERE LIFE INSURANCE, RBC FINANCE B.V., SCOR REINSURANCE COMPANY OF CANADA, SOCIÉTÉ GÉNÉRALE, BANK OF TOKYO, LTD., CHIBA BANK LTD., DAI-ICHI KANGYO BANK, LTD. (ATLANTA), HOKURIKU BANK LTD., JOROKU BANK LTD., KYOWA SAITAMA BANK (CHICAGO), LAURENTIAN BANK OF CANADA, LAURENTIAN GROUP CORPORATION AND IMPERIAL LIFE ASSURANCE COMPANY OF CANADA, LONG-TERM CREDIT BANK OF JAPAN, LTD., MARITIME LIFE ASSURANCE COMPANY, MITSUBISHI TRUST AND BANKING CORPORATION, SANWA BANK, LIMITED (LONDON), SHOKO CHUKIN BANK (NEW YORK) and TOHO BANK, LTD. v. CENTRAL CAPITAL CORPORATION

Finlayson, Weiler and Laskin JJ.A.

Heard: August 17, 1995
Judgment: February 7, 1996
Docket: Docs. CA C21479, C21477

Counsel: *Bryan Finlay, Q.C.*, and *John M. Buhlman*, for James W. McCutcheon and Central Guaranty Trust.
James H. Grout and *Anne Sonnen*, for Consolidated S.Y.H. Corporation.
Terence J. O'Sullivan and *Paul G. Macdonald*, for unsecured creditors of Central Capital Corporation.
Neil C. Saxe, for Peat Marwick Thorne Inc.

Subject: Corporate and Commercial; Insolvency

Appeals from judgment reported at (1995), 29 C.B.R. (3d) 33, 22 B.L.R. (2d) 210 (Ont. Gen. Div. [Commercial List]) dismissing appeals from denial of claims by administrator under *Companies' Creditors Arrangement Act* plan of reorganization.

***Finlayson J.A.* (dissenting):**

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1 The appellant James W. McCutcheon and Central Guarantee Trust Company as Trustee for the Registered Retirement Savings Plan of James W. McCutcheon (hereinafter sometimes referred to collectively as "McCutcheon") and the appellant Consolidated S.Y.H. Corporation ("SYH") appeal from the order of The Honourable Madam Justice Feldman of the Ontario Court (General Division) dated January 9, 1995 [reported at 29 C.B.R. (3d) 33]. Feldman J. dismissed appeals from decisions dated January 20, 1993 and February 16, 1993 of the respondent Peat Marwick Thorne Inc., in its capacity as Interim Receiver, Manager and Administrator ("Administrator") of certain assets of Central Capital Corporation ("Central Capital"). The Administrator disallowed Proofs of Claim submitted by the appellants with respect to a Plan of Arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Leave to appeal the order of Feldman J. was granted on March 17, 1995 by The Honourable Mr. Justice Houlden.

Overview of the Proceedings

2 These appeals arise out of the insolvency of Central Capital which in and prior to December 1991 defaulted under its obligations to various unsecured lenders, note holders and subordinated debt holders. In early December of 1991, Central Capital advised its creditors that, pending implementation of new financial arrangements, it had decided to discontinue payment of all interest and principal due under outstanding loans, with the exception of indebtedness due under secured notes issued to The Royal Trust Company. In an Agreed Statement of Facts, which was prepared by the parties for the purposes of appeals from the disallowances of the Administrator, it was agreed that at all material times since in or prior to December 1991, Central Capital was insolvent. It had a total unsecured debt of $1,577,359,000 and, among other things:

(a) it was unable to pay its liabilities as they became due; and

(b) the realizable value of its assets was less than the aggregate of its liabilities.

3 By Notice of Application issued June 12, 1992, thirty-nine of the creditors commenced an application pursuant to the *CCAA* for an order declaring the following: that Central Capital was a debtor company to which the *CCAA* applied; that Peat Marwick Thorne Inc. be appointed Administrator of the property, assets and undertaking of Central Capital; that a stay of proceedings against Central Capital, except with leave of the court, be granted and; that the applicants be authorized and permitted to file a plan of compromise or arrangement under the *CCAA*.

4 By order of Houlden J. made June 15, 1992, Central Capital was declared to be a company to which the *CCAA* applied and all proceedings against Central Capital were stayed. By further order of Houlden J. made July 9, 1992, it was provided, among other things, that:

(a) Peat Marwick Thorne Inc. was appointed Administrator, Interim Receiver and Manager of such of the undertaking, property and assets of Central Capital as necessary for the pur pose of effecting the transaction described in the order pursuant to which specified significant assets of Central Capital would be transferred to a newly incorporated company called Canadian Insurance Group Limited ("CIGL");

(b) the Administrator was authorized to enter into and carry out a Subscription and Escrow Agreement with creditors of Central Capital pursuant to which creditors of Central Capital would be entitled to elect to exchange a portion of the indebtedness owing to them by Central Capital for shares and debentures to be issued by CIGL;

(c) the Administrator was authorized and directed to supervise the calling for claims of creditors of Central Capital who elected to exchange a portion of the indebtedness from Central Capital for shares and debentures to be issued by CIGL as aforesaid; and

(d) Central Capital was authorized and permitted to file with the court a formal plan of compromise or arrangement with Central Capital's secured and unsecured creditors and shareholders in accordance with the *CCAA* and the

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> *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*"), which would provide for the restructuring and reorganization of the debt and equity of Central Capital in the manner set out in the said order.

5 According to the Agreed Statement of Facts, the order of Houlden J. was made without prejudice to the rights of the appellants to assert claims as creditors in the CIGL transaction. Pursuant to the terms of the July 9, 1992 order, all claims of creditors of Central Capital who wished to participate in CIGL were required to be submitted to the Administrator by September 8, 1992, or such other date fixed by the court. The Administrator received claims from various persons who wished to participate, including the claims submitted by the appellants herein.

6 The Administrator disallowed the claims of McCutcheon and SYH by Notices of Disallowance dated January 20, 1993 and February 16, 1993 in which various reasons were cited as to why the appellants did not qualify as creditors. The effect of this disallowance was that McCutcheon and SYH could participate only as shareholders in the plan of compromise and arrangement under the *CCAA* to be put forward by Central Capital. In dismissing the appeals from this disallowance, Feldman J. found that the appellants were not creditors because they did not have a claim provable under the *Bankruptcy Act* (Canada), R.S.C. 1985, c. B-3 ("*Bankruptcy Act*").

Issue

7 The Agreed Statements of Facts set out the issue in the appeal in the following language:

> Do the appellants, or any of them, have claims provable against CCC [Central Capital] within the meaning of the *Bankruptcy Act (Canada)*, as amended as of the date of the Restated Subscription and Escrow Agreement? If the appellants, or any of them, have provable claims, then the proof of claim of any appellant that has a claim provable is to be allowed as filed and the appeal from the disallowance allowed, and the appellants, or any of them, whose claim is allowed, are to participate in the Plan of Arrangement of Central Capital as a senior creditor.

8 The determination of this issue was deferred by Houlden J.'s order of October 27th, 1992. He ordered therein that preferred shareholders who had filed claims against Central Capital as creditors were not permitted to vote at the meeting of creditors called to consider the Plan of Arrangement "... but such is without prejudice to the rights of those claimants to prosecute their claims as filed". The last paragraph in the order ended:

> For greater certainty, the validity of any claim filed by a preferred shareholder shall not be affected by the terms of this paragraph.

Overview of the Restructuring of Central Capital

9 The order of Houlden J. of July 9, 1992 directed the restructuring of Central Capital under the *aegis* of the court. The order, and others that would follow, contemplated that the restructuring would take place in two stages. The first stage involved the transfer to the Administrator of certain major assets of Central Capital to a company to be incorporated called Central Insurance Group Limited (CIGL). This company is frequently referred to in the documentation and the reasons of Feldman J. as "Newco". CIGL was then to be owned by those Central Capital creditors who chose to participate in the reorganization by accepting a reduction in their debts due from Central Capital and exchanging this reduced indebtedness for debentures in CIGL. Subscription for debentures by this means additionally entitled the creditors to subscribe for shares in CIGL. Our understanding from counsel is that the assets transferred to CIGL included the assets acquired by Central Capital from the appellant in purchase agreements described later in these reasons.

10 The court approved a Subscription and Escrow Agreement setting out this arrangement. In order to participate, the creditors were required to file with the Administrator of Proof of Claim in the prescribed form along with other documents confirming the creditor's intention to reduce its claim against Central Capital and to subscribe for debentures and shares of CIGL. Claims were to be based on Central Capital's indebtedness to creditors as of June 15, 1992, the date of the court-ordered stay of proceedings. This transaction was completed on October 1, 1992 and resulted in CIGL

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being owned by the creditors of Central Capital in exchange for a reduction in Central Capital's unsecured debt in the amount of $603,000.000.

11 The second stage of the restructuring involved a Plan of Arrangement under the *CCAA*. That plan as put forward by Central Capital recognized four classes of creditors, only one of which, namely that of "Senior Creditors", could apply to the appellants. The Plan of Arrangement, as amended, provided that Central Capital would issue to Senior Creditors *pro rata* on the basis of their senior claims of secured promissory notes in the aggregate principal amount of $20,000,000 of secured debt, which were to be known as first secured notes. A similar arrangement was made for the issuance of $1,000,000 of second secured promissory notes to subordinated creditors. Senior and subordinated creditors included any creditor whose claim had been allowed under the CIGL claims procedure in the first stage, to the extent of that creditor's reduced claim.

12 The Plan of Arrangement also called for the creation of a new class of shares in Central Capital to be called the Central New Common Shares. Central Capital would issue to the above Senior and Subordinated Creditors ninety percent of the new share capital of Central Capital in extinguishment of the balance of their debt. The Central Capital shareholders of all classes would have their existing shares converted into the remaining ten percent of the Central New Common Shares. All of the existing preferred and common shares would be cancelled upon implementation of the plan.

13 The amended Plan of Arrangement was ultimately voted on and approved by all four classes of creditors of Central Capital. On December 18, 1992, Houlden J. sanctioned this plan of arrangement under the *CCAA*. He authorized and directed Central Capital to apply for Articles of Reorganization pursuant to s. 191 of the *CBCA*, so as to authorize the creation of the Central New Common Shares for implementation of the amended Plan of Arrangement. He also lifted the stays of proceedings affecting Central Capital and its ability to carry on business as of January 1, 1993.

14 The effect of the amended Plan of Arrangement after approval was that all remaining debts and obligations owed by Central Capital to its creditors on or before June 15, 1992 were extinguished and all outstanding and unissued shares of any kind in Central Capital were cancelled and replaced by Central New Common Shares. Central Capital was then free to carry on business. It was no longer insolvent.

Facts as They Relate to the Claim of McCutcheon

15 By a Share Purchase Agreement dated June 15, 1987 between Central Capital and Gormley Investments Limited ("Gormley") and Heathley Investments Limited ("Heathley"), Central Capital agreed to purchase all Class "B" Voting Shares of Canadian General Securities Limited ("CGS") that were owned by Gormley and Heathley. James W. McCutcheon and his brother, who were the sole shareholders of Gormley, represented to Central Capital that CGS owned substantially all of the shares of Canadian Insurance Sales Limited, which in turn owned substantially all of the shares in a number of operating insurance, credit and trust companies. The consideration for the purchase of the CGS shares was $575 per share. The vendors were to be paid $400 per share in cash on closing and were to receive seven Series B Senior Preferred Shares of Central Capital. These shares contained a retraction clause entitling the holder to retract each preferred share on July 1, 1992 for $25. Failing issuance of the shares by Central Capital, the vendors were to receive an additional $175 for each CGS share. The Share Purchase Agreement and later the Articles of Central Capital further provided that the holders of Series B Senior Preferred Shares were entitled to receive dividends as and when declared by the directors of Central Capital out of monies of the corporation properly applicable to the payment of dividends and in the amount of $1.90625 per share per annum (being 7 5/8% per annum on the stated capital of $25 per share) payable in equal quarterly payments. No dividends were in fact declared.

16 The Certificate of Amendment for Central Capital dated July 30, 1987, and the Articles of Amendment setting out the provisions attaching to the Series B Senior Preferred Shares contain all the terms and conditions governing the said shares. I am setting out below a description of those that are relevant to this appeal.

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17 Pursuant to Article 4.1 of the Senior Series B Provisions, each holder of Series B Senior Preferred Shares was entitled, subject to and upon compliance with the provisions of Article 4, to require Central Capital to redeem all or any part of the Series B Senior Preferred Shares registered in the name of that holder on July 1, 1992 at a price equal to $25 per share, plus all accrued and unpaid dividends thereon, calculated to but excluding the Retraction Date.

18 Article 4.2 of the Senior Series B Provisions sets out the procedure for retraction of the shares. Article 4.3 of the Senior Series B Provisions provides that if the redemption by Central Capital of all of the Series B Senior Preferred Shares required to be redeemed on the Retraction Date would be contrary to applicable law or the rights, privileges, restrictions and conditions attaching to any shares of Central Capital ranking prior to Series B Senior Preferred Shares, then Central Capital shall redeem only the maximum number of Series B Senior Preferred Shares which it determined was permissible to redeem at that time. Article 4.3 provides the mechanism for a *pro rata* redemption from each holder of the tendered Series B Senior Preferred Shares and redemption of the tendered Series B Senior Preferred Shares by Central Capital at further dates.

19 Article 4.4(a) provides that subject to Section 4.4(b), the election of any holder to require Central Capital to redeem any Series B Senior Preferred Shares shall be irrevocable upon receipt by the transfer agent of the Certificates for the shares to be redeemed and the signification of election of the holder of the Series B Senior Preferred Shares.

20 Article 4.4(b) of the Senior Series B Provisions provides that if the retraction price is not paid by Central Capital, Central Capital shall forthwith notify each holder of the Series B Senior Preferred Shares who has not received payment for his deposited shares of the holder's right to require Central Capital to return all (but not less than all) of the holder's deposited Share Certificates and the holder's rights under Article 4.3 outlined above.

21 Article 4.5 of the Senior Series B Provisions provides that the inability of Central Capital to effect a redemption shall not affect or limit the obligation of Central Capital to pay any dividends accrued or accruing on the Series B Senior Preferred Shares from time to time not redeemed and remaining outstanding.

22 Article 7 of the Series Senior B Provisions provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets of Central Capital among its shareholders for the purposes of winding up its affairs, the holders of the Series B Senior Preferred Shares shall be entitled to receive, from the assets of Central Capital, $25 per Series B Senior Preferred Shares, plus all accrued and unpaid dividends thereon, to be paid prior to payment to junior ranking shareholders. Upon payment of such amounts, the holders of the Series B Senior Preferred Shares shall not be entitled to share in any further distribution of assets of Central Capital.

23 A Notice of Retraction Privilege was sent by Central Capital to the holders of Series B Senior Preferred Shares with a cover letter dated April 23, 1992. The letter stated, among other things, that Central Capital would not redeem any shares because the redemption of such shares would be contrary to applicable law in the context of Central Capital's then current financial situation. McCutcheon and Central Guaranty Trust deposited for redemption 406,800 and 26,000 Series B Senior Preferred Shares, respectively, in accordance with the Senior Series B Provisions and the Notice of Retraction Privilege. The shares were deposited on May 28, 1992, with Montreal Trust Company of Canada, pursuant to the Notice of Retraction Privilege. The shares were properly tendered for redemption in the manner and within the time required by Central Capital's Articles of Amendment.

24 Central Capital did not pay the redemption price on July 1, 1992 and on July 20, 1992 it notified each holder of Series B Senior Preferred Shares of its right to require Central Capital to return all of the holder's deposited Share Certificates as required by Article 4.4(b) of the Senior Series B Provisions. McCutcheon and Central Guaranty Trust did not exercise that right.

25 Pursuant to the terms of Houlden J.'s order of July 9, 1992 directing the restructuring of Central Capital, McCutcheon submitted to the Administrator, as a creditor of Central Capital, Proofs of Claim dated September 3, 1992

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and September 4, 1992, respectively. McCutcheon claimed the amount of $10,913,593.69 in respect of his Series B Senior Preferred Shares tendered for redemption. Central Guaranty Trust claimed the amount of $697,526.68 in respect of its tendered 26,000 Series B Senior Preferred Shares. McCutcheon also executed and submitted the Restated Subscription and Escrow Agreement and other documents electing to participate in CIGL. These claims were completed and submitted in the prescribed form and within the time required by Houlden J.'s order.

26 As was previously noted, these claims were disallowed by the Administrator. The substance of the Administrator's reasons for disallowance was that the ability of Central Capital to redeem these preference shares is restricted by the provisions of the *CBCA* and it would be contrary to applicable law to redeem the shares in the context of Central Capital's financial position. The relevant provision of the *CBCA* provides:

> **Redemption of shares.**
>
> *36.* (1) Notwithstanding subsection 34(2) or 35(3), but subject to subsection (2) and to its articles, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.
>
> **Limitation.**
>
> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

Evidently, the Administrator equated redemption by the corporation with the right of retraction by the preferred shareholder. It agreed with Central Capital's position that once it became insolvent in December of 1991, Central Capital no longer had the ability to redeem the shares tendered for retraction and thus McCutcheon was restricted to exercising what rights it might have as a shareholder.

Facts as They Relate to the Claim of SYH

27 Pursuant to an Agreement of Purchase and Sale made as of June 30, 1989, as amended, Scottish & York Holdings Limited (the predecessor to SYH) sold to Central Capital the shares of Central Canada Insurance Services Limited, Eaton Insurance Company, Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada (collectively the "Insurance Companies"), except for certain preference shares held by the directors of those corporations. In consideration of this transfer, Central Capital issued to Scottish & York Holdings Limited 60,116,000 Series A Junior Preferred Shares and 9,618,560 Series B Junior Preferred Shares.

28 The Articles of Central Capital provided that it would pay on each dividend payment date prior to the fifth anniversary of this issue, as and when declared by the directors out of the assets of the corporation properly applicable to the payment of dividends, a dividend of $.08 for each outstanding Series A Junior Preferred Share. The dividend was payable quarterly by the issuance of .02 Series Junior Preferred Shares for every outstanding Series A Junior Preferred Share. No dividends were in fact declared.

29 The Articles also provided that Central Capital was obligated to retract the Series A Junior Preferred Shares and Series B Junior Preferred Shares, at the option of the holders of those shares, on the fifth anniversary of their issuance.

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The retraction price was $1.00 per share plus all accrued and unpaid dividends. Payment of the retraction price of these shares by Central Capital was subject to the provisions of the *CBCA*, which governs the affairs of Central Capital. For the purposes of this appeal, I believe that we can treat the balance of the provisions relating to these preferred shares as being the same as those governing the McCutcheon Series B Senior Preferred Shares.

30 Given that the operative date for proving claims against Central Capital was June 15, 1992, the retraction date governing the preferred shares of SYH was some two years removed. Notwithstanding, on September 8, 1992 SYH executed and delivered to the Administrator a Proof of Claim, a Counterpart of the Restated Subscription and Escrow Agreement, an initial Share Subscription and an Instrument of Claims Reduction Form, all in the prescribed form and within the time required. The claim was that SYH was holding or entitled to hold the following shares of Central Capital:

(a) 60,116,000 Junior Preferred Series A shares;

(b) 9,618,560 Junior Preferred Series B shares;

(c) 4,611,095 Junior Preferred Series B shares accrued to June 15th, 1992 but not yet issued to SYH;

for a total of 74,345,655 shares, each having a retraction value of $1.00. However, because of some adjustments in favour of Central Capital to the purchase price of the shares sold by SYH to Central Capital under the June 30, 1989 Agreement of Purchase and Sale, the net claim as of June 15, 1992 was reduced from $74,345,655 to $72,388,836.

31 By Notice of Disallowance dated January 20, 1993, the Administrator disallowed the claim by SYH to subscribe for debentures and common shares to be issued by CIGL. The reasons for the disallowance are similar to those provided for disallowing the claims of McCutcheon. The Administrator found that SYH's right to require Central Capital to retract the Series A and B Junior Preferred Shares only arose on the expiry of the fifth anniversary of their issuance and that Central Capital was precluded from retracting those shares by virtue of its insolvency and the provisions of the *CBCA*. Hence SYH, like McCutcheon, was limited to exercising what other rights it might have as a shareholder.

Analysis

32 Although the factual groundwork is necessary for putting in perspective the sole issue before the court, the final question confronting us is a narrow one. Did the retraction clauses in the appellants' shares create a debt owed by Central Canada as of June 15, 1992 within the meaning of the *Bankruptcy Act*? I think that they did.

33 It is agreed that the operative section of the *Bankruptcy Act* is s. 121(1). It reads as follows:

> *121.*(1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation in curred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

There was no bankruptcy in this case and thus the relevant date was agreed to be June 15, 1992. The obligations of Central Capital to the appellants were incurred before that date, and so the only question becomes whether the obligations created a debt between the appellants and Central Capital.

34 What then is a debt? All the parties turn to *Black's Law Dictionary*, quoting different editions. The following is from the Sixth Edition (1990), at p. 403:

> **Debt.**
>
> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only the obligation of debtor to pay but right of creditor to receive and enforce payment. ...

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> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future.

35 The above is consistent with what is defined as a debt by *Jowitt's Dictionary of English Law*, 2nd ed. (1977), at p. 562:

> A debt exists when a certain sum of money is owing from one person (the debtor) to another (the creditor). Hence "debt" is properly opposed to unliquidated damages; to liability, when used in the sense of an inchoate or contingent debt; and to certain obligations not enforceable by ordinary process. "Debt" denotes not only the obligation of the debtor to pay, but also the right of the creditor to receive and enforce payment.

And finally, *The Shorter Oxford Dictionary*, 3rd ed. (1973), at p. 497:

> **Debt**
>
> *1.* That which is owed or due; anything (as money, goods or service) which one person is under obligation to pay or render to another.
>
> *2.* A liability to pay or render something; the being under such liability.

36 I have no difficulty in finding that the claims of the appellants in the case under appeal fall within all of the above definitions. As will be discussed herein, concern was expressed in this case over whether or not the appellants as creditors were entitled to "receive and enforce payment" on the "debt" because of the insolvency of Central Capital on June 15, 1992. I will deal with the specific arguments relating to the effect of insolvency on this particular indebtedness in due course, but for the moment I am content to observe that the above definitions contemplate only that the creditor's right to recover is the reciprocal of the debtor's obligation to pay. For every debtor there must be a creditor. There may be cases where it is difficult to identify the person who in law may receive and enforce payment, but this is not such a one.

37 With great respect to the judge of first instance and to the submissions of counsel for the unsecured creditors, I believe that the fundamental error that has been made in these proceedings arises from the conception that the preferred shares in question can either be debt instruments or equity participation instruments, but they cannot have the attributes of both. Feldman J. had this to say at p. 48 of her judgment:

> Although the right of retraction at the option of the preferred shareholder may be less common than the usual right of the company to redeem at its option, that right is one of the incidents or provisions attaching to the preferred shares, but does not change the nature of those shares from equity to debt. The parties have characterized the transaction as a share transaction. The court would require strong evidence that they did not intend that characterization in order to hold that they rather intended a loan.
>
> In my view, this case turns on whether the right of retraction itself creates a debt on the date the company becomes obligated to redeem even if it cannot actually redeem by payment on that date, or a contingent future debt on the same analysis, not on whether the preferred shares themselves with the right of retraction are actually debt documents.
>
> Because the preferred shares remain in place as shares until the actual redemption, the appellants are not creditors and have no claim provable under the *Bankruptcy Act* (Canada), and the appeals are therefore dismissed.

38 As I read these reasons, the learned judge is in effect stating that these instruments are preferred shares in the corporation because the parties have so described them. In the first place, I do not think that describing the documents as preferred shares is conclusive as to what instrument the parties thought they were creating. In the second place, it is not what the parties call the documents that is determinative of their identity, but rather it is what the facts require the court to call them. The character of the instrument is revealed by the language creating it and the circumstances of its creation. Although these instrument may "remain in place as shares" until they are actually redeemed, they also contain

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a specific promise to pay at a specified date. This is the language of debt. I cannot accept the proposition that a corporate share certificate cannot create a corporate debt in addition to the certificate holder's rights as a shareholder.

39 The rules relating to the competing rights of shareholders and creditors of an insolvent corporation have become so regulated by governmental action that one can readily lose sight of the common law basis for making a distinction. To understand the difference in treatment, we must re-examine what a share of a corporation represents. Initially, a share is issued by the corporation to raise share capital. The price of the share is money or the promise of money. Accordingly, an individual share is one of a number of separate but integral parts of the authorized capital of a corporation. Even though it is the shareholders who contribute to the capital of the corporation, the capital remains the property of the corporation. The shareholders, however, as owners of the shares of capital, effectively control the corporation. They have the responsibility of managing its affairs through their control over the board of directors and in popular terminology are considered to be the owners of the corporation. However, the corporation is a separate entity in law, and if in the course of carrying out its business it incurs debts to third parties, those debts are those of the corporation. A corporation is an intangible and its capital therefore represents its substance to third parties having business dealings with the corporation. A preferred share is simply a share of a class of issued shares which contains a preference over other classes of shares, whether preferred or common: see Sutherland, *Fraser and Stewart on Company Law of Canada*, 6th ed. (1993), at pp. 157 and 195 for further discussion.

40 The rights of shareholders are conveniently summarized by R.M. Bryden in his chapter, "The Law of Dividends", contained in Ziegel ed., *Studies in Canadian Company Law* (1967), at p. 270:

> The purchaser of a share in a business corporation acquires three basic rights: he is entitled to vote at shareholders' meetings; he is entitled to share in the profits of the company when these are declared as dividends in respect of the shares of the class of which his share forms a part, and he is entitled, upon the winding-up of the corporation, to participate in the distribution of the assets of the company that remain after creditors are paid. A fourth right which should be noted is the right to transfer ownership in his share, whereby the owner for the time being may realize upon the increase in value of the company's assets, or its favourable prospects, by selling his share at a price reflecting the buyer's estimation of the value of the rights he will acquire. Unless the shareholder chooses to sell his share, he can realize a return upon his investment only through receipt of dividends or by the return of his capital upon an authorized reduction of capital or winding up.

41 Shareholders are variously characterized as entrepreneurs, investors or risktakers and as such they have the opportunities of benefitting from the successes of the corporation and suffering from its failures. While the corporation is an operating entity, the shareholders receive their rewards, if they are any, through the payment of dividends declared from time to time by the board of directors. While the source of these dividends is not restricted to surplus funds, the result of the payment of the dividend must not result in a return of capital to the shareholders. The classic justification for this rule was stated by Sir George Jessel, Master of the Rolls in *Re Exchange Banking Co.; Flitcroft's Case* (1882), 21 Ch. D. 519 (C.A.), at 533-4:

> The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor ... gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders. ...

42 Creditors, on the other hand, do not have an ownership or equity interest in the corporation. They are third parties who have loaned money or otherwise advanced credit to the corporation. They look to the company for payment in accordance with the terms of the contract creating the indebtedness. They are also restricted in their recovery to the amounts stipulated in the terms of indebtedness. They are entitled to payment regardless of the financial circumstances of the debtor corporation and accordingly are not restricted to receiving payment of the debt from surplus. They can be paid out of assets or through the creation of further indebtedness. It is immaterial how the corporation records this indebtedness in its internal books. In some circumstances the indebtedness could properly reflect the acquisition of

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property from a creditor as a capital asset. This does not, however, convert the creditor into an investor. The vendor of the property remains a creditor and retains priority over shareholders in the event of a bankruptcy or insolvency.

43 In my view, the reasons under appeal do not reflect a sensitivity to the circumstances which gave rise to the issuance of the preference shares. The shares were not issued by Central Capital to the general public in order to raise capital and do not represent an investment by the public in the capital of the corporation. They were issued to specific persons as payment for the acquisition of specified assets. While the corporation was authorized by its Articles of Incorporation to issue preferred shares generally, the shares issued to the appellants were structured to meet the requirements of the appellants as vendors of the controlling interest in the operating companies that Central Capital was acquiring. In my view, these preference shares are the equivalent of vendor shares in that the appellants received them in exchange for the transfer of assets to Central Capital.

44 In the case of McCutcheon, the retraction provision in the preferred shares represented only partial payment of an agreed value for the assets, but in the case of SYH, they represented the full value. In both cases, the agreed value as reflected in the retraction price was guaranteed by Central Capital to be retractable at a fixed price at a predetermined date. By postponing the obligation to pay the purchase price in this way, Central Capital was using the retraction provisions of the preference shares as a vehicle for the financing of its expanding asset base. The appellants, for their part, deferred the realization of the purchase price of their assets to the agreed dates and thereby extended credit to the corporation. In return for extending credit for some or all of the selling price, the appellants agreed to receive dividends calculated in advance but payable as and when declared by the board of directors.

45 Thus, in looking at the substance of the transaction that led to the issuance of the preference shares, it appears to me that the retraction clauses were promises by Central Capital to pay fixed amounts on definite dates to the appellants. They evidenced a debt to the appellants. The fact that the appellants as holders of the preference shares had rights as shareholders in the corporation up to the time when the retraction clauses were exercisable did not affect their right to enforce payment of the retraction price when it became due.

46 The validity of an analysis directed to the substance of the transaction is supported by *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558, a judgment of the Supreme Court of Canada delivered by Iacobucci J. The case involved a number of corporations constituting a support group which entered into an arrangement to provide emergency financial assistance to Canadian Commercial Bank ("CCB"). On the ultimate failure of the bank, the issue arose as to whether the monies advanced to CCB under this support arrangement were in the nature of a loan or in the nature of a capital investment. I find instructive to our situation Iacobucci J.'s observation at pp. 590-1:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplemen tary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement. [Emphasis in original.]

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47 I have no difficulty in finding that the appellants' preferred shares with their retraction clauses are of "a hybrid nature, combining elements of both debt and equity". As to the equity component, the appellants are shareholders prior to exercising their retraction rights in that they have the right to vote in certain circumstances and have a right to receive dividends when and if they are declared by the board of directors. The debt component is more significant however. The shares were not issued to investors, but to vendors of property. The vendors were entitled to receive a fixed sum at a specified time in payment therefor. Pending payment, the vendors were entitled to receive dividends which were the equivalent of interest on the unpaid balance.

48 I can think of no reason why the holders of these preferred shares should not be treated as both shareholders and creditors. It does not concern me that these appellants act as shareholders before their retraction rights are exercisable. Nor do I see any hardship to other creditors of Central Capital arising from the ability of these appellants to claim as creditors in the restructuring of the company given that the appellants are unpaid with respect to substantial assets sold to the corporation and now transferred on the restructuring to GIGL.

49 Much was made in argument of the fact that the retraction amounts could not be paid on the retraction dates. In the case of McCutcheon, the corporation was insolvent and subject to court administration on the due date of July 1, 1992. In the case of SYH, the retraction date did not arrive before the reorganization was complete.

50 The narrow issue of the effect of insolvency on a debt has been dealt with by the British Columbia Court of Appeal in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1. In this case, the appellants were one-time members of three co-operative associations. The rules of the co-operatives permitted a member to withdraw upon written notice to the board of directors to that effect. The member was entitled to elect to have his shares redeemed either in equal instalments over five years or in one payment with interest at the end of five years. In April of 1987, the superintendent of co-operatives, under the authority of the *Cooperative Association Act*, R.S.B.C. 1979, c. 66, suspended the co-operatives' right to redeem their shares until their financial situation was no longer impaired. The three co-operatives subsequently went bankrupt and a two-fold issue came before the bankruptcy court: (1) whether those members whose notices of withdrawal had been accepted by the board of directors but who had not yet received the value of the shares were entitled to rank as unsecured creditors, and (2) whether those who had delivered notices that had not been accepted were to be treated as unsecured creditors. The court of first instance found that the members were shareholders and answered both questions in the negative. That judge was reversed on appeal with the majority of the court deciding that the answer to both questions was yes. Hutcheon J.A. for the majority stated at p. 13:

> I shall use Mr. Neels [a co-operative member] as my example. According to R. 3.06 he ceased to be a shareholder in May 1983. In May 1984 the Agricultural Co-operative owed him the first of five payments, or $686.40. I know of no principle of law that would support the proposition that Neels could not sue for that amount if the Agricultural Co-operative failed to pay in May 1984. Of course, the superintendent of co-operatives has power under s. 15(2) to suspend payments if, in his opinion, the financial position of the co-operative was impaired. Subject to that power, the position of Neels and the Agricultural Co-operative would be that of ordinary creditor and debtor. In my opinion, the order made by the judge cannot be sustained on the first ground.

From this case, I extract the proposition that the fact of an insolvency, whether declared or not, does not change the nature of the relationship between debtor and creditor. It continues notwithstanding the inability of the debtor to pay or the creditor to collect.

51 It appears to me, with deference, that the issue of the effect of Central Capital's insolvency on the character of the retraction payments is something of a red herring. The contest in this appeal is between those who are conceded to be unsecured creditors and those whose claim to such status is contested. In both cases, any right to payment was suspended by Central Capital's announcement in December of 1991 that it was insolvent and that it had suspended all payments of principal and interest to unsecured creditors. This course of action was not freely chosen but was required by law. Any payments to creditors after the date of insolvency would be voidable at the instance of creditors on the basis that

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they were fraudulent preferences. In addition to ss. 95 and 96 of the *Bankruptcy Act* dealing with fraudulent preferences generally, there is provincial legislation in the form of the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29, and the *Assignments and Preferences Act*, R.S.O. 1990, c. A.33, that would be applicable. Counsel for the unsecured creditors maintains that the right to redeem shares, including preference shares was postponed by s. 36(2) of the *CBCA, supra*. I am not certain that s. 36(2) applies to the retraction provisions of the appellants' preference shares as opposed to the redemption privileges of Central Capital, but in my opinion the point is irrelevant to this appeal. Once Central Capital acknowledged its insolvency, it could neither redeem its shares nor honour its retraction obligations. The whole purpose for the creditors applying to the court for a stay of Central Capital's obligations, including those of the acknowledged unsecured creditors, was to arrange for a scheme of payments to all creditors that could not be subject to attack as preferences. There is no suggestion on the evidence before us that the claims of unsecured creditors accepted by the Administrator were claims that had crystallized prior to the insolvency of Central Capital. Nor is it suggested that any creditors were rejected because some or all of their claims were not payable until after the date of the insolvency. The fact of insolvency, by itself, does not provide a rational basis for distinguishing the claims of the appellants from those of other unsecured creditors.

52 Much also was made of the provision in the Articles authorizing the shares in question, which states that if the obligation to redeem "would be contrary to applicable law", then Central Capital "shall redeem only the maximum number of [shares] it is then permitted to redeem". Counsel for the unsecured creditors submits that the reference to "applicable law" is to s. 36 of the *CBCA*. The reference certainly embraces the *CBCA*, but it is not restricted by its terms to that statute. For example, "applicable law" would also capture s. 101 of the *Bankruptcy Act*, which provides for penalties against directors and shareholders where insolvent companies redeem shares or pay dividends.

53 There was no evidence led as to why this provision was placed in the Articles and the share certificates. It appears to be a standard clause in all the preference shares issued by the corporation and not just those that were adapted to the appellants' situations where specific retraction clauses were drafted to satisfy the particular asset acquisitions. For my part, I have difficulty in understanding how a consideration of this provision assists the process of determining the underlying character of the retraction obligations. The statement is so self-evident that it is almost banal. I can only assume that the statement was included in the share provisions of a corporation marketing its securities world-wide so as to inform purchasers that legal restrictions in this jurisdiction apply to the company's right to redeem shares.

54 In summary then regarding the insolvency argument, these various statutes prohibit payments of any kind to shareholders by an insolvent company. As I understand it, counsel does not question that when a dividend has been lawfully declared by a corporation, it is a debt of the corporation and each shareholder is entitled to sue the corporation for his proportion: see *Fraser and Stewart, supra*, at p. 220 for a list of authorities. However, once a company is insolvent it cannot make payments to shareholders or creditors so long as it continues to be insolvent. On the other hand, nowhere in the *CBCA* or else where will we find authority for the proposition that once a corporation is insolvent, it is no longer obliged to pay its debts. The obligation is postponed until the insolvency is corrected or the corporation makes an accommodation with its creditors and obtains a release with or without the assistance of the various statutes dealing with insolvency.

55 The existence of provisions prohibiting payment to shareholders and creditors on insolvency does not in anyway assist the determination of whether the retraction obligations at issue in this appeal constitute a debt or a return of capital at the time they are payable. Speaking of the obligation to honour the retraction in terms of the corporation redeeming its shares also introduces the wrong emphasis. The corporation is not redeeming the shares at its option as contemplated by most redemptions. It is being forced to redeem them because of a prior contractual obligation for which the preferred shareholder gave good consideration. It is for this reason that I question whether s. 36 of the *CBCA* is the appropriate reference point. This is not the type of payment which concerned Jessel M.R. in *Flitcroft's Case, supra*.

56 At the risk of over simplifying this case, it appears to me that many of the arguments made against the appellants' claims to be creditors of Central Capital are impermissible in the context of the Agreed Statement of Facts. The issue in appeal is frozen in time by the stipulation that the court is to determine if these retraction clauses created a debt

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within the meaning of the *Bankruptcy Act* on June 15, 1992. The arguments against the appellants' claims also ignore that debts under s. 121(1) of the *Bankruptcy Act* need not be payable at the date of the bankruptcy (or June 15, 1992 in our scenario). They need only come beneath the broad umbrella of "debts and liabilities, present and future, to which [Central Capital] is subject" on June 15, 1992. The fact that the debts could not be paid after June 15, 1992, does not mean that they were not provable claims pursuant to s. 121 of the *Bankruptcy Act*. Moreover, assuming the retraction clauses created a debt payable on a future date, neither the order of Houlden J. nor the restrictions in the Articles creating the shares themselves purported to extinguish that debt.

57 There is nothing in either the Articles of Central Capital or in the law that excuses the obligation to pay the retraction amounts. Rather, discharge of the obligation is simply postponed until the cessation of the disabling event of insolvency. Article 4.3 of the Senior Series B Provisions provides the mechanism for future redemption of tendered shares that are not redeemed because such redemption would be contrary to law. Article 4.5 provides that the inability to effect a redemption does not affect the obligation to pay dividends accrued or accruing on the unredeemed shares.

58 So far as SYH is concerned, the retraction price was not payable until the fifth anniversary of the June 1989 sale of assets. Therefore, no issue of the effect of insolvency arose in 1992. The orders of Houlden J. of June 15 and July 9, 1992 changed the rules of the game. If this appellant is a creditor, it does not have to wait until the retraction date. It can claim as a creditor now. It did and the claim was disallowed. However, if this court holds that the claim should have been allowed, then in accordance with the narrow issue put to us, SYH is entitled to be accepted as a full creditor in the entire reorganization of Central Capital.

59 An additional factor raised by counsel during argument was that Article 7, *supra*, provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets among its shareholders for the purpose of winding up its affairs, the holders of these preferred shares are entitled to recover "from the assets of Central Capital" the retraction price plus all accrued and unpaid dividends thereon. Such amount is to be paid prior to payment to junior ranking shareholders. The Article further provides that "[u]pon payment of such amounts, the holders of [the preferred shares] shall not be entitled to share in any further distribution of assets of [Central Capital]". Because it is trite law that shareholders are entitled to recover from assets only after all ordinary creditors have been paid in full, counsel for the unsecured creditors submits that the fact that the clause contemplates priorities between shareholders on a winding up or a liquidation of assets is clear evidence that they were shareholders only.

60 I have two responses to this submission. The first is the obvious, that we are not dealing with this contemplated event. We are dealing with a reorganization in which the parties have put a single question to the court: are the appellants creditors? Consideration of issues of priority or the valuation of claims have been taken away by the narrow scope of the agreed question. If the answer to the question posed is yes, then in accordance with the Agreed Statement of Facts, the appellants are entitled to have their claims as creditors allowed under the Subscription and Escrow Agreement and to participate in the Amended Plan of Arrangement as Senior Creditors. If the answer is no, they are to be treated as the Administrator has treated them: they are not creditors at all and are restricted to receiving Central New Common Shares under the Amended Plan of Arrangement.

61 My second response is that counsel for the unsecured creditors misses the significance of the clause. He assumes that there will be a deficiency in all circumstances leading up to a liquidation, dissolution or winding up that will necessitate a *pro rata* distribution, first to creditors and then to shareholders of all classes. However, the clause does not say that those with retraction rights are not creditors. It says that the retraction amounts are to be paid out of assets, not suplus. Once the retraction amounts have been paid in full, the appellants are not entitled to share in any further distribution. This contemplates a surplus after all creditors, including the appellants, have been paid in full. Accordingly, far from classifying the appellants as shareholders, the clause provides that they are not entitled to be treated as shareholders under a winding up or liquidation but only as creditors.

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62 Finally, with respect to SYH's claims, it was submitted that these claims were so contingent as to be virtually non-existent. The claims anticipate a retraction date that as of June 15, 1992 was some two years into the future. Upon approval of the Amended Plan of Arrangement of December 18, 1992, the shares of SYH were cancelled and replaced by a new issue of shares, the Central New Common Shares. Counsel relied upon the finding of Feldman J. that there was then no discernable basis upon which the retraction could occur. Once again, with respect, this conclusion misses the point. Following the final order of Houlden J. approving the Amended Plan of Arrangement, all the shares *and* all the debts of Central Capital disappeared. There was thereafter no discernable basis upon which any event contemplated by any debt or share instruments could occur. We are only concerned with the status of shareholders and creditors as of June 15, 1992.

63 Based on the reasons set out above, I have concluded that the retraction amounts do fall within the definition of debts and liabilities, present or future, to which Central Capital was subject on June 15, 1992. This does not apply to undeclared dividends however, because until a dividend is declared no action on behalf of a shareholder lies to enforce its payment: see *Fairhall v. Butler*, [1928] S.C.R. 369 at 374. If undeclared dividends have been claimed by any of the appellants they should be disallowed. In all other respects the claims should be allowed.

64 Accordingly, I would allow the appeals, set aside the order of Feldman J. and order that the appellants have provable claims that are to be allowed by the Administrator. The record does not disclose what order if any Feldman J. made as to costs. Certainly the appellants are entitled to their costs of this appeal. If the parties are unable to agree with respect to any other disposition of costs, I would suggest that they submit their positions to the court in writing.

***Weiler J.A.*:**

65 I have had the benefit of reading the reasons of Finlayson J.A. and for the reasons which follow I respectfully disagree with his conclusion that the appellants are entitled to prove a claim pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*").

66 Section 12(1) of the *CCAA* requires that persons wishing to participate in a reorganization have claims which would be provable in bankruptcy. Section 121(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, states that "[a]ll debts and liabilities, present or future ... shall be deemed to be claims provable in proceedings under this Act."

67 In order to decide whether the obligation of Central Capital to redeem the preferred shares of the appellants is a claim provable in bankruptcy, it is necessary to characterize the true nature of the transaction. The court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability by the company: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In this case, the decision is not an easy one. Where, as here the agreements between the parties are reflected in the articles of the corporation, it is necessary to examine them carefully to characterize the true relationship. It is not disputed that if the true nature of the relationship is that of a shareholder-equity relationship after the retraction date and at the time of the reorganization, then the appellants do not have a claim provable in bankruptcy. Consequently, they will not have a claim under the *CCAA*.

68 As I see it, three main questions need to be addressed:

(1) Was Feldman J. correct in characterizing the relationship between Central Capital and the companies owned by James McCutcheon ("McCutcheon"), and between Central Capital and Scottish and York Holdings Limited (the predecessor of S.Y.H., hereinafter referred to as "SYH"), as a shareholder relationship?

(2) Did the nature of the relationship change after the retraction date for redeeming the shares of McCutcheon or, in the case of SYH, at the time of the reorganization?

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(3) If the nature of the relationship is not a shareholder-equity relationship, are the appellants entitled to prove a claim under the *CCAA*.?

69 In addition, the appellants raise the question of whether they have a right to prove a claim for dividends, which have accrued but have not yet been declared payable. The price to be paid by Central Capital to McCutcheon on the retraction date, July 1, 1992, was $25 per share plus *all accrued and unpaid dividends thereon*. The dividends are therefore part of the retraction price. Similar provisions apply to SYH.

70 The reasons of Finlayson J.A. contain a comprehensive statement of the background to the litigation and I will therefore only refer to the facts in a summary fashion.

71 James McCutcheon and his brother sold their shares in Central Guarantee Trust Company to Central Capital Corporation ("Central Capital"), a trust company, for $575 a share. They received $400 per share in cash. The balance of $175 owing on each share was paid through the issue of seven preferred shares in Central Capital, with each share having a par value of $25. Following this transaction, McCutcheon purchased his brother's shares. These preferred shares, known as Senior Series B Preferred Shares, were to be listed on the Toronto Stock Exchange. These shares carried with them a retraction privilege. The shareholder had the right to have his shares redeemed by Central Capital on July 1, 1992, for $25 a share, provided that such redemption would not be "contrary to law in the context of the Corporation's current financial position." McCutcheon chose not to sell his shares.

72 Scottish & York Holdings Limited (the predecessor to SYH) sold its shares in certain insurance companies which it owned to Central Capital. Central Capital paid for these shares by the issue of Series A Junior Preferred Shares. These shares were not listed on a stock exchange. SYH had the right to have its shares redeemed by Central Capital on or after September 1994 at a price of $1 per share, subject to the provisions of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*").

73 It should be noted that the right of retraction was not unique to these two classes of shareholders. Even common shareholders had the right to have their shares retracted under certain circumstances.

74 By December 1991, Central Capital was unable to pay its liabilities as they became due and its total liabilities greatly exceeded the value of its assets. As a result, the various banks and subordinated debtholders, collectively referred to as the lenders, had a choice to make. Inasmuch as the definition of a corporation in s. 2 of the *Bankruptcy and Insolvency Act* precludes a creditor from bringing a petition against a trust company, they could either wind up Central Capital under the *Winding-up Act*, R.S.C. 1985, c. W-11, or they could try to restructure Central Capital under the *CCAA*. In a winding up or liquidation, the trustee would sell the company's assets, either piecemeal or as a going concern, to third parties. The proceeds from the sale would then be distributed to those who proved a claim according to set priority rules. In a reorganization, existing fixed amounts owed to Central Capital's creditors would be traded for new claims and ownership interests in the reorganized corporation which would remain a going concern. The lenders chose to reorganize.

75 Two transactions were involved. In the Consolidated Insurance Group Limited transaction, or "CIGL transaction", Central Capital transferred some of its significant assets to a newly incorporated company, CIGL. Thirty-nine creditors of Central Capital then elected to exchange a portion of Central Capital's debt owing to them for equity in this newly incorporated company. In the second transaction, common shares were issued for the remaining assets of Central Capital. The creditors of Central Capital were given 90 per cent of the common shares of the reorganized company. The balance of 10 per cent was allocated to the shareholders of Central Capital. All of the preferred, common and subordinate voting shares in Central Capital were then converted into these "new" common shares. The reorganization was subsequently approved by the creditors and sanctioned by the Court as required by the Act, but this approval was given without prejudice to any claims that McCutcheon and SYH might have.

76 McCutcheon's position was that the right to have his shares retracted accrued before the reorganization, and that his exercise of this right of retraction in May 1992 constituted a present debt or liability entitling him to rank as a

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creditor in the CIGL transaction and in the reorganized Central Capital. SYH's position was that the right to have its shares retracted in 1994 created a future debt or liability and thus a provable claim. The administrator of Central Capital disallowed both claims. McCutcheon and SYH appealed the administrator's decision to Feldman J. In dismissing their appeals, she held that the appellants were shareholders and that the right of retraction attaching to the shares did not change the nature of the shares from equity into debt.

1. Was Feldman J. correct in characterizing the agreement between Central Capital and the companies owned by McCutcheon, and between Central Capital and SYH, as creating a shareholder relationship between the parties?

77 Feldman J. analyzed the transaction and came to the conclusion that it was an equity transaction.

78 Finlayson J.A. is of the opinion that the nature of this transaction is different and that Feldman J. erred in not showing sensitivity to the fact that she was dealing with the sale of a business by its owners. He is of the opinion that the shares issued by Central Capital are the equivalent to "vendor shares" in that the appellants received them in exchange for the transfer of assets to Central Capital. He does not see the transaction as being either a contribution to capital by McCutcheon and SYH or as a return of capital. Although the transaction has debt and equity features, Finlayson J.A. is of the opinion that the true nature of the transaction is that of a debt owing by Central Capital to McCutcheon and SYH for the shares in their companies.

79 My analysis of the transaction is that when McCutcheon sold his shares in Central Guaranty and took back preferred shares in Central Capital as part payment, he transferred part of his capital investment from a smaller entity to a larger entity. Similarly, SYH transferred its investment in the shares of the insurance companies for shares in the larger entity of Central Capital. Both appellants could look to a larger asset base than before to generate a return on their capital. Until the retraction date, McCutcheon chose to take the risk of continuing his investment in Central Capital, which offered the prospect of a stable, yet relatively high, annual return through the receipt of 7-5/8 per cent dividends. Because the shares traded on the Toronto Stock Exchange, he would have had the option of realizing upon his investment by selling his shares for what they would bring on the open market, but he did not do so. In the case of SYH, although these shares were not required to be publicly listed, the corporation's articles did not restrict their transfer. The corporation's articles indicate that these shares had some preference over other shares with respect to the right to receive dividends and in the distribution of assets after creditors are paid on a liquidation. As preferred shareholders, McCutcheon and SYH did not have a voice in company affairs unless the company failed to pay the dividends it had promised to pay. This is quite typical: see Welling, *Corporate Law in Canada*, 2nd ed. (1991) at p. 604; Ziegel et al, *Cases and Materials on Partnership and Canadian Business Corporations*, 2nd ed. (1989) at p. 1198. Risk taking, profit sharing, transferability of investment, and the right to participate in a share of the assets on a liquidation after the creditors have been paid are the hallmarks of a shareholder: see R.M. Bryden, "The Law of Dividends" contained in Ziegel ed., *Studies in Canadian Company Law* (1967) at p. 270. In my opinion, Feldman J. was correct that the true nature of the relationship between the parties initially was that of an equity transaction.

2. Did the nature of the relationship change after the retraction date for McCutcheon's shares and did the reorganization trigger a right of redemption respecting SYH's shares?

80 Ordinarily, shareholders cannot realize on their investment in a company except by transferring their shares. The retraction privilege attaching to the shares gives the preferred shareholders the option of realizing on their investment other than by transferring their shares to a third party.

81 Feldman J. found that McCutcheon continued to be a shareholder after the retraction date and that he remained a shareholder at the time of the reorganization. She found SYH's claim to be too remote inasmuch as the retraction date not yet arrived at the time of the reorganization.

82 The appellants argue that Feldman J. erred in this conclusion. They submit that although McCutcheon and SYH may have been shareholders initially, this relationship changed. Upon McCutcheon's exercise of his right to have the

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corporation pay him the retraction price of his shares, he ceased to be a shareholder. When Central Capital failed to pay him, he became a creditor of the corporation. In the case of SYH, it is submitted that when the lenders opted to reorganize the company, they, in effect, triggered the obligation to redeem SYH's shares.

(a) Nature of the transaction's relationship to the capital structure of the corporation

83 Section 25(3) of the *CBCA* states that shares shall not be issued until the consideration for the shares is fully paid either in cash or with property having a fair market value equivalent to the shares issued. Therefore, by issuing preferred shares with a fixed par value, Central Capital paid McCutcheon for his shares of Central Guaranty and paid SYH for the shares of the insurance companies that Central Capital received. Central Capital could not issue preferred shares *except* as full payment for the shares it received. The preferred shares were part of the capital of Central Capital and the preferred shares were always shown as shareholders' equity on Central Capital's books. The capital of the corporation is representative of the assets available to pay creditors. If, on the date for redemption of McCutcheon's shares, or on the date of reorganization in the case of SYH, the shares are redeemed, the amount paid must be deducted from the stated capital of the corporation s. 39 *CBCA*. Consequently, the total assets that Central Capital will have available to pay the lenders and other creditors outside the corporation will be reduced. A reduction of capital by the redemption of redeemable shares is permitted under the *CBCA* but only where the requirements of s. 36 are met.

(b) Section 36 of the CBCA

84 Section 36 of the *CBCA* makes the ability of a corporation to redeem its redeemable shares subject to (1) its articles and (2) a solvency requirement. For ease of reference s. 36 is reproduced below.

> *36.*(1) Notwithstanding subsection 34(2) or 35(3) [both of which deal with a corporation's acquisition of its own shares in other circumstances], but *subject to subsection (2) and to its articles*, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.
>
> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of shares to be purchased or redeemed. [Emphasis added.]

85 There is no dispute that Central Capital was unable to redeem McCutcheon's shares on the retraction date. Nor could it redeem SYH's shares on the date of the reorganization. The appellants agree that the effect of s. 36 renders the agreement between themselves and Central Capital unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish a debt or liability which they say has been created. The appellants rely on the decision in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1 (B.C. C.A.) in support of their position that a debt or liability is created notwithstanding the solvency requirements of s. 36 respecting payment. The appellants' submission does not take into consideration the major differences between the decision in *East Chilliwack* and the present situation relating to the timing, effect of the solvency requirements and the provisions in the articles governing the relationship of the parties.

> 1) In *East Chilliwack*, farmers who owned shares in an agricultural co-operative gave notice to the co-op of their intention to have their shares redeemed. After the notices had been given, the superintendent of co-operatives suspended the right of the co-op to redeem its shares. Here, the request to redeem the shares by McCutcheon and the retraction date occurred after Central Capital had sent out a notice that it would not be able to redeem the shares

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due to its financial position. SYH had no right to demand that its shares be retracted until the retraction date, which was some two years after the date of Central Capital's insolvency.

As in the instant case, the issue in *East Chilliwack* was whether the farmers were entitled to rank with the creditors of the co-op. Hutcheon J.A., with Toy J.A. concurring, held that they were entitled to be treated as creditors.

At the outset of his reasons, Hutcheon J.A. noted, at p. 11, that the effect of the superintendent's suspension on the farmers' rights was not argued on appeal and that the court had been asked to determine the status of the farmers without regard to the suspension.

Here, the effect of Central Capital's inability to redeem its shares due to insolvency is very much in issue and cannot be ignored. Although the articles provide for the redemption of all of the shares held by McCutcheon and SYH on or after the retraction date, the articles also state that Central Capital will only redeem so many of its shares as would not be "contrary to law." Pursuant to s. 36(1) of the *CBCA*, a corporation may purchase or redeem redeemable shares, but the corporation is prohibited from doing so if the corporation is unable to pay its liabilities as they become due or if the assets of the corporation are less than the total of its liabilities and the amount required for the redemption. Because Central Capital could not comply with the solvency requirements, redemption would be "contrary to law."

2) In *East Chilliwack, supra*, at p. 13, the rules of the co-op provided that upon the giving of a notice of redemption, the farmer giving it ceased to be a shareholder. Central Capital's articles do not state that a request for redemption of the holder's shares terminates his status as a shareholder. McCutcheon continued to have the right to receive dividends pursuant to Article 4.5 while his shares were not redeemed. In effect, so long as Central Capital was unable to redeem the shares but had profits, McCutcheon continued to be entitled to a share of the profits through the declaration of dividends. If the dividends remained unpaid for eight consecutive quarters then, pursuant to Article 8, McCutcheon had the right to receive notice of, and to attend, each meeting of shareholders at which directors were to be elected and was entitled to vote for the election of two directors. The articles relating to the preferred shares held by SYH contain a similar provision. The result of insolvency as envisaged by the articles was that McCutcheon and SYH would continue as shareholders.

3) In *East Chilliwack, supra*, Hutcheon J.A. held, at p. 13, that, subject to the power of the superintendent of co-operatives, the farmer's position would be that of an ordinary creditor.

Here, the terms attaching to McCutcheon's shares do not give him that right. Instead, he is given the right to continue to receive dividends so long as the company cannot pay him. The articles relating to the shares held by SYH contain a similar provision. In addition, Article 4.3(b), respecting the retraction of the shares, indicates that if the directors have acted in good faith in making a determination that the number of shares the corporation is permitted to redeem is zero, then the *corporation* is not liable in the event this determination proves inaccurate. This would hardly be the position *vis à vis* an ordinary creditor.

4) Article 8 and a similar provision in the articles relating to the shares held by SYH provide that upon a sale of all or a substantial part of the company's undertaking, the preferred shareholders have a right to receive notice of and to be present at the meeting called to consider this sale. The farmers in *East Chilliwack* do not appear to have had any similar right.

5) Article 7 provides that in the event of a liquidation, dissolution or winding-up of the Corporation the preferred shareholders have a right to receive $25 per Series B Senior Preferred Share before the corporation pays any money or distributes assets to shareholders in any class subordinate or junior to the Series B Senior Preferred Shares. Similarly, SYH, as the holder of Series A and B Junior Preferred shares has the right, upon the dissolution or winding up of the corporation, to receive a sum equivalent to the redemption amount for each series junior preferred share.

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This right is subject to the rights of shares ranking in priority to the shares of these series, but is ahead of the rights of the holders of common shares.

Nothing in the articles concerning the retraction date affects the right of McCutcheon and SYH to participate in Central Capital's liquidation. The participation of the farmer in *East Chilliwack* ceased once he had given notice to redeem. Article 4.4 of Central Capital provides that once the shares have been tendered for retraction this election is irrevocable on the part of the holder. In the event that payment of the retraction price was not made, however, the holder had the right to have all deposited share certificates returned. Central Capital offered to return McCutcheon's shares to him, but he refused. Because McCutcheon retained all the rights and privileges of a preferred shareholder after the retraction date, the fact that he refused to take back his share certificates cannot alter the true nature of the relationship. The refusal was merely evidence of a dispute concerning what the relationship was. SYH also retained its full status as a shareholder until the date of the reorganization. This was not the situation in *East Chilliwack*.

86 By way of summary, on the date of the reorganization McCutcheon and SYH had not ceased to be preferred shareholders of Central Capital. The rights attaching to their retractable preferred shares entitled them to continue to share in the profits of the company when these were declared as dividends, to vote at shareholders meetings to elect directors so long as dividends remained unpaid for a specified period of time, and, on a winding up of the company, to participate in the distribution of assets that remained after the creditors were paid according to the ranking of the series of their shares. The company's obligation to redeem its shares was not absolute. Instead, the articles provided for what was realistically a "best efforts" buy-back based on solvency and continuation as a shareholder to the extent a buy-back could not take place. In *East Chilliwack*, because the farmer ceased to be a shareholder, the articles do not appear to make any provision for continued participation or for the postponement of payment depending on the solvency of the co-op.

(c) Evidence of a debtor-creditor relationship is lacking in the articles

87 Looked at another way, after the retraction date and at the time of the reorganization, the common features of a debtor-creditor relationship are not in evidence in Central Capital's articles. The agreements between the parties contain no express provisions that the redemption of the shares is in repayment of a loan. The corporation was not obliged to create any fund or debt instrument to ensure that it could redeem the shares on the retraction date. There is no indemnity in the event that the money is not repaid on the retraction date. There is no provision for the payment of any interest after the retraction date in the event that the money is not repaid on the retraction date. There is no provision that after the retraction date and in the event of insolvency, the appellants would have the right to have the company wound up. (See *Imperial General Properties Ltd. v. R.*, *(*sub nom. *R. v. Imperial General Properties Ltd.)* [1985] 2 S.C.R. 288, for a case where the articles of the company contained this right.) There is no provision that upon a winding up or insolvency the parties are entitled to rank *pari passu* with the creditors as was the case in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank, supra*.

(d) The effect of the reorganization

88 Finlayson J.A. is of the view that it is immaterial that the articles provide, in the event of the liquidation, dissolution or winding-up of the company, that the appellants are only entitled to rank after the creditors but ahead of the junior ranking shareholders. In his view, this provision is irrelevant because we are not dealing with a liquidation but with a reorganization. He finds it significant that, like debtors, the preferred shareholders are not entitled to participate in any surplus once they have been paid. I am of the view that this provision in the articles is significant. It represents a clear indication that the holders of the retractable shares were not to be dealt with on the same footing as ordinary creditors even after the retraction date. Instead, they were to be dealt with as shareholders, albeit an elevated class. Under the *CBCA* all shares carry equal rights. Words used in the articles to differentiate a class of shares are nothing more than authorized deviations from this statutory position of equality: Welling, *supra*, at p. 683.

89 The appellants submit that a winding-up or liquidation is not the same as a reorganization. This is true. Both, however, are methods of dealing with insolvency. Both are methods for secured creditors to enforce their claims by seizing

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the assets in which they hold security interests. If the value of the corporation as a going concern exceeds the liquidation value of the assets, it is in the interest of all the debt holders that the corporation be preserved as a going concern. The purpose of both a liquidation and a reorganization is to permit the rehabilitation of the insolvent person unfettered by debt: *Vachon v. Canada (Employment & Immigration Commission)*, [1985] 2 S.C.R. 417. By virtue of s. 20 of the *CCAA*, arrangements under the Act mesh with the reorganization provisions of the *CBCA* so as to affect the company's relations with its shareholders. Shareholders have no right to dissent to a reorganization: s. 191(7), *CBCA*. On a reorganization, among other things, the articles may be amended to alter or remove rights and privileges attaching to a class of shares and to create new classes of shares: s. 173, *CBCA*. These statutory provisions provide a clear indication that, on a reorganization, the interests of all shareholders, including shareholders with a right of redemption, are subordinated to the interests of the creditors. Where the debts exceed the assets of the company, a sound commercial result militates in favour of resolving this problem in a manner that allows creditors to obtain repayment of their debt in the manner which is most advantageous to them.

90 The similarities between a liquidation and a reorganization, together with the express statement in the articles of Central Capital with respect to what is to happen on a winding-up, dictate that the interests of the holders of retractable shares, McCutcheon and SYH, are subordinated to the creditors and they are not entitled to claim under the *CCAA* equally with the creditors. This position is also consistent with the provisions of the *Bankruptcy and Insolvency Act* and the *Winding-up Act*. In the case of an insolvency where the debts to creditors clearly exceed the assets of the company, the policy of federal insolvency legislation appears to be clear that shareholders do not have the right to look to the assets of the corporation until the creditors have been paid.

Dividends

91 Although dividends were payable on the shares of McCutcheon and SYH, no dividends were in fact declared. The appellants contend that the dividends, which have accrued but which were not declared, are a debt or liability because they were stipulated to be part of the retraction price.

92 Article 7 of Central Capital respecting McCutcheon's shares states that in the event of liquidation, dissolution or winding up of the corporation, the shareholders are entitled to receive not only the $25 per Series B preferred share, but "all accrued and unpaid dividends thereon, whether or not declared ... before any amount is paid by the Corporation or any assets of the Corporation are distributed to the holders of any shares ... ranking as to capital junior to the Series B Senior preferred Shares."

93 It is trite law that a dividend may only be declared if a company is solvent. For corporations governed by the *CBCA*, it appears that the common law tests for solvency have all been subsumed or overruled: *McClurg v. Minister of National Revenue*, *(*sub nom. *R. v. McClurg)* [1991] 2 W.W.R. 244 (S.C.C.) at 259, 260.

94 Section 42 of the *CBCA* provides:

> A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.

95 Section 42 prevents the corporation from declaring or paying a dividend when it does not meet certain solvency requirements. There was no declaration of a dividend in the present case. Any obligation to pay a dividend as part of the retraction price cannot therefore be enforced when the company is insolvent. Dividends which have accrued but which are unpaid are not considered to be a debt because, on reading the articles as a whole, the provision for payment is not one which is made independant of the ability to pay: see Welling, *supra*, at p. 689, citing *Porto Rico Power Co., Re*, [1946] S.C.R. 178 (S.C.C.), where it was held there was no guarantee of payment and hence the accrued but unpaid dividends

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were not a debt. Instead, accrued but unpaid dividends are considered to be akin to a return of capital. Making these accrued dividends part of the retraction price does not alter this.

96 By way of analogy to the treatment of dividends, it could be said that until the company has declared it will redeem the shares which are tendered to it the obligation to redeem them is not a debt or liability. The promise to pay in the articles of Central Capital is not made independent of any ability to pay.

97 In the event that I am wrong in my conclusion that the true nature of the relationship is one of equity, I shall now consider the position in the event that a debt has been created.

3. If the nature of the relationship is not an equity relationship are the appellants entitled to be claimants under the CCAA.?

98 The parties agree that the effect of s. 36 renders the agreement to redeem their preferred shares unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish Central Capital's obligation to repay them. Their position is that Central Capital's obligation to repay them is a contingent liability and therefore gives them a claim provable in bankruptcy, bringing them under s. 12(1) of the *CCAA*.

The Meaning of Debt

99 Debt is defined in a very broad manner in *Black's Law Dictionary*, 6th ed. (1990) at p. 403. It is the position of the appellants that this definition of "debt" is broad enough to include McCutcheon's right to have Central Capital redeem his shares. In the case of SYH, it is submitted that the right to redemption constitutes a future liability. It is the appellants' position that Feldman J. erred in holding that to have a provable claim, McCutcheon and Central Capital must be able to obtain a judgment against Central Capital for the retraction price and be entitled to seek payment on the judgment. Finlayson J.A. agrees with the appellant's position.

100 Debt is defined in *Black's Law Dictionary, supra*, as:

> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only obligation of debtor to pay but right of creditor to receive and enforce payment.
>
> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future. In a still more general sense, that which is due from one person to another, whether money, goods, or services. In a broad sense, any duty to respond to another in money, labour, or service; it may be even a moral or honorary obligation, unenforceable by legal action. Also, sometimes an aggregate of separate debts, or the total sum of the existing claims against person or company. Thus we speak of the "national debt", the "bonded debt" of a corporation, etc.

101 It will be readily apparent that in *Black's* the term "debt" is defined in two distinct ways. In order to constitute a debt as defined in the first paragraph, the obligation must be enforceable. In the second paragraph debt is defined more broadly as any duty or obligation even if unenforceable by legal action. Feldman J. considered the first portion of the definition in her reasons. If the first portion of the definition applies, no debt is created because the obligation is not enforceable under the *CBCA*. The appellants rely on the second portion of the definition. They also rely on the definition of of the word "liability" in *Black's* which is also defined very broadly.

102 In one sense, support for the position of the appellants is found in s. 40 of the *CBCA*. Section 40 states that a contract with a corporation providing for the purchase of shares of the corporation is specifically enforceable against the corporation except to the extent that the corporation cannot perform the contract without being in breach of ss. 34 or 35. Section 34 contains the solvency requirements concerning the redemption by a company of its own shares other than those carrying a right of redemption. Section 35 deals with shares which have been issued to settle or compromise a debt. In s. 2, "liability" is defined as including "a *debt* of a corporation arising under section 40 ... ."

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103 Section 40 does not include any reference to the obligation of a company to repurchase redeemable shares under s. 36. As a result s. 36 is not incorporated by reference into the definition of liability. While it might be suggested that this is a legislative oversight, the omission is also consistent with the position that only the articles of the corporation govern the relationships between the company and the holders of the retractable shares under s. 36. I have already stated my opinion that the articles of Central Capital do not make the obligation to redeem the shares a debt or, for that matter, a liability. Moreover, even if a provision like s. 40 is implied with respect to redeemable preferred shares, it would also be necessary to imply a provision like s. 40(3) which states that in the event of liquidation where the company has not performed its contract to redeem, the other party is entitled to be ranked subordinate to the rights of creditors but in priority to the shareholders. This is a clear expression of legislative intention that on insolvency the claim of those entitled to have their shares redeemed should not be placed on the same footing with the claims of creditors but should rank subordinate to them: see *Nelson v. Rentown Enterprises Inc.*, [1994] 4 W.W.R. 579 (Alta. C.A.), adopting the reasons of Hunt J. at (1992), 96 D.L.R. (4th) 586 (Alta. Q.B.). Policy reasons would again militate in favour of the result being the same on a reorganization.

Claims in Bankruptcy

104 Even if the broader definitions of a debt or liability in *Black's* are adopted, the appellants still do not have a claim provable in bankruptcy.

105 Persuasive authority already exists to the effect that in order to be a provable claim within the meaning of s. 121 of the *Bankruptcy and Insolvency Act* the claim must be one recoverable by legal process: *Farm Credit Corp. v. Holowach (Trustee of)*, [1988] 5 W.W.R. 87 (Alta. C.A.) at 90, leave to appeal to the Supreme Court of Canada dismissed at [1989] 4 W.W.R. lxx (note).

106 In *Holowach*, the seven members of the court were dealing with a situation in which some persons borrowed money from a mortgagee and mortgaged certain lands as security for repayment of the loan. The mortgagors then made an assignment in bankruptcy. The mortgagee filed a proof of claim for the full amount of the deficiency, that is, the amount of the indebtedness less the value of the land which the mortgagee was permitted to purchase. The Alberta *Law of Property Act*, R.S.A. 1980, c. L-8, precluded deficiency claims against individuals in foreclosure actions, although the effect of the legislation was not to extinguish or satisfy the debt. The mortgagee argued that it had a claim provable in bankruptcy under s. 95(1), now s. 121(1), of the *Bankruptcy and Insolvency Act*. The court rejected this argument, holding that a provable claim must be one recoverable by legal process. In coming to its conclusion, the court relied on *Reference re Debt Adjustment Act, 1937 (Alberta)*, [1943] 1 All E.R. 240 (P.C.), and a number of decisions at the trial level which are collected at p. 91 of the decision.

107 Here, the contract to repurchase the shares, while perfectly valid, is without effect to the extent that there is a conflict between the corporation's promise to redeem the shares and its statutory obligation under s. 36 of the *CBCA* not to reduce its capital where it is insolvent. As was the case in the *Holowach* decision, this statutory overlay renders Central Capital's promise to redeem the appellants' preferred shares unenforceable. Although there is a right to receive payment, the effect of the solvency provision of the *CBCA* means that there is no right to enforce payment. Inasmuch as there is no right to enforce payment, the promise is not one which can be proved as a claim.

108 It could be suggested that the decision in *Holowach* can be distinguished from the instant case on the basis that in *Holowach* the claim is made unenforceable forever by statute whereas under the *CCAA* the claim is unenforceable only so long as the corporation does not meet the solvency requirements of s. 36 of the *CBCA*. I do not believe this is a valid distinction for three reasons. First, the relevant date for determining any contingent liability is not the future but the past, namely, September 8, 1992, the date by which proofs of claim had to be submitted. On that date, Central Capital was insolvent. Second, it is only because the lenders were willing to convert their debt obligations into equity in the reorganization that Central Capital is now solvent. Central Capital is not the same company and its liabilities are not the same. The redeemable shares no longer exist. Third, in order to be profitable, the assets of a company must be

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managed. Any value in the assets after the insolvency of the company is, in this case, due to the new management and not to the preferred shareholders extending credit to the company by having their claim for redemption postponed.

109 Even if Central Capital's obligation to redeem the shares of the appellants created a debt or liability, the appellants do not have a claim provable within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*.

Conclusion

110 I would dismiss the appeal. For the reasons I have given, the retraction amounts do not constitute a debt or liability within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*. Even if I am wrong in my conclusion and a debt or liability is created, it is not a claim within the meaning of the *CCAA*. This is a case of first impression. For these reasons, I would not award any costs of this appeal.

***Laskin J.A.* (concurring):**

111 I have read the reasons of my colleagues Justice Finlayson and Justice Weiler. Like Justice Weiler, I would affirm the decision of the motions judge, Feldman J., and dismiss these appeals. I prefer, however, to state my own reasons for upholding the position of the unsecured creditors of Central Capital Corporation.

The Issue

112 The application was argued before Madam Justice Feldman on an agreed statement of facts. My colleagues have summarized the relevant facts and important provisions of the documents. Each appellant holds preferred shares of Central Capital and each appellant's shares contain a right of retraction — a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. The retraction date for the appellants James McCutcheon and Central Guarantee Trust Company (collectively McCutcheon) was July 1, 1992, and before that date McCutcheon exercised his right of retraction and tendered his shares for redemption. The retraction date for the appellant S.Y.H. Corporation was September 1994 and although it could not render its shares for redemption, it did file a proof of claim with the Administrator of Central Capital. The Administrator disallowed each appellant's claim and Feldman J. dismissed appeals from the Administrator's decisions.

113 The issue on these appeals is whether McCutcheon and S.Y.H. Corporation "have claims provable against Central Capital Corporation within the meaning of the *Bankruptcy Act (Canada)* as amended as of the date of the Restated Subscription and Escrow Agreement." Under the *Bankruptcy Act*, R.S.C. 1985, c. B-3, s. 2, a claim provable "includes any claim or liability provable in proceedings under this Act by a creditor" and a creditor "means a person having a claim, preferred, secured or unsecured, provable as a claim under this Act." Section 121(1) of the *Bankruptcy Act* further defines claims provable as follows:

> *121.* (1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation incurred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

114 The date of the Restated Subscription and Escrow Agreement is May 1992. [1] By then, and indeed since December 1991, Central Capital had been insolvent and therefore was prohibited by s. 36(2) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, from making any payment to redeem the appellants' shares.

115 On June 15, 1992, Houlden J. provided that Central Capital could be reorganized under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 and he stayed proceedings against it. Houlden J.'s order of July 9, 1992, which approved the restructuring of Central Capital, was made without prejudice to the right of the appellants to assert claims as creditors. Thus the question for this court is whether the appellants' retraction rights created debts of Central Capital in May, 1992. In other words were McCutcheon and S.Y.H. Corporation creditors of Central Capital in May, 1992? If they were creditors, then like the other unsecured creditors of Central Capital, they can elect to take shares in the newly

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incorporated company, Canadian Insurance Group Limited; if they were not creditors, then they remain shareholders of Central Capital under the restructuring plan.

116 This is a question of characterization. I will address the question first, by considering the "substance" of the relationship between each appellant and the company; and second by considering s. 36(2) of the *Canada Business Corporations Act, supra*. In brief I conclude:

(1) Although the relationship between each appellant and the company has characteristics of debt and equity, in substance both McCutcheon and S.Y.H. Corporation are shareholders, not creditors of Central Capital. Neither the existence of their retraction rights nor the exercise of those rights converts them into creditors;

(2) Finding that the appellants were creditors of Central Capital would defeat the purpose of s. 36(2) of the statute.

I. The Relationship between the Appellants and Central Capital

117 Preferred shares have been called "compromise securities" and even "financial mongrels": Grover and Ross, *Materials and Corporate Finance* (1975), at p. 49. Invariably the conditions attaching to preferred shares contain attributes of equity and, at least in an economic sense, attributes of debt. Over the years financiers and corporate lawyers have blurred the distinction between equity and debt by endowing preferred shareholders with rights analogous to the rights of creditors. One example is the right of redemption — the right of the corporation to compel preferred shareholders to sell their shares back to the corporation. Another example, and it is the case before us, is the right of retraction — the right of shareholders to compel the corporation to buy back their shares on a specific date for a specific price.

118 I acknowledge, therefore, that redeemable or retractable preferred shares are somewhat different from conventional equity capital. What makes the appeals before us difficult is that although the appellants appear to hold equity, their right of retraction appears to be a basic characteristic of a debtor-creditor relationship. See Grover and Ross, *supra*, at pp. 47-49; Buckley, Gillen and Yalden, *Corporations: Principles and Policies*, 3rd ed. (1995), at pp. 938-940.

119 If the certificate or instrument contains features of both equity and debt — in other words if it is hybrid in character — then the Court must determine the "substance" of the relationship between the holder of the certificate and the company. This is the lesson of Justice Iacobucci's judgment in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In that case the Supreme Court of Canada had to determine whether the financial assistance given by several lending institutions to try to rescue the Canadian Commercial Bank was "in the nature of a loan" or "in the nature of a capital investment." Justice Iacobucci discussed his approach to the problem at pp. 590-591 of his judgment:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction.

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> When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

120 In determining the substance of the relationship, as in any other case of contract interpretation, the court looks to what the parties intended. In *CDIC v. CCB, supra*, Iacobucci J. put this proposition as follows at p. 588:

> As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

121 In these appeals what the parties intended is reflected mainly in the share purchase agreements and the conditions attaching to the appellants' shares, but also in the articles of incorporation and in the way Central Capital recorded the appellants' shares in its financial statements. These documents indicate that in substance the appellants are shareholders of Central Capital, not creditors. I rely on the following considerations to support my conclusion:

122 (i) Both appellants agreed to take preferred shares instead of some other instrument — for example, a bond or debenture — that would obviously have made them creditors. The appellant McCutcheon sold shares of one corporation (Canadian General Securities Limited) for cash and for shares of another corporation (Central Capital). Neither the share purchase agreements nor the share conditions support McCutcheon's contention that in taking preferred shares he was extending credit to Central Capital by deferring payment of the purchase price. He made an investment in the capital of Central Capital, no doubt because of the attractive dividend rate, the income tax advantages of preferred shares and "sweeteners" such as conversion privileges. Unlike Finlayson J.A., I place little weight on what he termed "the unique nature of the transaction". McCutcheon transferred assets to acquire his preferred shares rather than acquiring them with cash. But he nonetheless decided to invest in Central Capital and to take the risk and the profits (through dividends) of his investment.

123 Similarly, S.Y.H. Corporation exchanged its equity investment in four insurance companies for an equity investment in Central Capital. It too chose equity not debt. None of the contractual documents indicates that the appellants' retraction rights were intended to trigger an obligation on the part of Central Capital to repay a loan. Moreover, as Weiler J.A. points out, neither the share purchase agreements nor the share conditions provides for interest if Central Capital fails to honour its retraction obligations.

124 (ii) The senior preferred shares and junior preferred shares that the appellants own were part of the authorized capital of Central Capital before the appellants acquired them.

125 (iii) The appellants' shares were recorded in the financial statements of Central Capital as "capital stock," along with the company's issued and outstanding common shares, class "A" shares and warrants. The amount Central Capital might be obligated to pay the appellants if they exercised their retraction rights was not recorded as debt (even contingent debt) in the company's financial statements.

126 (iv) Both appellants had the right to receive dividends on their shares and McCutcheon had the right to vote his shares for the election of directors of Central Capital if dividends remained unpaid for a specified time. These rights — to receive dividends and to vote — are well recognized rights of shareholders. And these rights continue, even after the retraction dates, until the appellants' shares are redeemed.

127 (v) The preferred share conditions provide that on a liquidation, dissolution or winding up, the holders rank with other shareholders and therefore, implicitly, behind creditors. The appellant McCutcheon, who holds senior preferred shares, would rank behind creditors but ahead of the holders of subordinate classes of shares; the appellant S.Y.H. Corporation, which holds junior preferred shares, would rank behind senior preferred shareholders but ahead of common shareholders.

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128 These provisions in the preferred share conditions also state that on payment of the amount owing to them the appellants "shall not be entitled to share in any further distribution of assets of the corporation." Finlayson J.A. interprets this to mean that the appellants "are not entitled to be treated as shareholders under a winding up or a liquidation but only as creditors." I disagree. These are typical preferred share provisions, which limit the recovery of the holders but do not treat them as creditors: *Sutherland et al., Fraser & Stewart Company Law of Canada*, 6th ed. (1993), at p. 198. At least on a liquidation, dissolution or winding up, the preferred share conditions evidence that the appellants would be treated not as creditors but as shareholders. In *CDIC v. CCB, supra*, Iacobucci J. placed considerable weight on a provision in the Participation Agreement stating that each participant "shall rank *pari passu* with the rights of the depositors." No such provision exists in this case. Indeed the share conditions I have referred to state the opposite.

129 Of course, Central Capital was reorganized, not liquidated, dissolved or wound up and the preferred share conditions are silent about what occurs on a reorganization. Still these conditions shed light on what the parties intended on the reorganization. Section 12(1) of the *Companies' Creditors Arrangement Act, supra*, defines claim as "any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy Act*." The question the court has been asked to answer is the same question that would arise on a liquidation. It is illogical to conclude that the appellants could claim only as shareholders on a liquidation and yet can claim as creditors on the reorganization. Whether Central Capital's financial difficulties led to a liquidation or a reorganization, the issue is the same and the analysis and the result should also be the same.

130 The appellants argue, however, that they are shareholders only until they exercise their retraction rights but once they exercise these rights they become creditors. I do not agree with this argument. The share conditions provide that even after exercising their retraction rights, the appellants continue to be entitled to dividends and to vote until their shares are redeemed. In other words, they continue to enjoy the rights of shareholders. Moreover, if when the appellants exercised their retraction rights the company were insolvent and were to be subsequently liquidated (or dissolved or wound up), the appellants would rank as shareholders on the liquidation. And as I have indicated above the result should be no different on the reorganization.

131 It seems to me that these appellants must be either shareholders or creditors. Except for declared dividends, they cannot be both. Once they are characterized as shareholders, their rights of retraction do not create a debtor-creditor relationship. These rights enable them to call for the repayment of their capital on a specific date (and at an agreed upon price) provided the company is solvent. Ordinarily shareholders have to recoup their investment by selling their shares to third parties. If they have retraction rights, however, they can compel the company (if solvent) to repay their investment at a given time for a given price. But the right of retraction provides for the return of capital not for the repayment of a loan. Certainly the *Canada Business Corporations Act* treats a redemption of shares as a return of capital because s. 39 of the statute requires a company on a redemption to deduct from its stated capital account an amount equal to the value of the shares redeemed. The shares redeemed are then either cancelled or returned to the status of authorized but unissued shares.

132 Putting it differently, a preferred shareholder exercising a right of retraction on the terms that exist here must rank behind the company's creditors. Grover and Ross make this point more generally in their *Materials and Corporate Finance, supra*, at pp. 48-49:

> On the other hand, the company cannot issue "secured" preferred shares in the sense that shares cannot have a right to a return of capital which is equal or superior to the rights of creditors. Preferred shareholders are risk-takers who are required to invest capital in the business and who can look only to what is left after creditors are fully provided for. Thus, in the absence of statutory authorization, the claims of shareholders cannot be secured by a lien on the corporate assets. They rank behind creditors but before com mon shareholders (if specified) on a voluntary or involuntary dissolution of the company.

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133 Admittedly there is little authority in Canada on the issue confronting this court. Some of the cases that the respondent relies on — for example, *Re Patricia Appliance Shops Ltd.* (1922), [1923] 3 D.L.R. 1160 (Ont. S.C.), *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 63 C.B.R. (N.S.) 76 (B.C. C.A.), and even *Re Meade (Debtor); Ex parte Humber v. Palmer (Trustee)* [1951], 2 All E.R. 168 (P.C.) — are of limited assistance because the shareholders in those cases did not have retraction rights.

134 Perhaps the closest case — and the appellants rely heavily on it — is the judgment of the British Columbia Court of Appeal in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1. In that case a majority of the court (Craig J.A. dissenting) held that a withdrawing member of a co-operative association who elected to have his shares redeemed in instalments over a five-year period should be treated on the subsequent bankruptcy of the association as an ordinary creditor rather than as a shareholder. I decline to apply *East Chilliwack* for three reasons. First, because the case was decided in 1989, the British Columbia Court of Appeal did not have the benefit of the Supreme Court of Canada's reasons in *CDIC v. CCB, supra*. In *East Chilliwack* Hutcheon J.A., writing for the majority did not focus on what the parties intended when the member contracted with the co-operative. Instead he only considered the relationship between the member and the co-operative after the member had withdrawn. I do not think his approach is consistent with Justice Iacobucci's judgment in *CDIC v. CCB, supra*.

135 Second, there are important factual differences between *East Chilliwack* and the appeals before us. Justice Weiler has referred to these factual differences in her reasons. The most important of these differences are the following: in *East Chilliwack* the rules of the association provided that a member had to withdraw from the association to trigger the right of redemption, whereas the appellants' share conditions provide that they continue to be shareholders of Central Capital until their shares are redeemed; in *East Chilliwack* the member elected to withdraw and redeem his shares when the association was solvent whereas when the appellant McCutcheon exercised his right of retraction Central Capital was insolvent; and in *East Chilliwack* Hutcheon J.A. expressly stated that he was not considering the effect of the superintendent's power to suspend payments if the financial position of the co-operative was impaired, whereas the effect of the statutory prohibition against Central Capital making payment, found in s. 36(2) of the *Canada Business Corporations Act*, is in issue in these appeals.

136 Third, the decision in *East Chilliwack* is at odds with most of the American case law and I favour the American approach. When a company repurchases shares by instalment and bankruptcy intervenes, the prevailing American position is that the shareholder's claim is deferred to the claims of ordinary creditors. The decision of the Fifth Circuit Court of Appeals in *Robinson v. Wangemann*, 75 F.2d 756 (Tex. 1935) is frequently cited. The facts of that case are virtually identical to the facts in *East Chilliwack*. A company had agreed to repurchase a stockholder's stock by instalments. Although the company was solvent when the agreement was made it went bankrupt before the repurchase was completed. The stockholder sought to prove as an ordinary creditor for the unpaid purchase price. Foster, Circuit Judge, writing for a unanimous court rejected the stockholder's claim at p. 757:

> A transaction by which a corporation acquires its own stock from a stockholder for a sum of money is not really a sale. The corporation does not acquire anything of value equivalent to the depletion of its assets, if the stock is held in the treasury, as in this case. It is simply a method of distributing a proportion of the assets to the stockholder. The assets of a corporation are the common pledge of its creditors, and stockholders are not entitled to receive any part of them unless creditors are paid in full. When such a transaction is had, regardless of the good faith of the parties, it is essential to its validity that there be sufficient surplus to retire the stock, without prejudice to creditors, at the time payment is made out of assets.

137 At the heart of *Robinson v. Wangemann* is the finding that the selling stockholder is not a creditor in the sense of a person who loans money to a corporation, and therefore is not entitled to parity with the general creditors. The principle in *Robinson v. Wangemann* seeks to protect creditors by refusing to permit selling stockholders, who were risk investors, to withdraw their capital on the same terms as general creditors in the event of insolvency. Section 40(3) of the *Canada Business Corporations Act* — a section to which I shall return when considering s. 36(2) of the same statute — codifies the

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principle in *Robinson v. Wangemann* for share repurchases, though not for share redemptions. See also Blumberg, *The Law of Corporate Groups* (1989), at pp. 205-210 and see *contra Wolff v. Heidritter Lumber Co.*, 163 A. 140 (N.J. Ch. 1932).

138 Quite apart from the instalment purchase price cases, American courts have often grappled with the question whether preferred stockholders can claim as creditors of the corporation. Although there are cases going both ways, most appear to come to the same conclusion as I do. The American cases are collected in Bjor and Solheim, *Fletcher Cyclopedia of the Law of Private Corporations* (1995), revised vol. 11 and in Bjor and Reinholtz, *Fletcher Cyclopedia of the Law of Private Corporations* (1990), revised vol. 15A. In volume 11 the authors of the text indicate — as did the Supreme Court of Canada in *CDIC v. CCB* — that "[w]hether or not the holder of a particular instrument or certificate is to be regarded as a shareholder or a creditor is a question of interpretation, and depends on the terms of the contract as evidenced by the instrument, the articles of incorporation, and the statutes of the state. The nature of the transaction is to be determined by the real substance and effect of the contract rather than by the name given to the obligations or its form ..." (at p. 566).

139 And in volume 15A the authors state at pp. 290 and 292 that even the arrival of a fixed redemption date does not change a preferred stockholder into a creditor:

> Holders of preferred stock of a corporation, in the absence of express provision to the contrary, are stockholders and not creditors of the corporation, except for dividends declared. They have no lien upon, and are not entitled to, any of the assets of the corporation when it becomes insolvent, until all debts are paid. Furthermore, there is authority that the status of a preferred stockholder is not changed to that of creditor, even though a dividend is guaranteed. Indeed it is beyond the power of a corporation to issue a class of stock, the holders of which are entitled to preference over general creditors.
>
> . . . . .
>
> Even where preferred stock has a fixed redemption date, arrival of that date does not change the status of a preferred stockholder to that of a creditor. (pp. 290, 292)

140 I agree with these statements. I therefore conclude first that the appellants, in substance, were shareholders of Central Capital not creditors; and second that neither the existence nor the exercise of their retraction rights turned them into creditors.

II. Provable Claims and Section 36(2) of the Canada Business Corporations Act

141 In May 1992 Central Capital was insolvent. It was unable to pay its liabilities as they became due and the realizable value of its assets was less than the aggregate of its liabilities. Because it was insolvent it was prohibited by s. 36(2) of the *Canada Business Corporations Act* from redeeming the appellants' shares. Section 36(2) of the statute provides:

> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

142 As well, the appellants' share conditions provide that they are not permitted to redeem their shares if to do so would be "contrary to applicable law," in this case s. 36(2) of the statute.

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143 To hold that the appellants have provable claims would defeat the purpose of s. 36(2) of the *Canada Business Corporations Act*. At common law a company could not repurchase its own shares on the open market or in the language of *Trevor v. Whitworth* (1887), 12 App. Cas. 409 (H.L.), a company could not "traffick in its own shares." The obvious reason was to prevent companies from using their assets to destroy the claims of their creditors. Modern corporate statutes, such as the *Canada Business Corporations Act*, modified the rule in *Trevor v. Whitworth* to permit repurchases provided the company's creditors would not be prejudiced. Thus the legislation insisted that the company could not repurchase its own shares unless it satisfied stated solvency tests. And so, s. 34(2) of the *Canada Business Corporations Act* provides:

> (2) A corporation shall not make any payment to purchase or otherwise acquire shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of its liabilities and stated capital of all classes.

144 In *Nelson v. Rentown Enterprises Inc.* (1992), 96 D.L.R. (4th) 586 (Alta. Q.B.), affirmed (1994), 109 D.L.R. (4th) 608 (Alta. C.A.), Hunt J. of the Alberta Queen's Bench wrote at p. 589:

> The policy behind the s. 34(2) limitation upon a corporation's power to purchase its own shares seems obvious. It is intended to ensure that one or more shareholders in a corporation do not recoup their investments to the detriment of creditors and other shareholders. It has been observed that:
>
> > Corporate power to purchase its own stock has been frequently abused. Done by corporations conducting faltering businesses, it has been employed to create preferences to the detriment of creditors and of the other stockholders.
>
> *(Mountain State Steel Foundries, Inc. v. C.I.R., supra, at p. 741* [284 F.2d 737 (1960)].*)*
>
> Modern business statues permit these share purchases to take place provided that the position of creditors and other shareholders is protected, by virtue of the application of the s. 34(2) tests.

145 Redemptions of preferred shares, unlike repurchases, were always permitted at common law as long as they were not made in contemplation of bankruptcy. But the solvency test in s. 36(2) of the *Canada Business Corporations Act* has the same purpose as the solvency test in s. 34(2): to prevent redemptions if they would allow the company to prejudice the claims of creditors. See Buckley *et al., Corporations: Principles and Policies, supra*, at pp. 968-71. To hold that the appellants' retraction rights gave rise to provable claims in the face of s. 36(2), thereby allowing the appellants to rank equally with the unsecured creditors, would undermine the purpose of the section. If a claim in a bankruptcy or reorganization proceeding is unenforceable under the statute, the claim is not entitled to recognition on a parity with the claims of unsecured creditors: See *Blumberg, supra*, at pp. 205-6; and *Farm Credit Corp. v. Holowach (Trustee of)* (1988), 68 C.B.R. (N.S.) 255 (Alta. C.A.).

146 I draw comfort in this conclusion from s. 40 of the *Canada Business Corporations Act*. Section 40(1) provides that a contract with a corporation for the purchase of its shares is specifically enforceable against the corporation "except to the extent that the corporation cannot perform the contract without thereby being in breach of section 34 ..." Section 40(3) then states:

> (3) Until the corporation has fully performed a contract referred to in subsection (1), the other party retains the status of a claimant entitled to be paid as soon as the corporation is lawfully able to do so or, in a liquidation, to be ranked subordinate to the rights of creditors but in priority to the shareholders.

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147 In other words, the section recognizes that if a company contracts to repurchase its shares but is prohibited from doing so because it is insolvent, the vendor of the shares is not a creditor and on a liquidation ranks subordinate to the rights of creditors. The shareholder cannot be repaid at the expense of the company's creditors. Although s. 40 does not expressly apply to s. 36, I think that the rationale for s. 40(3) applies to redemptions as well as to repurchases. Whether a repurchase or a redemption, the shareholder is not a creditor and is subordinate to the rights of creditors. More simply the shareholder does not have a provable claim.

148 The appellants rely on *National Bank für Deutschland v. Blucher*, *(*sub nom. *Blucher v. Canada (Custodian))* [1927] 3 D.L.R. 40 (S.C.C.), but in my view this case does not assist them. In *Blucher* dividends were declared on stock but payment of the dividends was suspended during World War I. The Supreme Court of Canada held at p. 43 that "[t]he right of recovery was in suspense during the war, but the debt nevertheless existed." In that case, however, the dividend was declared before the suspension of payment took place. Moreover, as Justice Finlayson points out in his reasons, courts have always accepted the proposition that when a dividend is declared it is a debt on which each shareholder can sue the corporation.

149 Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies. Permitting preferred shareholders to be turned into creditors by endowing their shares with retraction rights runs contrary to this policy of creditor protection.

150 I would dismiss these appeals. I would not make any cost order. I am grateful to all counsel for their assistance on this interesting and difficult problem.

Appeals dismissed.

Footnotes

1 There is a discrepancy in the materials before this court on the relevant date for establishing a claim provable against Central Capital: S.Y.H. Corporation used May, 1992, the date of the Restated Subscription and Escrow Agreement whereas McCutcheon and the unsecured creditors of Central Capital Corporation used June 15, 1992, the date of the court-ordered stay of proceedings against Central Capital. I have used the May 1992 date but nothing turns on the use of this date as opposed to the June 15, 1992 date.

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2014 ONSC 5274
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2014 CarswellOnt 11369, 2014 ONSC 5274, 244 A.C.W.S. (3d) 10

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Newbould J.

Heard: July 25, 2014
Judgment: September 11, 2014
Docket: 09-CL-7950

Counsel: Benjamin Zarnett, Graham Smith, for Monitor and Canadian Debtors
Ken Rosenberg, for Canadian Creditors' Committee
Michael Barrack, D.J. Miller, Michael Shakra, for UK Pension Claimants
Tracy Wynne, for EMEA Debtors
Kenneth Kraft, for Wilmington Trust, National Association
Richard Swan, Gavin Finlayson, Kevin Zych, for Ad Hoc Group of Bondholders
Shayne Kukulowicz, for US Unsecured Creditors' Committee
John D. Marshall, for Law Debenture Trust Company of New York
Brett Harrison, for Bank of New York Mellon
Andrew Gray, Scott Bomhof, for US Debtors

Subject: Insolvency

CLAIM by bondholders for post-filing interest against an insolvent estate under *Companies' Creditors Arrangement Act*.

***Newbould J.*:**

1 Nortel Networks Corporation ("NNC") and other Canadian debtors filed for and were granted protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. c-36, ("CCAA") on January 14, 2009. On the same date, Nortel Network Inc. ("NNI") and other US debtors filed petitions in Delaware under the United States Bankruptcy Code, 11 U.S.C., Chapter 11.

2 Beginning in 1996, unsecured *pari passu* notes were issued under three separate bond indentures, first by a US Nortel corporation guaranteed by Nortel Networks Limited ("NNL"), a Canadian corporation, and then by NNL in several tranches jointly and severally guaranteed by NNC and NNI (the "crossover bonds"). Thus all of the notes are payable by Nortel entities in both Canada and the US, either as the maker or guarantor. Under claims procedures in both the Canadian and US proceedings, claims by bondholders for principal and pre-filing interest in the amount of US $4.092 billion have been made against each of the Canadian and US estates. The bondholders also claim to be entitled to post-filing interest and related claims under the terms of the bonds which, as of December 31, 2013, amounted to approximately US$1.6 billion.

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3 The total assets realized on the sale of Nortel assets worldwide which are the subject of the allocation proceedings amongst the Canadian, US, and European, Middle East and African estates ("EMEA") are approximately US$7.3 billion, and thus the post-filing bond interest claims of now more than US$1.6 billion represent a substantial portion of the total assets available to all three estates. While the post-filing bond interest grows at various compounded rates under the terms of the bonds, the US$7.3 billion is apparently not growing at any appreciable rate because of the very conservative nature of the investments made with it pending the outcome of the insolvency proceedings. Apart from the bondholders, the main claimants against the Canadian debtors are Nortel disabled employees, former employees and retirees.

4 The bond claims in the Canadian proceedings have been filed pursuant to a claims procedure order in the CCAA proceedings dated July 30, 2009. The order contemplated that the claims filed under it would be finally determined in accordance with further procedures to be authorized, including by a further claims resolution order. By order dated September 16, 2010, a further order was made in the CCAA proceedings that authorized procedures to determine claims for all purposes.

5 By direction of June 24, 2014, it was ordered that the following issues be argued:

(a) whether the holders of the crossover bond claims are legally entitled in each jurisdiction to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest (namely, above and beyond US$4.092 billion); and

(b) if it is determined that the crossover bondholders are so entitled, what additional amounts are such holders entitled to so claim and receive.

6 The hearing in the US Bankruptcy Court was scheduled to proceed at the same time as the hearing in this Court but was adjourned due to an apparent settlement between the US Debtors and certain bondholders.

7 The Monitor and Canadian debtors, supported by the Canadian Creditors' Committee, the UK Pension Claimants, the EMEA debtors, and the Wilmington Trust take the position that in a liquidating CCAA proceeding such as this, post-filing interest is not legally payable on the crossover bonds as a result of the "interest stops" rule. The Ad Hoc Group of Bondholders, supported by the US Unsecured Creditors' Committee, Law Debenture Trust Company of New York and Bank of New York Mellon take the position that there is no "interest stops" rule in CCAA proceedings and that the right to interest on the crossover bonds is not lost on the filing of CCAA proceedings and can be the subject of negotiations regarding a CCAA plan of reorganization. They take the position that no distribution of Nortel's sale proceeds that fails to recognize the full amount of the crossover bondholders' claims, including post-filing interest, can be ordered under the CCAA except under a negotiated CCAA plan duly approved by the requisite majorities of creditors and sanctioned by the court.

8 For the reasons that follow, I accept the position and hold that post-filing interest is not legally payable on the crossover bonds in this case.

The interest stops rule

9 In this case, the bondholders have a contractual right to interest. The other major claimants, being pensioners, do not. The Canadian debtors contend that the reason for the interest stops rule is one of fundamental fairness and that the rule should apply in this case.

10 The Canadian debtors contend that the interest-stops rule is a common law rule corollary to the *pari passu* rule governing rateable payments of an insolvent's debts and that while the CCAA is silent as to the right to post-filing interest, it does not rule out the interest-stops rule.

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11 The bondholders contend that to deny them the right to post-filing interest would amount to a confiscation of a property right to interest and that absent express statutory authority the court has no ability to interfere with their contractual entitlement to interest. I do not see their claim to interest as being a property right, as the bonds are unsecured. See *Thibodeau v. Thibodeau* (2011), 104 O.R. (3d) 161 (Ont. C.A.), at para. 43. However, the question remains as to whether their contractual rights should prevail.

12 It is a fundamental tenet of insolvency law that all debts shall be paid *pari passu* and all unsecured creditors receive equal treatment. See *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2005), 74 O.R. (3d) 652 (Ont. C.A.) at para. 25, per Blair J.A. and *Indalex Ltd., Re* (2009), 55 C.B.R. (5th) 64 (Ont. S.C.J. [Commercial List]), at para. 16 per Morawetz J. This common law principle has led to the development of the interest stops rule. In *Canada (Attorney General) v. Confederation Life Insurance Co.*, [2001] O.J. No. 2610 (Ont. S.C.J. [Commercial List]), Blair J. (as he then was) stated the following:

> **20** One of the governing principles of insolvency law - including proceedings in a winding-up - is that the assets of the insolvent debtor are to be distributed amongst classes of creditors rateably and equally, as those assets are found at the date of the insolvency. This principle has led to the development of the "interest stops rule", i.e., that no interest is payable on a debt from the date of the winding-up or bankruptcy. As Lord Justice James put it, colourfully, in *Re Savin* (1872), L.R. 7 Ch. 760 (C.A.), at p. 764:
>
> > I believe, however, that if the question now arose for the first time I should agree with the rule [i.e. the "interest stops rule"], seeing that the theory in bankruptcy is to stop all things at the date of the bankruptcy, and to divide the wreck of the man's property as it stood at that time.

13 This rule is "judge-made" law. See *Humber Ironworks & Shipbuilding Co., Re* (1869), 4 Ch. App. 643 (Eng. Ch. Div.), at 647, per Sir G. M. Giffard, L.J.

14 In *Shoppers Trust*, Blair J.A. referred to *pari passu* principles in the context of the interest stops rule and the common law understanding of those rules in liquidation proceedings. He stated:

> 25. The rationale underlying this approach rests on a fundamental principle of insolvency law, namely, that "in the case of an insolvent estate, all the money being realized as speedily as possible, should be applied equally and rateably in payment of the debts as they existed at the date of the winding-up": *Humber Ironworks*, *supra*, at p. 646 Ch. App. Unless this is the case, the principle of *pari passu* distribution cannot be honoured. See also *Re McDougall*, [1883] O.J. No. 63, 8 O.A.R. 309, at paras. 13-15; *Principal Savings & Trust Co. v. Principal Group Ltd. (Trustee of)* (1993), 109 D.L.R. (4th) 390, 14 Alta. L.R. (3d) 442 (C.A.), at paras. 12-16; and *Canada (Attorney General) v. Confederation Trust Co.* (2003), 65 O.R. (3d) 519, [2003] O.J. No. 2754 (S.C.J.), at p. 525 [O.R.] While these cases were decided in the context of what is known as the "interest stops" rule, they are all premised on the common law understanding that claims for principal and interest are provable in liquidation proceedings to the date of the winding-up.

15 The interest stops rule has been applied in winding-up cases in spite of the fact that the legislation did not provide for it. In *Shoppers Trust*, Blair J.A. stated:

> 26. Thus, it was of little moment that the provisions of the *Winding-up Act* in force at the time of the March 10, 1993 order did not contain any such term. The 1996 amendment to s. 71(1) of the *Winding-up and Restructuring Act*, establishing that claims against the insolvent estate are to be calculated as at the date of the winding-up, merely clarified and codified the position as it already existed in insolvency law.

16 In *Abacus Cities Ltd. (Trustee of) v. AMIC Mortgage Investment Corp.* (1992), 11 C.B.R. (3d) 193 (Alta. C.A.), Kerans J.A. applied the interest stops rule in a bankruptcy proceeding under the BIA even although, in his view, the BIA assumed that interest was not payable after bankruptcy but did not expressly forbid it. He did so on the basis of the

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common law rule enunciated in *Savin, Re* [(1872), 7 Ch. App. 760 (Eng. Ch. Div.)], quoted by Blair J. in *Confederation Life*. Kerans J.A. stated:

> 19. ... I accept that *Savin* expresses the law in Canada today: claims provable in bankruptcy cannot include interest after bankruptcy.

17 In *Confederation Life*, Blair J. was of the view that the Winding-Up Act and the BIA could be interpreted to permit post-filing interest. Yet he held that the common law insolvency interest stops rule applied. He stated:

> **22** This common law principle has been applied consistently in Canadian bankruptcy and winding-up proceedings. This is so notwithstanding the language of subsection 71(1) of the Winding-Up Act and section 121 of the BIA, which might be read to the contrary, in my view....
>
> **23** Yet the "interest stops" principle has always applied to the payment of post-insolvency interest, and the provisions of subsection 71(1) have never been interpreted to trump the common law insolvency "interest stops rule".

18 Thus I see no reason to not apply the interest stops rule to a CCAA proceeding because the CCAA does not expressly provide for its application. The issue is whether the rule should apply to this CCAA proceeding.

Nature of the CCAA proceeding

19 When the Nortel entities filed for CCAA protection on January 14, 2009, and filed on the same date in the US and the UK, the stated purpose was to stabilize the Nortel business to maximize the chances of preserving all or a portion of the enterprise. However that hope quickly evaporated and on June 19, 2009 Nortel issued a news release announcing it had sold its CMDA business and LTE Access assets and that it was pursuing the sale of its other business interests. Liquidation followed, first by a sale of Nortel's eight business lines in 2009-2011 for US$2.8 billion and second by the sale of its residual patent portfolio under a stalking-horse bid process in June 2011 for US$4.5 billion. The sale of the CMDA and LTE assets was approved on June 29, 2009.

20 The Canadian debtors contend that this CCAA proceeding is a liquidating proceeding, and thus in substance the same as a bankruptcy under the BIA. The bondholders contend that there is no definition of a "liquidating" CCAA proceeding and no distinct legal category of a liquidating CCAA, essentially arguing that like beauty, it is in the eyes of the beholder.

21 In this case, I think there is little doubt that this is a liquidating CCAA process and has been since June, 2009, notwithstanding that there was some consideration given to monetizing the residual intellectual property in a new company to be formed (referred to as IPCO) before it was decided to sell the residual intellectual property that resulted in the sale to the Rockstar consortium for US$4.5 billion. In *Nortel Networks Corp., Re*, 2012 ONSC 1213, 88 C.B.R. (5th) 111 (Ont. S.C.J. [Commercial List]), Morawetz J. referred to his recognizing in his June 29, 2009 Nortel decision approving the sale of the CMDA and LTE assets that the CCAA can be applied in "a liquidating insolvency". See also Dr. Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2nd ed. (Toronto: Carswell, 2013) at p. 167, in which she states "increasingly, there are 'liquidating CCAA' proceedings, whereby the debtor corporation is for all intents and purposes liquidated".

22 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), Farley J. recognized in para. 7 that a CCAA proceeding might involve liquidation. He stated:

> It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company ... provided the same is proposed in the best interests of the creditors generally.

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23 It is quite common now for there to be liquidating CCAA proceedings in which there is no successful restructuring of the business but rather a sale of the assets and a distribution of the proceeds to the creditors of the business. Nortel is unfortunately one of such CCAA proceedings.

Can the interest stops rule apply in a CCAA proceeding?

24 There is no controlling authority in Canada in a case such as this in which there is a contested claim being made by bondholders for post-filing interest against an insolvent estate under the CCAA, let alone under a liquidating CCAA process, or in which the other creditors are mainly pensioners with no contractual right to post-filing interest. Accordingly, it is necessary to deal with first principles and with various cases raised by the parties.

25 The Canadian debtors contend that the rationale for the interest stops rule is equally applicable to a liquidating CCAA proceeding as it is in a BIA or Winding-Up proceeding. They assert that the reason for the interest stops rule is one of fundamental fairness. An insolvency filing under the CCAA stays creditor enforcement. Accordingly, it is unfair to permit the bondholders with a contractual right to receive a payment on account of interest, and thus compensation for the delay in receipt of payment, while other creditors such as the pension claimants, who have been equally delayed in payment by virtue of the insolvency, receive no compensation. They cite Sir G. M. Giffard, L.J. in *Humber Ironworks*:

> I do not see with what justice interest can be computed in favour of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest.

26 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter Century Services], Deschamps J. reaffirmed that the purpose of a CCAA stay of proceedings is to preserve the *status quo*. She stated at para. 77:

> The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all.

27 If post-filing interest is available to one set of creditors while the other creditors are prevented from asserting their rights and obtaining post-judgment interest, the Canadian Creditors' Committee contend that the *status quo* has not been preserved.

28 It has long been recognized that the federal insolvency regime includes the CCAA and the BIA and that the two statutes create a complimentary and interrelated scheme for dealing dealing with the property of insolvent companies. See *Ivaco Inc., Re* (2006), 83 O.R. (3d) 108 (Ont. C.A.), at paras. 62 and 64, per Laskin J.A.

29 Recently the Supreme Court of Canada analysed the CCAA and indicated that the BIA and CCAA are to be considered parts of an integrated insolvency scheme, the court will favour interpretations that give creditors analogous entitlements under the CCAA and BIA, and the court will avoid interpretations that give creditors incentives to prefer BIA processes.

30 In *Century Services*, Deschamps J. enunciated guiding principles for interpreting the CCAA. Deschamps J. also stated that the case was the first time that the Supreme Court was called upon to directly interpret the provisions of the CCAA. The case involved competing interpretations of the federal *Excise Tax Act* ("ETA") and the CCAA in considering a deemed trust for GST collections. The ETA expressly excluded the provisions in the BIA rendering deemed trusts ineffective, but did not exclude similar provisions in the CCAA. In holding in favour of a stay under the CCAA, Deschamps J. was guided in her interpretation of the relevant CCAA provision by the desire to have similar results under the BIA and CCAA.

31 In her analysis, Deschamps J. made a number of statements, including

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> Because the CCAA is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a CCAA reorganization is ultimately unsuccessful. (para. 23)
>
> With parallel CCAA and BIA restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation. (para. 24)
>
> Moreover, a strange asymmetry would arise if the interpretation giving the ETA priority over the CCAA urged by the Crown is 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 where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the BIA, creditors' incentives would lie overwhelmingly with avoiding proceedings under the CCAA and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the CCAA can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert. (para. 47)
>
> Notably, acting consistently with its goal of treating both the BIA and the CCAA as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes... (para. 54)
>
> The CCAA and BIA are related and no gap exists between the two statutes which would allow the enforcement of property interests at the conclusion of CCAA proceedings that would be lost in bankruptcy. (para. 78)

32 In *Indalex Ltd., Re*, [2013] 1 S.C.R. 271 (S.C.C.), a case involving a competition between a deemed trust under provincial pension legislation and the right of a lender to security granted under the DIP lending provisions of the CCAA, Deschamps J. had occasion to refer to the *Century Services* case and her statement in *Century Services* in para 23 referred to above. She then stated:

> In order to avoid a race to liquidation under the BIA, courts will favour an interpretation of the CCAA that affords creditors analogous entitlements.

33 Thus it is a fair comment taken the direction of the Supreme Court in *Century Services* and *Indalex* regarding the aims of insolvency law in Canada to say that if the common law principle of the interest stops rule was applicable to proceedings under the BIA and *Winding-Up Act* before legislative amendments to those statutes were made, (or if the comments of Blair J. in *Confederation Life* are accepted that the BIA still might be read to prevent its application but does not trump the application of the rule), there is no reason not to apply the interest stops rule in liquidating CCAA proceedings. I accept this and note that there is no provision in the CCAA that would not permit the application of the rule.

34 There are also policy reasons for this result, and they flow from *Century Services* and *Indalex*. I accept the argument of the Canadian Creditors' Committee that to permit some creditors' claims to grow disproportionately to others during the stay period would not maintain the *status quo* and would encourage creditors whose interests are being disadvantaged to immediately initiate bankruptcy proceedings, threatening the objectives of the CCAA.

35 In my view, there is no need for there to be a "liquidating" CCCAA proceeding in order for the interest stops rule to apply to a CCAA proceeding. The reasoning for the application of the common law insolvency rule, being the desire to prevent a stay of proceedings from militating against one group of unsecured creditors over another in violation of the *pari passu* rule, is equally applicable to a CCAA proceeding that is not a liquidating proceeding. In such a proceeding, the parties would of course be free to include post-filing interest payments in a plan of arrangement, as is sometimes done.

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36 The bondholders contend, however, that *Stelco Inc., Re*, 2007 ONCA 483, 32 B.L.R. (4th) 77 (Ont. C.A.) is binding authority that the interest stops rule does not apply in any CCAA proceeding. I do not agree. The facts of the case were quite different and did not involve a claim for post-filing interest against the debtor. Stelco was successfully restructured under the CCAA by a plan of compromise and arrangement approved by the creditors. The sanctioned plan did not provide for payment of post-petition interest. As among senior unsecured debenture holders, subordinated (junior) debenture holders and ordinary unsecured creditors, the plan treated all in the same class and *pro rata* distributions were calculated on the basis that no post-filing interest was allowed. That result was not challenged.

37 The relevant pre-filing indenture in *Stelco* provided that in the event of any insolvency, the holders of all senior debt would first be entitled to receive payment in full of the principal and interest due thereon, before the junior debenture holders would be entitled to receive any payment or distribution of any kind which might otherwise be payable in respect of their debentures. While the plan cancelled all Stelco debentures, subject to section 6.01(2) of the plan, that section provided that the rights between the debenture holders were preserved. The plan was agreed to by the junior debenture holders. After the plan had been sanctioned, the junior debenture holders challenged the senior debt holders' right to receive the subordinated payments towards their outstanding interest.

38 Wilton-Siegel J. rejected the argument, holding that the subordination agreement continued to operate independently of the sanctioned plan and was not affected by it. While it is not clear why, the junior Noteholders contended that interest stopped accruing in respect of the claims of the senior debenture holders against Stelco after the CCAA filing. There was no issue about a claim against Stelco for post-filing interest, as no such claim had ever been made. The issue was a contest between the two levels of debenture holders. However, Wilton-Siegel J. stated that in situations in which there was value to the equity, a CCAA plan could include post-filing interest. I take this statement to be *obiter*, but in any event, it is not the situation in Nortel as there is no equity at all. At the Court of Appeal, O'Connor A.C.J.O, Goudge and Blair JJ.A. agreed that the interest stops rule did not preclude the continuation of interest to the senior note holders from the subordinated payments to be made by the junior note holders under the binding inter-creditor arrangements.

39 In the course of its reasons, the Court of Appeal stated that there was no persuasive authority that supports an interest stops rule in a CCAA proceeding, and referred to statements of Binnie J. in *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24, [2006] 1 S.C.R. 865 (S.C.C.), [*NAV Canada*]. A number of comments can be made.

40 First, *Stelco* did not involve proceeding or claims against the debtor for post-filing interest. Second, the decision in *Stelco* was derived from the terms of negotiated inter-creditor agreements in the note indenture that were protected by plan. There was nothing about the common law interest stops rule that precluded one creditor from being held to its agreement to subordinate its realization to that of another creditor including foregoing its right to payment until the creditor with priority received principal and interest. That is what the Court of Appeal concluded by stating "We do not accept that there is a 'Interest Stops Rule' that precludes such a result". Third, the general statements made in *Stelco* and *NAV Canada* must now be considered in light of the later direction in *Century Services* and *Indalex*. I now turn to *NAV Canada*.

41 In *NAV Canada*, Canada 3000 Airlines filed for protection under the CCAA. Three days later the Monitor filed an assignment in bankruptcy on its behalf. Federal legislation gave the airport authorities a right to apply to the court authorizing the seizure of aircraft for outstanding payments owed by an airline for using an airport. The contest in the case was between the airport authorities and the owners/lessors of the aircraft as to the extent that the owners/lessors were liable for those payments and whether a seizure order could be made against the aircraft leased to the airline. It was ultimately held that the owners/lessors were not liable for the outstanding payments owed by the airline but that the aircraft could be seized.

42 Interest on the arrears was raised in the first instance before Ground J. He held that the airport authorities were entitled as against the bankrupt airline to detain the aircraft until all amounts with interest were paid in full or security

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for such payment was posted under the provisions of the legislation, i.e. interest continued to accrue and be payable after bankruptcy. The Court of Appeal did not deal with interest as in their view it was relevant only if the airport authorities had a claim against the owners/lessors of the aircraft, which the court held they did not.

43 In the Supreme Court, which also dealt with an appeal from Quebec which dealt with the same issues, nearly the entire reasons of Binnie J. dealt with the issues as to whether the owners/lessors of the aircraft were liable for the outstanding charges and whether the aircraft could be seized by the airport authorities. It was held that the owners/lessors were not directly liable for the charges owed by the airline but that the aircraft could be seized until the charges were paid.

44 At the end of his reasons, Binnie J. dealt with interest and held that it continued to run until the earlier of payment, the posting of security, or bankruptcy. The bondholders rely on the last two sentences of the following paragraph from the reasons of Binnie J. which refer to the running of interest under the CCAA:

> **96** Given the authority to charge interest, my view is that interest continues to run to the first of the date of payment, the posting of security or bankruptcy. If interest were to stop accruing before payment has been made, then the airport authorities and NAV Canada would not recover the full amount owed to them in real terms. Once the owner, operator or titleholder has provided security, the interest stops accruing. The legal titleholder is then incurring the cost of the security and losing the time value of money. It should not have to pay twice. While a *CCAA* filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the *Bankruptcy and Insolvency Act*.

45 The Quebec airline in question had first filed to make a proposal under the BIA and when that proposal was rejected by its creditors, it was deemed to have made an assignment in bankruptcy as of the date its proposal was filed. Thus the comments of Binnie J. regarding the CCAA could not have related to the Quebec airline, but only to Canada 3000, which had been under the CCAA for only three days before it was assigned into bankruptcy. It is by no means clear how much effort, if any, was spent in argument on the three days' interest issue. Binnie J. did not refer to any argument on the point.

46 There was no discussion of the common law interest stops rule and whether it could apply during the three day period in question or whether it should apply to a liquidating CCAA proceeding. Nor was there any discussion of the definition of claim in the CCAA, being a claim provable within the meaning of the BIA, and how that might impact a claim for post-filing interest under the CCAA. The statement regarding interest under the CCAA was simply conclusory. It may be fair to say that the statement of Binnie J. was *per incuriam*.

47 In my view, the statement of Binnie J. should not be taken as a blanket statement that interest always accrues in a CCAA proceeding, regardless of whether or not it is a liquidating proceeding. The circumstances in *NAV Canada* were far different from Nortel involving several years of compound interest in excess of US$1.6 billion out of a total world-wide asset base of US$7.3 billion. The statement of Binnie J. should now be construed in light of *Century Services* and *Indalex*.

Need for a CCAA plan

48 The bondholders contend that there is no authority under the CCAA to effect a distribution of a debtor's assets absent a plan of arrangement or compromise that must be negotiated by the debtor with its creditors, and that as a plan can include payment of post-filing interest, it is not possible for a court to conclude that the bondholders have no right to post-filing interest. They assert that there is no jurisdiction for a court to compromise a creditor's claim in a CCAA proceeding except in the context of approving a plan approved by the creditors. They also assert that plan negotiations cannot meaningfully take place "in earnest" until the allocation decision as to how much of the US$7.3 billion is to be allocated to each of the Canadian, US, or EMEA estates.

49 One may ask what is left over in this case to negotiate. The assets have long been sold and what is left is to determine the claims against the Canadian estate and, once the amount of the assets in the Canadian estate are known, distribute the assets on a *pari passu* basis. This is not a case in which equity is exchanged for debt in a reorganization of a business such as *Stelco*.

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50 However, even if there were things to negotiate, they would involve creditors compromising some right, and bargaining against those rights. What those rights are need to be determined, and often are in CCAA proceedings.

51 In this case, compensation claims procedure orders were made by Morawetz J. The order covering claims by bondholders is dated July 30, 2009. It was made without any objection by the bondholders. That order provides for a claim to be proven for the purposes of voting and distribution under a plan. The claims resolution order of Morawetz J. dated September 16, 2010 provides for a proven claim to be for all purposes, including for the purposes of voting and distribution under any plan. The determination now regarding the bondholders claim for post-filing interest is consistent with the process of determining whether these claims by the bondholders are finally proven. Contrary to the contention of the bondholders, it is not a process in which the court is being asked to compromise the bondholders' claim for post-filing interest. It is rather a determination of whether they have a right to such interest.

52 It is perhaps not necessary to determine at this stage how the assets will be distributed and whether a plan, or what type of plan, will be necessary. However, in light of the argument advanced on behalf of the bondholders, I will deal with this issue.

53 I first note that the CCAA makes no provision as to how money is to be distributed to creditors. This is not surprising taken that plans of reorganization do not necessarily provide for payments to creditors and taken that the CCAA does not expressly provide for a liquidating CCAA process. There is no provision that requires distributions to be made under a plan of arrangement.

54 A court has wide powers in a CCAA proceeding to do what is just in the circumstances. Section 11(1) provides that a court may make any order it considers appropriate in the circumstances. Although this section was provided by an amendment that came into force after Nortel filed under the CCAA, and therefore by the amendment the new section does not apply to Nortel, it has been held that the provision merely reflects past jurisdiction. In *Century Services*, Deschamps J. stated:

> **65** I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).
>
> **67** The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.
>
> **68** In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence. (underlining added)

55 I note also that payments to creditors without plans of arrangement or compromises are often ordered. In *Timminco Ltd., Re*, 2014 ONSC 3393 (Ont. S.C.J.), Morawetz J. noted at para. 38 that the assets of Timminco had been sold and distributions made to secured creditors without any plan and with no intention to advance a plan. In that case, there was a shortfall to the secured creditors and no assets available to the unsecured creditors. The fact that the distributions went to the secured creditors rather than to an unsecured creditor makes no difference to the jurisdiction under the CCAA to do so.

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56 In *AbitibiBowater Inc., Re*, 2009 QCCS 6461 (C.S. Que.), Gascon J.C.S. (as he then was) granted a large interim distribution from the proceeds of a sale transaction to senior secured noteholders ("SSNs"). The bondholders opposed the distribution on the same grounds as advanced by the bondholders in this case:

> 56 The Bondholders claim that the proposed distribution violates the CCAA. From their perspective, nothing in the statute authorizes a distribution of cash to a creditor group prior to approval of a plan of arrangement by the requisite majorities of creditors and the Court. They maintain that the SSNs are subject to the stay of proceedings like all other creditors.
>
> 57 By proposing a distribution to one class of creditors, the Bondholders contend that the other classes of creditors are denied the ability to negotiate a compromise with the SSNs. Instead of bringing forward their proposed plan and creating options for the creditors for negotiation and voting purposes, the Abitibi Petitioners are thus eliminating bargaining options and confiscating the other creditors' leverage and voting rights.
>
> 58 Accordingly, the Bondholders conclude that the proposed distribution should not be considered until after the creditors have had an opportunity to negotiate a plan of arrangement or a compromise with the SSNs.

57 Justice Gascon did not accept this argument. He stated:

> 71 Despite what the Bondholders argue, it is neither unusual nor unheard of to proceed with an interim distribution of net proceeds in the context of a sale of assets in a CCAA reorganization. <u>Nothing in the CCAA prevents similar interim distribution of monies. There are several examples of such distributions having been authorized by Courts in Canada.</u> (underlining added)

58 Justice Gascon was persuaded that the distribution should be made as it was part and parcel of a DIP loan arrangement that he approved. Whatever the particular circumstances were that led to the exercise of his discretion, he did not question that he had jurisdiction to make an order distributing proceeds without a plan of arrangement. I see no difference between an interim distribution, as in the case of *AbitibiBowater*, or a final distribution, as in the case of *Timminco*, or a distribution to an unsecured or secured creditor, so far as a jurisdiction to make the order is concerned without any plan of arrangement.

59 There is a comment by Laskin J.A. in *Ivaco Inc., Re* (2006), 83 O.R. (3d) 108 (Ont. C.A.) that questions the right of a judge to order payment out of funds realized on the sale of assets under a CCAA process, in that case to pension plan administrators for funding deficiencies. He stated:

> [I]n my view, absent an agreement, I doubt that the CCAA even authorized the motions judge to order this payment. Once restructuring was not possible and the CCAA proceedings were spent, as the motions judge found and all parties acknowledged, I question whether the court had any authority to order a distribution of the sale proceeds.

60 This was an *obiter* statement. But in any event Justice Laskin was discussing a situation in which all parties agreed that the CCAA proceedings "were spent". That is, there was effectively no CCAA proceeding any more. This is not the situation with Nortel and I do not see the *obiter* statement as being applicable. As stated by Justice Gascon, distribution orders without a plan are common in Canada.

61 While it need not be decided, I am not persuaded that it would not be possible for a court to make an order distributing the proceeds of the Nortel sale without a plan of arrangement or compromise.

Conclusion

62 I hold and declare that holders of the crossover bond claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest (namely, above and beyond US$4.092 billion).

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63 Those seeking costs may make cost submissions in writing within 10 days and responding submissions may be made in writing within a further 10 days. Submissions are to be brief and include a proper cost outline for costs sought.

Claim dismissed.

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2015 ONCA 681
Ontario Court of Appeal

Nortel Networks Corp., Re

2015 CarswellOnt 15461, 2015 ONCA 681, 127 O.R. (3d) 641, 259 A.C.W.S. (3d) 15, 32 C.B.R. (6th) 21, 340 O.A.C. 234, 391 D.L.R. (4th) 283

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Janet Simmons, E.E. Gillese, Paul Rouleau JJ.A.

Heard: April 29, 2015
Judgment: October 13, 2015
Docket: CA C59703

Proceedings: affirming *Nortel Networks Corp., Re* (2014), 121 O.R. (3d) 228, 2014 ONSC 4777, 2014 CarswellOnt 17193 (Ont. S.C.J. [Commercial List])

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Subject: Civil Practice and Procedure; Insolvency

APPEAL by bondholders from judgment reported at *Nortel Networks Corp., Re* (2014), 2014 ONSC 4777, 2014 CarswellOnt 17193, 121 O.R. (3d) 228 (Ont. S.C.J. [Commercial List]), finding interest stops rule applied in *Companies' Creditors Arrangement Act* proceedings and that bondholders were not legally entitled to claim or receive any amounts beyond outstanding principal debt and pre-petition interest.

***Paul Rouleau J.A.*:**

A. Overview

1 This appeal represents another chapter in the Nortel proceeding under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), which has been on-going since January 2009. A parallel proceeding under Chapter 11 of the United States *Bankruptcy Code* has also been on-going in Delaware since that time.

2 The *Ad Hoc* Group of Bondholders (the "appellant") brings this appeal with leave. The group represents substantial holders of "crossover bonds", which are unsecured bonds either issued or guaranteed by certain of the Canadian Nortel

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entities. The relevant indentures provide for the continuing accrual of interest until payment, at contractually specified interest rates, as well as other post-filing payment obligations, such a make-whole provisions and trustee fees.

3 In contrast, the claims of other claimants, such as Nortel pensioners and former employees, do not have a provision for interest on amounts owing to them.

4 Holders of the crossover bonds have filed claims for principal and pre-filing interest in the amount of US$4.092 billion against each of the Canadian and U.S. Nortel estates. They also claim they are entitled to post-filing interest and related claims under the terms of the crossover bonds. As of December 31, 2013, the amount of this claim was approximately US$1.6 billion. The total of these two amounts represents a significant portion of the proceeds generated from the worldwide sale of Nortel's business lines and other Nortel assets, totalling approximately $7.3 billion. This latter amount is apparently not growing at any appreciable rate because of the conservative nature of the investments made with it pending the outcome of the insolvency proceedings.

5 In the context of a joint allocation trial, the *CCAA* judge directed that two issues be argued:

> 1. whether the holders of the crossover bond claims are legally entitled ... to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest (namely, above and beyond US$4.092 billion); and
>
> 2. if it is determined that the crossover bondholders are so entitled, what additional amounts are such holders entitled to so claim and receive.

6 The *CCAA* judge answered the first question in the negative and so he did not need to answer the second question. In reaching that conclusion, he accepted that the common law "interest stops rule", which has been held to be a fundamental tenet of insolvency law, applies in the *CCAA* context. He disagreed with the appellant's submission that the Supreme Court of Canada's decision in *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24, [2006] 1 S.C.R. 865 (S.C.C.) [hereinafter *Canada 3000*], and this court's subsequent decision in *Stelco Inc., Re*, 2007 ONCA 483, 35 C.B.R. (5th) 174 (Ont. C.A.), are binding authority that the interest stops rule does not apply in the *CCAA* context.

7 On appeal, the appellant raises two related issues — whether the *CCAA* judge erred in concluding that an interest stops rule applies in *CCAA* proceedings and, if not, whether he erred in concluding that the holders of Crossover Bond Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest.

8 I would dismiss the appeal. As I will explain, there are sound legal and policy reasons for applying the interest stops rule in the *CCAA* context, and as I read *Stelco Inc., Re* and *Canada 3000*, they do not preclude such a result. Nor do I see a basis for varying the order that he made.

B. Background

9 In the *CCAA* court's initial order of January 14, 2009, the Canadian Debtors [1] were directed, subject to certain exceptions, to make no payments of principal or interest on account of amounts owing by the Canadian Debtors to any of their creditors as of the filing date, unless approved by the Monitor. Further, all proceedings and enforcement processes, and all rights and remedies of any person against the Canadian Debtors were stayed absent consent of the Canadian Debtors and the Monitor, or leave of the court.

10 In accordance with a claims procedure order dated July 30, 2009, claims against the Canadian Debtors were required to be filed by a claims bar date. Under a subsequent claims resolution order dated September 16, 2010, a disputed claim could be brought before the *CCAA* court for final determination.

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11 As previously noted, holders of the crossover bonds filed proofs of claim that included not only the principal amount of the debt and interest accrued to the date of insolvency but also contractual claims for interest and other amounts post-filing.

12 In May 2014, a joint allocation trial, conducted by way of video-link by the *CCAA* judge in Ontario and Judge Gross in Delaware, commenced on the issue of the allocation of the sale proceeds among the debtor estates, including the Canadian and U.S. estates. In his 2015 decision, the *CCAA* judge, citing the "fundamental tenet of insolvency law that all debts shall be paid *pari passu*" and that "all unsecured creditors receive equal treatment" held that the $7.3 billion in funds generated from the Nortel liquidation should be allocated on a *pro rata* basis as among the estates: 2015 ONSC 2987, 23 C.B.R. (6th) 249 (Ont. S.C.J. [Commercial List]), at para. 209. He ordered, at para. 258, that the funds be allocated among the debtor estates in accordance with a number of principles, including the principle that each debtor estate "is to be allocated that percentage of the [liquidation proceeds] that the total allowed claims against that Estate bear to the total allowed claims against all Debtor Estates." A number of parties have sought leave to appeal that decision.

13 It was on June 24, 2014, while the joint allocation trial was proceeding, that the *CCAA* judge directed that the two issues set out above be decided.

C. Decision Below

14 The *CCAA* judge began his analysis with a review of cases applying the interest stops rule in the bankruptcy and winding-up context. He noted the relationship between the interest stops rule and the *pari passu* principle, which he described as "a fundamental tenet of insolvency law" that requires equal treatment of unsecured creditors. He found there was "no reason to not apply the [common law] interest stops rule to a CCAA proceeding because the CCAA does not expressly provide for its application." The issue was "whether the rule should apply to this CCAA proceeding."

15 He went on to conclude that "[t]here is no controlling authority in Canada in a case such as this in which there is a contested claim being made by bondholders for post-filing interest against an insolvent estate under the CCAA, let alone under a liquidating CCAA process, or in which the other creditors are mainly pensioners with no contractual right to post-filing interest." In reaching this conclusion, he distinguished *Stelco* and *Canada 3000* and found that the application of the interest stops rule was supported by the more recent decisions in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter *Century Services*], and *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271 (S.C.C.).

16 The *CCAA* judge thus ordered that "holders of Crossover Bond Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest (namely, above and beyond US$4.092 billion)."

D. Issues on Appeal

17 The appellant raises two related issues:

1. Did the *CCAA* judge err in concluding that an interest stops rule applies in *CCAA* proceedings?

2. If the *CCAA* judge did not err in concluding that an interest stops rule applies in *CCAA* proceedings, did he err in holding that holders of Crossover Bonds Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest?

E. Analysis

(1) Did the CCAA judge err in concluding that an interest stops rule applies in CCAA proceedings?

18 The appellant, supported by the Bank of New York Mellon and the Law Debenture Trust Company of New York as indenture trustees, submits that the *CCAA* judge erred in concluding that the interest stops rule applies.

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19 First, the appellant submits he applied inapplicable case law and misinterpreted case law in concluding that the rule did and should apply. Among other things, the appellant criticizes the *CCAA* judge's application of the Supreme Court of Canada's decisions in *Century Services* and *Indalex*, which deal with the inter-play between the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*").

20 The appellant also submits that the application of the interest stops rule in the *CCAA* context is inconsistent with the *CCAA* and would have negative practical consequences.

21 Finally, the appellant submits that *Canada 3000* and *Stelco* are binding authority that preclude the application of the interest stops rule in the *CCAA* context and that the *CCAA* judge violated the principle of *stare decisis* in refusing to follow them.

22 I will deal with these submissions in turn, beginning with a discussion of the interest stops rule and the related *pari passu* principle.

(a) Should the interest stops rule apply in CCAA proceedings?

(i) Origin and scope of the interest stops rule

23 It is well settled that the *pari passu* principle applies in insolvency proceedings. This principle, to the effect that "the assets of the insolvent debtor are to be distributed amongst classes of creditors rateably and equally, as those assets are found at the date of insolvency" is said to be one of the "governing principles of insolvency law" in Canada: *Canada (Attorney General) v. Confederation Life Insurance Co.*, [2001] O.T.C. 486 (Ont. S.C.J. [Commercial List]), at para. 20, *per* Blair J. [2] In fact, the *pari passu* principle has been said to be the foremost principle in the law of insolvency not just in Canada but around the world: Rizwaan J. Mokal "Priority as Pathology: The *Pari Passu* Myth" (2001) 60:3 Cambridge L.J. 581, at p. 581. According to an article in the Cambridge Law Journal, "[c]ommentators claim to have found [the *pari passu*] principle entrenched in jurisdictions far removed ... in geography and time": Mokal, at pp. 581-582.

24 The *pari passu* principle is rooted in the need to treat all creditors fairly and to ensure an orderly distribution of assets.

25 As explained in *Humber Ironworks & Shipbuilding Co., Re* (1869), 4 Ch. App. 643 (Eng. Ch. Div.), nearly 150 years ago, a necessary corollary of the *pari passu* principle is the interest stops rule. Absent the interest stops rule, the fairness and orderly distribution sought by the *pari passu* principle could not be achieved. Selwyn L.J. explained the rationale for the interest stops rule, at pp. 645-646:

> In the present case we have to consider what are the positions of the creditors of the company, when, as here, there are some creditors who have a right to receive interest, and others having debts not bearing interest.
>
> . . . . .
>
> It is very difficult to conceive a case in which the assets of a company could be ... immediately realized and divided; but suppose they had a simple account at a bank, which could be paid the next day, that would be the course of proceeding. Justice, I think, requires that that course of proceeding should be followed, and that no person should be prejudiced by the accidental delay which, in consequence of the necessary forms and proceedings of the Court, actually takes place in realizing the assets; but that, in the case of an insolvent estate, all the money being realized as speedily as possible, should be applied equally and rateably in payment of the debts as they existed at the date of the winding-up. I, therefore, think that nothing should be allowed for interest after that date.

26 Giffard L.J. similarly stated, at p. 647-648:

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> That rule ... works with equality and fairness between the parties; and if we are to consider convenience, it is quite clear that, where an estate is insolvent, convenience is in favour of stopping all the computations at the date of the winding-up.
>
> . . . . .
>
> I may add another reason, that I do not see with what justice interest can be computed in favour of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest.

27 Thus, the primary purpose behind the common law interest stops rule is fairness to creditors. Another purpose is to achieve the orderly administration of an insolvent debtor's estate.

28 The common law interest stops rule has been consistently applied in proceedings under bankruptcy and winding-up legislation. In fact, as explained by Blair J. in *Confederation Life Insurance Co.* at paras. 22-23, the rule has been applied even when the legislation might be read to the contrary:

> This common law principle has been applied consistently in Canadian bankruptcy and winding-up proceedings. This is so notwithstanding the language of subsection 71(1) of the *Winding-Up Act* and section 121 of the *BIA*, which might be read to the contrary, in my view.
>
> . . . . .
>
> Yet, the "interest stops" principle has always applied to the payment of post-insolvency interest, and the provisions of subsection 71(1) have never been interpreted to trump the common law insolvency "interest stops rule".

29 I will now turn to the question of whether the interest stops rule should be applied in the *CCAA* context.

(ii) Should the interest stops rule apply in CCAA proceedings?

30 The respondents[3] maintain that one would expect the interest stops rule to apply in *CCAA* proceedings given that *CCAA* proceedings are insolvency proceedings to which the common law *pari passu* principle applies. Consistent with the *pari passu* principle and the related interest stops rule, creditors in *CCAA* proceedings must surely expect to be treated fairly and not see creditors with interest entitlements have their claims grow, post-insolvency, disproportionately to those with no, or lesser, interest entitlements. In the respondents' submission, the same reasoning used by courts to conclude that the interest stops rule applies in winding-up and bankruptcy proceedings leads to the conclusion that the interest stops rule applies in *CCAA* proceedings.

31 The appellant, on the other hand, submits that *CCAA* proceedings are different from other insolvency proceedings in that they do not immediately or permanently alter the rights of creditors. The filing is intended to give the debtor breathing space so that a plan of compromise or arrangement can be negotiated with creditors and the business can continue. The objective of a *CCAA* proceeding is a consensual, statutory compromise in the form of a *CCAA* plan. Such a *CCAA* plan can provide for any kind of distribution, provided it is approved by the requisite majority of creditors and the court.

32 In the appellant's submission, until a plan is negotiated or the proceeding is converted to bankruptcy or winding-up, the rights of creditors are not altered; rather, their rights to execute on them are simply stayed. In the appellant's view, therefore, unless and until this sought-after compromise of rights is negotiated, only the exercise of the rights is stayed. The *CCAA* filing does not affect the right to accrue interest; it only stays the collection of that interest.

33 The appellant further argues that the *CCAA* judge's decision is contrary to the established *CCAA* practice and the reasonable expectations of the parties in this proceeding. In particular, the appellant notes that a *CCAA* plan may, and often does, provide for the recovery of post-filing interest. The appellant also submits that the application of the interest

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stops rule would allow debtors to obtain a permanent interest holiday simply by filing for *CCAA* protection, even if the filing were later withdrawn, causing a permanent prejudice to the creditors not contemplated by the *CCAA*. And, the appellant submits that an interest stops rule would create a disincentive for creditors to participate in *CCAA* proceedings since they would not be compensated for delays under the *CCAA* even if there were ultimately assets available to do so

34 I do not accept the appellant's submissions on this point. Admittedly, there are differences between the *CCAA* and other insolvency schemes, including that the *CCAA* does not provide for a fixed scheme of distribution. Further, assuming a plan of compromise or arrangement under the *CCAA* is negotiated it may or may not result in a distribution to creditors. Nevertheless, in my view, the same principles that underpin the conclusion that the interest stops rule is necessary in bankruptcy and winding-up proceedings — namely, the fair treatment of creditors and the orderly administration of an insolvent debtor's estate - apply with equal force to *CCAA* proceedings. I say so for several reasons.

35 First, the *CCAA* is part of an integrated insolvency regime, which also includes the *BIA*. The Supreme Court of Canada in *Century Services* considered the *CCAA* regime and opined, at para. 24, that "[w]ith parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation". The court went on to explain, at para. 78, that the *CCAA* and *BIA* are related and "no 'gap' exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy".

36 Consistent with the notion of harmonization, because the common law interest stops rule applies upon bankruptcy under the *BIA*, it should follow that the common law rule also applies in a *CCAA* proceeding unless, of course, the rule is ousted by the *CCAA*. The *CCAA* does not address entitlement to claim post-filing interest let alone oust the common law rule with clear wording.

37 Second, if the interest stops rule were not to apply in *CCAA* proceedings, the creditors who do not have a contractual right to post-filing interest would, as the Supreme Court explained in *Century Services* at para. 47, have "skewed incentives against reorganizing under the *CCAA*" and this would "only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert." This concern over skewed incentives was confirmed in *Indalex* where the Supreme Court held, at para. 51, that "[i]n order to avoid a race to liquidation under the *BIA*, courts will favour an interpretation of the *CCAA* that affords creditors analogous entitlements" to those they would receive under the *BIA*.

38 Without an interest stops rule under the *CCAA*, the creditors with no claim to post-filing interest would have an incentive to proceed under the *BIA* or the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11, where the interest stops rule operates to prevent creditors, such as the appellant, who have a contractual right to interest from improving their proportionate claim against the debtor at the expense of other creditors.

39 Third, as recognized by the Supreme Court in *Century Services* at para. 77, the "*CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all". This is achieved through grouping all claims within a single proceeding and staying all actions against the debtor, thus putting creditors on an equal footing: *Century Services*, para. 22.

40 As submitted by the Canadian Creditors' Committee, if post-filing interest is available to one set of creditors while the other creditors are prevented from asserting their rights to sue the debtor and obtaining a judgment that bears interest, the *status quo* has not been preserved.

41 Fourth, if the interest stops rule were not to apply in *CCAA* proceedings, the key objective of that statute — to facilitate the restructuring of corporations through flexibility and creativity — may be undermined. This is because of the asymmetrical entitlement to interest that would be created. Creditors with an entitlement to post-filing interest may be less motivated to compromise than those creditors without such an entitlement. Using the case under appeal as an

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example, if post-filing interest is allowed to accrue, the delay and failure to reach a compromise will see the appellant's proportionate claim against the assets of the debtors rise very significantly at the expense of other creditors. One could well understand that if the urgency for reaching a compromise and the incentive to compromise are significantly lower for one group of unsecured creditors than for the balance of the unsecured creditors, restructuring will be more difficult to achieve and the ability to reach creative solutions will be lessened.

42 Furthermore, if the amount of an unsecured creditor's legal entitlement is constantly shifting as post-filing interest accrues, the ability to find a compromise that is acceptable to all creditors at any one point in time will pose a greater challenge than if the entitlements are fixed as of the date of filing.

43 Fifth, the principle of fairness supports the application of the interest stops rule. Insolvency proceedings are intended to be fair processes for liquidating or restructuring insolvent corporations. How, one may ask, is it fair if the appellant, an unsecured creditor, sees its claim against the assets of the debtor balloon from $4.092 billion to $5.692 billion (as of December 31, 2013) because of contractual provisions when the claims of unsecured creditors, who have no such contractual provisions and who have been prevented for almost seven years by the *CCAA* stay from converting their claims into court judgments that would bear interest, have seen no increase at all? Delays in liquidating the Nortel assets have helped the Monitor achieve the very significant recoveries made ($7.3 billion) and, in fairness, this achievement should be for the benefit of all creditors.

44 Finally, I wish to respond to the appellant's concerns.

45 As to past practice and the reasonable expectations of the parties, I do not view the existence of an interest stops rule as being contrary to established *CCAA* practice or as preventing a *CCAA* plan from providing for post-filing interest. Parties may negotiate for a plan that provides for payments of more or less than a creditor's legal entitlement in lieu of the foregone interest. Thus, I do not accept the appellant's submission that there would be a disincentive to participate in *CCAA* proceedings, which is based on the premise that post-filing interest may not be recovered under a *CCAA* plan.

46 The appellant also raised the concern that a debtor company could obtain a permanent interest holiday, resulting in unfairness. The appellant says that if there are proceeds over and above the amounts needed to satisfy the pre-filing claims of creditors, those proceeds would be for the benefit of the shareholders of the debtor. This follows from the fact that the *CCAA* contains no provision for the payment of a "surplus" to creditors and the interest stops rule would prevent the unsecured creditors from recovering any post-filing interest. The debtor could therefore resort to the *CCAA* to stop interest from accruing and operate his business interest free.

47 This hypothetical raises the same concern about the loss of post-filing interest but in a somewhat different way. The concern is that a debtor may seek *CCAA* protection to avoid the obligation to pay interest.

48 There may well be exceptional situations where, at some point in a *CCAA* proceeding, the common law interest stops rule risks working an unfairness of some sort. I leave for another day what orders, if any, might be made by a *CCAA* judge in cases such as the hypothetical presented by the appellant where a debtor might be considered to benefit unfairly as a result of the common law interest stops rule. I note, however, that in order to achieve the remedial purpose of the *CCAA*, *CCAA* courts have been innovative in their interpretation of their stay power and in the exercise of their authority in the administration of *CCAA* proceedings. This approach has been specifically endorsed by the Supreme Court of Canada in *Century Services* and would no doubt guide the court should the need arise: see, for example, paras. 61 and 70.

49 In conclusion, there are sound reasons for adopting an interest stops rule in the *CCAA* context. I now turn to the argument that *Canada 3000* and *Stelco* preclude the application of the rule.

(b) Are Canada 3000 and Stelco binding authorities to the effect that the interest stops rule does not apply in CCAA proceedings?

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50 The appellant vigorously maintains that the *CCAA* judge was bound by *Canada 3000* and *Stelco*, which both confirm that the interest stops rule does not apply in *CCAA* proceedings.

51 I would not give effect to this submission. As I will explain, both of these decisions should be read narrowly and do not constitute a precedent with respect to the issue raised in this appeal — whether the common law interest stops rule applies in *CCAA* proceedings.

(i) Canada 3000

Background and lower court decisions

52 The decision in *Canada 3000* arose out of the collapse of three airlines — Canada 3000 Airlines Ltd. and Royal Aviation Inc. (collectively "Canada 3000"), and Inter-Canadian (1991) Inc. ("Inter-Canadian"). Canada 3000 filed for protection under the *CCAA* and, three days later, filed for bankruptcy. Inter- Canadian filed a *BIA* proposal but the proposal ultimately failed and so it too was placed into bankruptcy effective as of the date it filed its notice of intention to make a proposal.

53 At the time the airlines collapsed, they owed significant amounts in unpaid airport and navigation charges. As a result, various airport authorities and NAV Canada sought remedies under the *Airport Transfer (Miscellaneous Matters) Act*, S.C. 1992, c. 5 ("*Airports Act*") and the *Civil Air Navigation Services Commercialization Act*, S.C. 1996, c. 20 ("*CANSCA*"). In particular, they sought orders seizing and detaining aircraft leased by the bankrupt airlines. While the lessors of the planes retained legal title to the aircraft, the bankrupt airlines were the registered owner for the purposes of the *Aeronautics Act*, R.S.C. 1985, c. A- 2.

54 The airport authorities and NAV Canada brought proceedings in Ontario and Quebec.

55 In Ontario, Ground J. dismissed motions for orders permitting the airport authorities and NAV Canada to seize and detain the aircraft leased by Canada 3000: *Canada 3000 Inc., Re* (2002), 33 C.B.R. (4th) 184 (Ont. S.C.J.). On the question of interest, he concluded, at para. 73, that the airport authorities and NAV Canada were entitled to charge interest on the unpaid charges up to the date of payment or the posting of security for payment.

56 On appeal from Ground J.'s decision, this court held that the interest question need not be determined since the airport authorities and NAV Canada did not have the right to detain the aircraft: *Canada 3000 Inc., Re* (2004), 69 O.R. (3d) 1 (Ont. C.A.), at para. 197.

Supreme Court's decision

57 On appeal to the Supreme Court of Canada, the court determined that the airport authorities and NAV Canada had the right to detain the aircraft leased and operated by the bankrupt airlines. The issue of post-filing interest was, therefore, an issue the court had to decide.

58 In deciding that issue, Binnie J. made the following comment at para. 96:

> While a CCAA filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the [*BIA*].
>
> [Emphasis added.]

59 The appellant submits that the underlined words are binding *ratio* and must be followed in this case.

60 While I agree that Binnie J.'s comment about the *CCAA* is not *obiter*, I am not convinced that it should be read as broadly as the appellant contends. In *R. v. Henry*, 2005 SCC 76, [2005] 3 S.C.R. 609 (S.C.C.), Binnie J. warned, at

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para. 57, against reading "each phrase in a judgment ... as if enacted in a statute". Rather, the question to be asked is "what did the case decide?".

61 To answer what *Canada 3000* decided about post-filing interest under the *CCAA*, it is important to consider the context in which Binnie J. made his comment, including the facts of the case, the issues before the court, the structure of his reasons, the wording he used, and what he said as well as what he did not say.

62 At para. 40., Binnie J. defined the "two major questions raised by the appeals" as follows: (1) "are the *legal titleholders* liable for the debt incurred by the registered owners and operators of the failed airlines to the service providers?" and (2) "even if they are not so liable, are *the aircraft* to which they hold title subject on the facts of this case to judicially issued seizure and detention orders to answer for the unpaid user charges incurred by Canada 3000 and Inter-Canadian?" (emphasis in original). The answer to those two questions turned on the interpretation of the *Airports Act* and *CANSCA*. As Binnie J. noted at para. 36, the case was "from first to last an exercise in statutory interpretation".

63 After engaging in a lengthy exercise of statutory interpretation, he concluded that: (1) under s. 55 of *CANSCA*, the legal titleholders were not jointly and severally liable for the charges due to NAV Canada; and (2) under s. 56 of *CANSCA* and s. 9 of the *Airports Act*, the airport authorities and NAV Canada were entitled to apply for an order detaining the aircraft operated by the failed airlines.

64 Binnie J. then addressed eight additional arguments made by the parties and just before his last paragraph on disposition, he included a section simply entitled "Interest", starting at para. 93.

65 He began his analysis of the interest issue by outlining the statutory authority for charging interest: s. 9(1) of the *Airports Act* expressly provided for the payment of interest, and while *CANSCA* did not explicitly provide for interest, a regulation under *CANSCA* imposed interest: para. 93.

66 "The question then", said Binnie J. at para. 95, was "how long the interest can run". He addressed that question as follows, at paras. 95-96:

> The airport authorities and NAV Canada have possession of the aircraft until the charge or amount in respect of which the seizure was made is paid. It seems to me that this debt must be understood in real terms and must include the time value of money.
>
> Given the authority to charge interest, my view is that interest continues to run to the first of the date of payment, the posting of security or bankruptcy. If interest were to stop accruing before payment has been made, then the airport authorities and NAV Canada would not recover the full amount owed to them in real terms. Once the owner, operator or titleholder has provided security, the interest stops accruing. The legal titleholder is then incurring the cost of the security and losing the time value of money. It should not have to pay twice. <u>While a CCAA filing does not stop the accrual of interest</u>, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the [*BIA*].
>
> [Emphasis added.]

67 Significantly, Binnie J. made no mention in his reasons of the common law interest stops rule or the related *pari passu* principle. Nor did he cite any case law dealing with those issues. In fact, even though it is well established that the interest stops rules applies under the *BIA*, he did not rely on the common law rule in support of his finding that interest stopped on bankruptcy. Instead, he relied on ss. 121 and 122 of the *BIA* in concluding that the interest payable under the *Airports Act* and the regulation under *CANSCA* did not accrue post-bankruptcy.

68 Binnie J.'s analysis of the issue is rooted in the factual and statutory context of the case. In discussing the accrual of interest under the *CCAA*, he specified that the interest was on "unpaid charges", namely charges under *CANSCA* and

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the *Airports Act*. Binnie J. was not answering an abstract legal question but rather deciding how long interest ran in the particular factual and statutory context.

69 In effect, I read Binnie J. as saying that a *CCAA* filing does not stop the accrual of interest under *CANSCA* or the *Airports Act* but the statutory provisions of the *BIA* ss. 121 and 122 do. He was not deciding whether, in the absence of the right to interest under *CANSCA* and the *Airports Act*, interest would have accrued or been stopped by the common law interest stops rule.

70 Let me add that I agree with the *CCAA* judge's comment that Binnie J.'s statement in *Canada 3000* should "now be construed in light of *Century Services* and *Indalex*". In fact, one can well imagine that the court's interpretation of *CANSCA* and the *Airports Act* as allowing the accrual of interest in a *CCAA* proceeding but not in a *BIA* proceeding might have been different had it reached the Supreme Court after these two more recent cases. That question, however, is for another day. For now, I turn to this court's decision in *Stelco*.

(ii) Stelco

Background and motion judge's decision

71 The post-filing interest issue in *Stelco* arose in "the final chapter of the financial restructuring of Stelco" under the *CCAA*: *Stelco Inc., Re* (2006), 24 C.B.R. (5th) 59 (Ont. S.C.J. [Commercial List]), at para. 1. The final chapter involved competing claims to a portion of the amount payable to the holders of subordinated notes (the "Junior Noteholders") pursuant to Stelco's plan of arrangement (the "Plan"). The claim to these funds ("Turnover Proceeds") was made by the "Senior Debentureholders".

72 The dispute over the Turnover Proceeds arose after Stelco's Plan had been sanctioned and Stelco had emerged from restructuring with its debt reorganized. The Senior Debentureholders claimed the Turnover Proceeds on the basis of subordination provisions contained in the Note Indenture under which Stelco had issued convertible unsecured subordinated debentures to the Junior Noteholders.

73 Under the terms of the Note Indenture, the Junior Noteholders expressly agreed that, in the event that the debtor became insolvent, they would subordinate their right of repayment until after repayment in full of "Senior Debt".

[74] The plan of arrangement that had been approved was a "no interest" plan, meaning that distribution from Stelco to the creditors did not include or account for post-filing interest. The Plan, however, provided that the rights as between the Senior Debentureholders and the Junior Noteholders were preserved. The Senior Debentureholders, who had not received payment of post-filing interest from Stelco under the Plan, demanded payment of it from the Junior Noteholders pursuant to the terms of the Note Indenture. The Junior Noteholders argued, among other things, that the subordination provisions did not survive the Plan's implementation and that the Senior Debentureholders were not entitled to claim post-filing interest from them.

75 The motion judge, and on appeal, this court ruled in favour of the Senior Debentureholders. The courts found that the Plan was expressly drafted to preserve the subordination provisions and that the *CCAA* does not purport to affect rights as between creditors to the extent that they do not directly involve the debtor.

How to read Stelco?

76 The appellant and the respondents offer different readings of *Stelco*.

77 The appellant argues that this court's decision is binding authority for the proposition that the interest stops rule does not apply in the *CCAA* context. The passages relied on by the appellant include para. 67:

> [T]here is no persuasive authority that supports an Interest Stops Rule in a *CCAA* proceeding. Indeed, the suggested rule is inconsistent with the comment of Justice Binnie in [*Canada 3000*] at para. 96, where he said:

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> While a *CCAA* filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the [*BIA*].

78 The respondents, for their part, read the case more narrowly as a resolution of an inter-creditor dispute. They submit that the *ratio* of the case is that there was no rule that prohibited giving effect to the agreed upon inter- creditor postponement. To the extent that this court discussed the interest stops rule in the abstract, its comments are *obiter*.

79 I agree with the respondents. In my view, the court in *Stelco* did not need to decide whether the interest stops rule applies in *CCAA* proceedings for it to decide the inter-creditor dispute before the court and so its statements about the rule's application are not binding.

80 This court expressly noted, at para. 44, that it was dealing with an inter-creditor dispute. The Junior Noteholders had accepted the subordination terms in the Note Indenture. They had agreed not to be paid anything, in the event of insolvency, until those who held Senior Debt were paid principal and interest in full. The court affirmed, at para. 44, that the *CCAA* does not change the relationship among creditors where it does not directly involve the debtor.

81 As noted, this was a "no interest" plan, meaning that the Senior Debentureholders received no post-filing interest from Stelco. Rather, they sought and eventually received payment of post-filing interest from the Junior Noteholders' share of the proceeds. The court found that the Stelco Plan contemplated the continued accrual of interest to Senior Debentureholders for the purpose of their rights as against the Junior Noteholders after the *CCAA* filing date: paras. 59 and 70. It noted that *CCAA* plans can and sometimes do provide for payments in excess of claims filed in *CCAA* proceedings. There was no rule precluding the payment of post-filing interest to the Senior Debentureholders in accordance with the Stelco Plan: para. 70.

82 The court's conclusion that the Junior Noteholders could not rely on the interest stops rule is consistent with the traditional interest stops rule. The interest stops rule relates to claims by creditors against the debtor. It does not deal with arrangements as between creditors. In other words, whether or not the interest stops rule applies in *CCAA* proceedings did not need to be decided because the agreement between creditors fell outside the scope of that rule.

83 The appellant makes two further submissions based on its interpretation of s. 6.2(1) of the Note Indenture. That paragraph reads as follows:

> 6.2 Distribution on Insolvency or Winding-up.
>
> . . . . .
>
> (1) the holders of all Senior Debt will first be entitled to receive payment in full of the principal thereof, premium (or any other amount payable under such Senior Debt), if any, and interest <u>due thereon</u>, before the Debentureholders will be entitled to receive any payment or distribution of any kind or character, whether in cash, property or securities, <u>which may be payable or deliverable in any such event in respect of any of the Debentures</u>;
>
> [Emphasis added.]

84 The first argument is that the Senior Debentureholders were only entitled to receive principal, premium and interest "which may be payable or deliverable in any such event", the event being insolvency or bankruptcy proceedings. Therefore, the court must have concluded, at least implicitly, that the Senior Debentureholders would have been entitled to maintain their claim for post-filing interest against Stelco.

85 The second argument is that, by the terms of s. 6.2(1), the Senior Debentureholders were only entitled to interest "due thereon" and so they could not claim post-filing interest from the Junior Noteholders unless they could claim post-filing interest from Stelco.

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86 I would not give effect to either submission.

87 In *Stelco*, the court did not address either argument and we do not have a copy of the entire agreement nor do we have the other agreements that form part of the factual matrix. Without that context, this court is not in the position to interpret s. 6.2(1).

88 In my view, the key question for this court is not how to properly interpret s. 6.2(1) but, rather, how we should read the reasons in *Stelco*. What did the *Stelco* court decide, and specifically, should we read the panel as implicitly deciding that the Senior Debentureholders could not recover post-filing interest from the Junior Noteholders unless they could claim post-filing interest against Stelco?

89 In discussing post-filing interest, the court's only mention of the Senior Debentureholders' claim as against Stelco is found at paras. 57-59, where the panel expressly rejected the argument that "any claim the Senior [Debentureholders] have for interest must be based on a "claim" [as defined in the Plan] they have against Stelco for such interest" and that "[i]f the Senior Debt does not include post-filing interest, there can be no claim against the [Junior] Noteholders for such amounts": see paras. 58-59.

90 Admittedly, the panel made this comment in discussing the effect of the Stelco Plan as opposed to the effect of the interest stops rule. However, as I read the section on post-filing interest as a whole, the court is saying that the Junior Noteholders agreed to be bound by the deal they made. They had agreed to the subordination provisions that guaranteed full payment to the Senior Debentureholders in the event of insolvency, and the Plan affirmed that the Senior Noteholders could claim the full amount that would have been owing had there been no *CCAA* filing. In this court's words at para. 70, there is no interest stops rule "that precludes such a result." In my view, therefore, this court did not make an implicit finding that the Senior Debentureholders had to be able to claim post-filing interest from Stelco in order to claim post-filing interest from the Junior Noteholders.

91 In conclusion, I consider the comment that there is no persuasive authority that supports an interest stops rule in *CCAA* proceedings to be *obiter*. *Stelco* dealt with the effect of an agreement as between creditors as to how, between them, they would share distributions. Whether or not interest stops upon a *CCAA* filing was of no import in answering that question.

(2) If the CCAA judge did not err in concluding that an interest stops rule applies in CCAA proceedings, did he err in holding that holders of Crossover Bonds Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest?

92 The appellant objects to the wording of the *CCAA* judge's order. It provides that "holders of Crossover Bond Claims are not legally entitled to claim *or receive* any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest" (emphasis added). While the appellant asked the *CCAA* judge to amend his order to delete "or receive", he refused. The appellant submits that, to the extent this precludes the bondholders from receiving post-filing interest under a *CCAA* plan, the *CCAA* judge erred. The appellant notes that all the parties in this proceeding agree that a *CCAA* plan may provide for post-filing interest.

93 As I explained above, the interest stops rule does not preclude the payment of post-filing interest under a plan of compromise or arrangement.

94 As I read the *CCAA* judge's reasons and order, he did not decide otherwise. His decision confirms that the common law interest stops rule applies in *CCAA* proceedings. If a plan of compromise or arrangement is concluded, it should not, for example, be read as limiting any right to recover post-filing interest creditors may have as amongst themselves, as existed in *Stelco*, or from non-parties. Nor does it dictate what any creditor may seek in bargaining for a fair plan of compromise or arrangement. In that regard, I do not interpret the *CCAA* judge's use of the words "or receive" as preventing the appellant from seeking and obtaining such a result in a negotiated plan. In particular, I note the *CCAA*

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judge's comment at para. 35 of his reasons that "the parties would of course be free to include post-filing interest payments in a plan of arrangement, as is sometimes done."

95 The appellant also seeks clarification as to the effect of the words "*any amounts* under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest" (emphasis added). The appellant notes that, without clarification, the wording of the order could potentially preclude the recovery of other contractual entitlements under the relevant indentures, such as costs and make-whole provisions, even though no arguments were advanced before the *CCAA* judge with respect to any amounts other than post-filing interest.

96 The issue the *CCAA* judge was directed to answer was "whether the holders of the crossover bond claims ... [were] legally entitled ... to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest". As indicated in the appellant's factum, the only arguments advanced before the *CCAA* judge related to post-filing interest and not any other amounts under the indentures. The appellant does not appear to have made submissions to the *CCAA* judge with respect to the costs and make-whole fees it now raises in its factum. This court is in no position to deal with the new argument raised by the appellant. Further, beyond making the broad submission noted above, the appellant did not expand on that submission and direct the court to the specific claims or indenture provisions it relies on in support of its argument or explain why the claims should not be caught by the order.

97 As I have already indicated, the *CCAA* judge's order confirms that the interest stops rule, and the limits imposed by the rule, apply in *CCAA* proceedings. To the extent that the appellant maintains that there are other contractual entitlements under the relevant indentures not covered by the interest stops rule, it is up to the *CCAA* court to decide if those can now be raised and ruled upon.

F. Final Comments

98 I acknowledge that the Nortel *CCAA* proceedings are exceptional, particularly with respect to the length of the delay. The amount the appellant claims for post-filing interest and related claims under the indentures, and the resulting impact on other unsecured creditors is so great because of the length of that process. The principle, however, is the same whether the *CCAA* process is short or long. After the imposition of a stay in *CCAA* proceedings, allowing one group of unsecured creditors to accumulate post-filing interest, even for a relatively short period of time, would constitute unfair treatment vis-à-vis other unsecured creditors whose right to convert their claim into an interest-bearing judgment is stayed.

99 This decision does not purport to change or limit the powers of *CCAA* judges. Although the decision clearly settles at the outset of a *CCAA* proceeding whether there is a legal entitlement to post-filing interest, it does not dictate how the proceeding will progress thereafter until a plan of compromise or arrangement is approved, or the *CCAA* proceeding is otherwise brought to an end.

100 The determination of legal entitlement is important as it clearly establishes the starting point in a *CCAA* proceeding. It tells creditors, debtors and the court what legal claim a particular creditor has. Its significance is not only for purposes of setting the voting rights of creditors on any proposed plan of compromise or arrangement, it also ensures that, in assessing any such proposed plan, the parties will know what they are or are not compromising and the court will be equipped to consider the fairness of such a plan.

G. Disposition

101 For these reasons, I would dismiss the appeal. Pursuant to the agreement of the parties, I would award the respondent Monitor, as successful party, costs as against the appellant fixed in the amount of $40,000, inclusive of disbursements and applicable taxes. I would make no other order as to costs.

***Janet Simmons J.A.*:**

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I agree

***E.E. Gillese J.A.*:**

I agree

Appeal dismissed.

Footnotes

1 There are five Canadian Debtors: Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Technology Corporation, Nortel Networks International Corporation and Nortel Networks Global Corporation.

2 As explained in Roderick J. Wood's text on bankruptcy and insolvency law, "insolvency law is the wider concept, encompassing bankruptcy law but also including non-bankruptcy insolvency systems.": Roderick J. Wood, *Bankruptcy & Insolvency Law* (Toronto: Irwin Law Inc., 2009), at p. 1.

3 The respondents are the Monitor, the Canadian Debtors, the Canadian Creditors' Committee and the Wilmington Trust, National Association. While technically The Bank of New York Mellon and the Law Debenture Trust Company of New York are also respondents, they support the appellant's position and so my use of the term "respondents" excludes them.

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2016 CarswellOnt 7202
Supreme Court of Canada

Ad Hoc Group of Bondholders v. Nortel Networks Corp.

2016 CarswellOnt 7202, 2016 CarswellOnt 7203, 42 C.B.R. (6th) 3

Ad Hoc Group of Bondholders v. Ernst & Young Inc. in its capacity as Monitor, Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation, Nortel Networks Technology Corporation, Superintendent of Financial Services as Administrator of the Pension Guarantee Fund, Wilmington Trust, National Association, Law Debenture Trust Company of New York, Bank of New York Mellon, Nortel Networks Inc., Canadian Creditors Committee, Joint Administrators of Nortel Networks UK Limited, Board of the Pension Protection Fund and Nortel Networks UK Pension Trust Limited

McLachlin C.J.C., Moldaver, Gascon JJ.

Judgment: May 5, 2016
Docket: 36778

Proceedings: refusing leave to appeal *Nortel Networks Corp., Re* (2015), 32 C.B.R. (6th) 21, 340 O.A.C. 234, 127 O.R. (3d) 641, 2015 CarswellOnt 15461, 2015 ONCA 681, 391 D.L.R. (4th) 283, E.E. Gillese J.A., Janet Simmons J.A., Paul Rouleau J.A. (Ont. C.A.); affirming *Nortel Networks Corp., Re* (2014), 2014 CarswellOnt 17193, 2014 ONSC 4777, 121 O.R. (3d) 228, Newbould J. (Ont. S.C.J. [Commercial List])

Counsel: Counsel — not provided

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

APPLICATION for leave to appeal judgment reported at *Nortel Networks Corp., Re* (2015), 2015 ONCA 681, 2015 CarswellOnt 15461, 391 D.L.R. (4th) 283, 127 O.R. (3d) 641, 340 O.A.C. 234, 32 C.B.R. (6th) 21 (Ont. C.A.), dismissing applicant's appeal.

***Per curiam*:**

1 The motions of the Board of the Pension Protection Fund and Nortel Networks UK Pension Trust Limited to be added as respondents and for an extension of time to serve and file the response to the application for leave to appeal are granted. The application for leave to appeal from the judgment of the Court of Appeal for Ontario, Number C59703, 2015 ONCA 681, dated October 13, 2015, is dismissed with costs.

Application dismissed.

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2009 CarswellOnt 4465
Ontario Superior Court of Justice [Commercial List]

Indalex Ltd., Re

2009 CarswellOnt 4465, [2009] O.J. No. 3165, 179 A.C.W.S. (3d) 267, 55 C.B.R. (5th) 64, 79 C.C.P.B. 104

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF INDALEX LIMITED, INDALEX HOLDINGS (B.C.) LTD., 6326765 CANADIAN INC. AND NOVAR INC. (Applicants)

Morawetz J.

Heard: July 2, 2009
Judgment: July 2, 2009
Written reasons: July 24, 2009
Docket: CV-09-8122-00CL

Counsel: Linc Rogers, Katherine McEachern, Jackie Moher for Applicants
Ashley Taylor, Lesley Mercer for Monitor, FTI Consulting Canada ULC
Paul Macdonald, Jeff Levine for JPMorgan (DIP Lender)
Kenneth D. Kraft for SAPA Holding AB
Andrew Hatnay, Demetrios Yiokaris, Andrew Mckinnon for Keith Carruthers and SERP Retirees
B. Empey for Sun Indalex Finance LLC
John D. Leslie for U.S. Unsecured Creditors' Committee
G. Finlayson for U.S. Bank as Trustee for the Noteholders

Subject: Insolvency

MOTION by members of retirement plan for order to reinstate payment of supplemental pension benefits.

***Morawetz J.*:**

1 I heard argument in this matter on July 2, 2009 at the conclusion of which I dismissed the motion with reasons to follow. These are those reasons.

2 Members of the Indalex Supplemental Executive Retirement Plan or "SERP", (referred to collectively as the "SERP Group") brought this motion for an order requiring the Indalex Applicants to reinstate payment of supplemental pension benefits retroactive to April 2009.

3 The motion is opposed by the Indalex Applicants, the Noteholders and by the DIP Lender. Counsel to the DIP Lender submits that if these payments are made, they would constitute an event of default under the DIP Agreement. Such payments would need the consent or waiver from the DIP Lender which counsel submits, is not forthcoming.

4 The SERP Group have a contractual entitlement to pension benefits under the Supplemental Retirement Plan for executive employees of Indalex Limited and associated companies (the "Supplemental Plan").

5 The Supplemental Plan is an unfunded and non-registered supplemental pension plan. Benefits under the Supplemental Plan are paid out of the general revenues of the Indalex Applicants.

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6 Immediately after filing for CCAA protection on April 3, 2009, the Indalex Applicants informed the SERP Group that their supplemental pension benefits were being stopped.

7 The situation confronting members of the SERP Group is very similar to that faced by certain former employees of Nortel Networks ("Former Nortel Employees") who recently brought a motion requesting an order requiring the Applicants in Nortel's CCAA proceedings (the "Nortel Applicants") to make payments which the Nortel Applicants were contractually obligated to pay to Former Nortel Employees, relating to the Transitional Retirement Allowance and any pension benefit payments Former Nortel Employees were entitled to receive in excess of the pension plan. The motion was dismissed. (See *Nortel Networks Corp., Re*, 2009 CarswellOnt 3583 (Ont. S.C.J. [Commercial List]).

8 The reasons provided for the dismissal of the motion of the Former Nortel Employees are applicable to this case.

9 SERP payments are based on services provided to Indalex prior to April 2009. These obligations are, in my view, pre-filing unsecured obligations. A breach of the SERP payment obligations gives rise to an unsecured claim of the SERP Group against the Indalex Applicants. The SERP Group is stayed from enforcing these payment obligations.

10 The SERP Group has not established that they are entitled to any priority with respect to their SERP benefits and there is, in my view, no basis in principle, to treat the SERP Group differently than any other unsecured creditors of the Indalex Applicants. The reinstatement of the SERP payments would, in my view, represent an improper re-ordering of the existing priority regime.

11 The Amended and Restated Order authorizes the Indalex Applicants to pay all reasonable expenses incurred by the Indalex Applicants in carrying on their business in the ordinary course. SERP payments are not, in my view, payments required to carry on the business and, accordingly, the Indalex Applicants are not authorized to pay the monthly SERP payments.

12 In certain CCAA proceedings, the court has granted relief to permit payment of pre-filing unsecured debt. However, in these cases, such payments have for the most part, been considered to be crucial to the ongoing business of the debtor company. In this case, the Indalex Applicants are seeking a going concern solution for the benefit of all stakeholders and their resources should be used for such purposes. I have not been persuaded that the SERP payments are crucial to the ongoing business of the Indalex Applicants and such payments offer no apparent benefit to the Indalex Applicants. (*Re Nortel*, *supra*, at paragraphs 80 and 86.)

13 The SERP Group submits that there are hardship issues that should be taken into account. In Nortel, a hardship exception was made. However, the Nortel exception was predicated, in part, on the reasonable expectation that there will be a meaningful distribution to unsecured creditors, including the Former Nortel Employees. The Nortel hardship exception recognizes that any distribution would represent an advance on the general distribution. The situation facing the Indalex Applicants is different. The Indalex Applicants have significant secured creditors and unlike the situation in Nortel, it is premature to comment on the prospects of any meaningful distribution to unsecured creditors.

14 Counsel to SERP Group also submitted that CCAA protection in this case had been obtained for a company that was liquidating its assets. Counsel for the SERP Group submitted that Indalex had put itself up for sale and commenced a "marketing process" and as such it was not restructuring, rather, it was selling itself. This led to the submission that the cutting of benefits payable to the SERP Group was not necessary or justified for the sale of the company under the CCAA.

15 I fail to see the relevance of this submission. At the present time, the Applicants are properly under CCAA protection. No motion has been brought to challenge the appropriateness of the CCAA proceedings and, in my view, nothing in the CCAA precludes the ability of a debtor applicant to sell its assets. See *Re Nortel Networks Corporation* - endorsement released July 23, 2009 on this point.

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16 Finally, counsel to SERP Group placed emphasis on the fact that the amount required to satisfy the obligations to SERP Group is not significant. While this submission may be attractive on the surface, to give effect to this argument would violate a fundamental tenet of insolvency law, namely, that all unsecured creditors receive equal treatment. In my view, there is no basis to prefer the SERP Group or, indeed, any retired executive who is entitled to SERP payments in priority to other unsecured creditors.

17 Counsel to SERP Group also relied upon *Doman Industries Ltd., Re*, 2004 BCSC 733 (B.C. S.C.) for the proposition that, the fact that a company can reduce its costs if it can terminate contracts, is not sufficient for a CCAA court to authorize the termination of the contract. In *Doman*, *supra*, the point at issue concerned licences under the *Forest Act* which created the concept of replaceable contracts. Doman held certain licences. As noted by Tysoe J. (as he then was), at paragraph 7, a replaceable contract is a form of evergreen contract which contains statutorily mandated provisions, the most important of which is that the licence holder must offer a new or replacement contract to the contractor upon each expiry of the term of the contract as long as the contractor is not in default under the contract. That is not the situation in this case. The contractual situation in *Doman*, *supra*, is not, in my view, comparable to this case. *Doman*is clearly distinguishable on the facts.

18 For the forgoing reasons, the motion of SERP Group for reinstatement of SERP benefits is dismissed.

Motion dismissed.

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2005 CarswellOnt 1071
Ontario Court of Appeal

Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.

2005 CarswellOnt 1071, [2005] O.J. No. 1081, 10 C.B.R. (5th) 93, 138 A.C.W.S. (3d) 225, 195 O.A.C. 331, 251 D.L.R. (4th) 315, 74 O.R. (3d) 652

IN THE MATTER OF THE LOAN AND TRUST CORPORATIONS ACT, R.S.O. 1990, c. L.25, as amended

AND IN THE MATTER OF THE WINDING-UP AND RESTRUCTURING ACT, R.S.C. 1985, c. W.10, as amended

AND IN THE MATTER OF THE WINDING-UP OF SHOPPERS TRUST COMPANY

DELOITTE & TOUCHE INC., Liquidator of Shoppers Trust Corporation appointed pursuant to the Winding-up and Restructuring Act, R.S.C. 1985, c. W.11 (Applicant / Respondent in Appeal) and SHOPPERS TRUST COMPANY (Respondent)

Moldaver, Blair, LaForme JJ.A.

Heard: January 26, 2005
Judgment: March 24, 2005
Docket: CA C41924

Proceedings: reversing *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2004), 2004 CarswellOnt 358, 3 C.B.R. (5th) 155 (Ont. S.C.J.)

Counsel: Jeffrey Leon, Edmund Lamek for Appellant, Canada Deposit Insurance Company
John B. Laskin, Cynthia Tape for Respondent, Phillip Daniels

Subject: Corporate and Commercial; Insolvency

APPEAL by liquidator from judgment reported at *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2004), 2004 CarswellOnt 358, 3 C.B.R. (5th) 155 (Ont. S.C.J.), determining date of calculating interest on debts of corporation subject to winding-up proceedings.

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

Background

1 Shoppers Trust Corporation was a loan and trust company, incorporated under the Ontario *Loan and Trust Corporations Act*.[1] It invested in mortgages, held and leased commercial real estate properties, and administered a portfolio of mortgage-backed securities. By 1992, it was the second-largest enterprise of its kind in Canada.

2 Like many enterprises with a focus on real estate, however, Shoppers fell into financial difficulties in the early 1990's. On March 6, 1992, the Ontario Superintendent of Deposit Institutions took possession and control of its assets and it was shortly ordered to be wound up under the Ontario *Corporations Act*.[2] When investigations confirmed that Shoppers Trust was insolvent, the Liquidator applied for an order under the federal winding-up legislation. On August 19, 1992, Mr. Justice Houlden granted an order under the *Winding-up Act*, now the *Winding-up and Restructuring Act*,[3] directing that the Corporation be liquidated, with an effective winding-up date of July 31, 1992.

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3 At the time of these events, everyone believed there would be insufficient funds from the liquidation of the assets of the Corporation to satisfy in full the claims of depositors, the Crown, and secured and unsecured creditors. That belief has turned out to be somewhat pessimistic, however. Because of various delays in the administration of the estate — the reasons for which are not pertinent to this appeal — a significant amount of interest has accumulated on the liquidated assets. The Liquidator finds itself with unanticipated extra funds of approximately $6 million available for distribution.

4 At issue on this appeal is who is entitled to receive those funds.

5 The appellant, Canada Deposit Insurance Corporation ("CDIC") — which is subrogated to the rights of insured depositors whose claims it has paid — asserts that the extra funds should be disbursed to the deposit creditors and ordinary creditors of the Corporation to the extent there is unpaid principal and unpaid interest outstanding to the date of the winding-up. The respondent, Mr. Daniels, submits that the additional monies should be paid towards the principal outstanding on the sub debt held by him and other members of his family, notwithstanding that the claims of the subordinate noteholders rank behind the claims of all other creditors in the insolvency. Mr. Daniels makes this submission on the strength of an order made by Justice Houlden on March 10, 1993, authorizing and directing the Liquidator to calculate interest due on provable claims to April 24, 1992 (approximately three months before the effective winding-up date of July 31, 1992, set out in his earlier order of August 19, 1992).

6 In January 2004, the Liquidator applied to Justice Ground for directions regarding the distribution of the extra funds. Treating the motion as in substance a motion to vary the March 10, 1993 order of Justice Houlden, the motion judge declined to do so, and ruled in favour of Mr. Daniels. It is that order which is under appeal.

7 Respectfully, in my view, Ground J. erred, and I would allow the appeal, for the reasons that follow.

Facts

The Claimants and the Scheme of Distribution

8 The respondent held 75% of the shares of Shoppers; his brother, John Daniels, the remaining 25%. These shares were held either directly or indirectly through family members and related corporations. The Daniels were issued subordinated notes by the corporation in exchange for advances totalling approximately $8 million. It is not disputed that this is a legitimate corporate debt. However, the notes specifically provide that the indebtedness evidenced by them "is subordinated in right of payment to all other indebtedness of the corporation".

9 Because of the obligation of a loan and trust corporation to keep certain of its assets segregated as security for the monies placed with it on deposit, the assets of Shoppers are divided into two categories for purposes of its liquidation, namely, a Guaranteed Fund and a Company Fund. The Guaranteed Fund consists of monies held for the benefit of the corporation's depositors. The Company Fund consists of all other company assets and is subject to the claims of the Deposit Creditors (to the extent they are not satisfied from the Guaranteed Fund), the Crown, secured and unsecured creditors, and the subordinated noteholders.

10 In the liquidation, the administration of the Guaranteed Fund is substantially completed, and a final distribution was made from that fund in April 2000. The distribution was insufficient to satisfy the claims of the Deposit Creditors in full, leaving them with a shortfall claim ("the Shortfall Claim") against the Company Fund for $40,250,000, based on provable claims for principal as at July 31, 1992 (the date of the winding-up), with interest calculated as at April 24, 1992, pursuant to the order of March 10, 1993, referred to above.

11 The Deposit Creditors consist of CDIC and a group of depositors whose claims exceed $60,000. CDIC is by far the largest claimant. It acquired that position in its subrogated capacity, having reimbursed the corporation's depositors — up to $60,000 each — in accordance with its guarantee obligations under the *Loan and Trust Corporations Act*. On April 24, 1992, CDIC paid a total of approximately $491.5 million to depositors, representing the insured portion of

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their claims. Its subrogated interest represents 99% of the claims against the Shoppers Trust estate. In addition to CDIC's subrogated claim, a number of depositors whose claims exceeded the $60,000, also maintain claims in their own right for that excess. These uninsured depositor claims total approximately $5 million.

12 Shoppers had trade creditors and other unsecured creditors (together, the "Ordinary Creditors") with claims totalling about $1.2 million. The claims of the Crown and of the secured creditors are not pertinent to the issues on this appeal.

13 As at December 31, 2002, the Liquidator had funds of $47,283,000 for distribution from the Company Fund. This constitutes an excess of approximately $6 million over the amounts necessary to pay the claims of the Deposit Creditors and the Ordinary Creditors, with interest calculated to April 24, 1992, in accordance with the March 10, 1992 order. The effect of calculating the quantum of those claims based on interest to the date of the winding-up is to eliminate the $6 million excess referred to above. The following chart illustrates this outcome:

	April 24, 1992	**July 31, 1992**
Guaranteed Fund Shortfall Claimants	$ 40,250,000	$ 53,636,000
Trade Creditors	$ 565,000	$ 577,000
Other ordinary Creditors	$ 555,000	555,000
Subtotal:	$ 41,370,000	$ 54,768,000
Total Amount Available for Distribution	$ 47,283,000	$ 47,283,000
Less Claims by Shortfall Claimants and Other Unsecured Creditors:	$ 41,370,000	$ 54,768,000
Balance Available for Distribution	$ 5,913,000	0

The March 10, 1993 Order and the Interest Calculation Date

14 The March 10, 1993 order of Justice Houlden fixing an interest calculation date of April 24, 1992 was made — on the recommendation of the Liquidator and with the support of CDIC — for practical reasons. At the time, no one thought there would be sufficient funds in the insolvent estate to satisfy the claims of the Deposit Creditors and the Ordinary Creditors for principal and interest to the date of the winding-up. CDIC had made its payment to depositors based upon an interest calculation it had already done as at April 24, 1992. It was not worth the expense of re-calculating the interest amounts as at July 31 because doing so would not change the proportionate amounts that claimants would receive and the cost of the exercise would diminish the funds available for distribution.

15 In support of the motion leading to the March 10, 1993 order, the Liquidator filed a memorandum — as Liquidators normally do in the course of such proceedings — reporting on the status of the liquidation to that point and making various recommendations. At paragraphs 91 and 92 of the memorandum, the Liquidator said:

> 91. The major creditor claiming against the Company Fund is CDIC as to 98% in Proposal One and as to 97% in Proposal Two. [4] Again, CDIC has agreed to accept April 24, 1992 as the interest calculation date for the purposes of any distribution of the proceeds of assets in the Company Fund.
>
> 92. If there is a surplus after all other claims on the Company Fund have been satisfied, then claims for interest accruing to July 31, 1992 will be considered. The Liquidator expects a recovery for unsecured creditors on the Company Fund assets of only 46% under Proposal One and no recovery under Proposal Two and therefore does not expect there to be any surplus.

16 The motion judge accepted the respondent's argument that the Liquidator had in effect committed that it would not seek to pay interest to the Deposit Creditors and Ordinary Creditors to the date of the winding-up, unless there was "a surplus after *all other claims* on the Company Fund" had been satisfied [emphasis added]. He concluded that there was no

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such "surplus" on the facts before him because the words "all other claims" must include the subordinated debt, and no amounts had yet been paid on those claims. Accordingly, he ruled that the March 10, 1993 order should not be "varied".

Analysis

17 On behalf of the respondent, Mr. Laskin argues that the motion judge — an experienced commercial list judge responsible for supervising the liquidation of Shoppers Trust — exercised a discretion based on findings of fact and decided in the circumstances not to vary the earlier order of Justice Houlden. He submits that the judge's exercise of discretion is entitled to deference and that the appeal should be dismissed.

18 In my view, however, the directions the motion judge was called upon to provide did not entail the exercise of discretion at all. Instead, he was required to determine whether, as a matter of law, the Deposit Creditors and Ordinary Creditors were entitled to prove their claims, including any interest component of those claims, to the date of the winding-up, and, if so, whether the terms of the March 10, 1993 order precluded them from doing so in priority to the claims of the subordinated noteholders. The motion judge failed to address his mind to these questions and, in my respectful opinion, this led him astray in three respects and resulted in a decision that must be set aside.

19 First, the motion judge erred in treating the proceeding before him as a motion to vary, governed by the provisions of rule 59.06 of the *Rules of Civil Procedure*, rather than approaching it as the motion for directions in the liquidation proceedings that it was. Secondly, and most significantly, he was mistaken in viewing the right of a creditor to claim the full amount of principal plus interest due and owing to the date of the winding-up as a "usual practice" rather than as the governing principle of insolvency law that it is. Finally, he misconceived the effect of the memorandum filed by the Liquidator at the time of the motion before Justice Houlden; he placed too much emphasis on and misconstrued its wording; and, as a result, he failed to give effect to the fundamental principle of *pari passu* distribution underlying insolvency law.

Motion for Directions

20 The motions judge was not faced with a motion to vary the March 10, 1993 order of Justice Houlden. He was faced with a motion by the Liquidator for directions as to how the unanticipated extra funds in the estate should be distributed in the circumstances. While the incidental effect of an order for directions in an insolvency proceeding might be to alter or vary a previous order made during the course of supervision of the proceedings, such a motion for directions is not governed by the same principles that apply to rule 59.06 motions to vary, in my opinion.

21 The basis upon which an order may be set aside or varied under that rule is restricted to situations involving fraud or facts arising or discovered after the original order was made. Courts have traditionally taken a narrow approach to granting such relief. Where the ground asserted is that of fresh evidence or a change in circumstances -the approach taken by the motion judge here — the moving party must show that the new evidence (a) could not have been obtained through reasonable diligence prior to the order being made, (b) is apparently credible and (c) would probably have affected the outcome of the earlier hearing.

22 Such an approach is inapposite to a motion for directions in a winding-up proceeding, where the emphasis is not so much on whether the subsequent change in circumstances would have affected the original order made, but rather is on what order should be made in the present circumstances based upon the governing legal principles, the objectives of the winding-up regime, and what is fair and reasonable in the circumstances. A motion for directions may or may not involve an exercise of discretion by the motion judge. In this case, it did not.

The Law Respecting the Payment of Interest in Winding-up Proceedings

23 At para. 37 of his reasons, the motion judge said:

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> I am not satisfied that the fact that claims of creditors in a liquidation normally include interest up to the Winding-Up Date is a basis for the court, in this case, exercising its jurisdiction to vary the Houlden Order. There was no provision in the *WUA* [5] applicable at the date of the Houlden Order providing that claims were to be calculated as of the Winding-Up Date and interest payable up to the Winding-Up Date. The fact that that appears to have been the usual practice in liquidations at that time does not, in my view, override a specific provision of a judicial order that a different calculation date apply [*sic*] and a direction to calculate claims as of that date.

24 Respectfully, the motion judge erred in concluding that a creditor's right to claim principal plus interest due to the date of the winding-up was simply "the usual practice" in liquidation matters. The creditor's right in that regard was not a matter of practice; it was, and remains, a matter of insolvency law. As Selwyn L.J. stated in *Humber Ironworks & Shipbuilding Co., Re* (1869), 4 Ch. App. 643 (Eng. Ch. Div.), at 646-647:

> Now, it has been very properly admitted, on the part of the Appellant, that there can be no question as to any interest due at the time of the winding-up . . . because [the creditor's] interest due at the date of the winding-up is just as much a debt as the principal. . . . I think the tree must lie as it falls; that it must be ascertained what are the debts as they exist at the date of the winding-up, and that all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained.

25 The rationale underlying this approach rests on a fundamental principle of insolvency law, namely, that "in the case of an insolvent estate, all the money being realized as speedily as possible, should be applied equally and rateably in payment of the debts as they existed at the date of the winding-up": *Humber Ironworks*, at 646. Unless this is the case, the principle of *pari passu* distribution cannot be honoured. See also *McDougall, Re* (1883), 8 O.A.R. 309 at paras. 13-15, ; *Principal Savings & Trust Co. v. Principal Group Ltd. (Trustee of)* (1993), 109 D.L.R. (4th) 390 (Alta. C.A.) at paras. 12-16; and *Canada (Attorney General) v. Confederation Trust Co.* (2003), 65 O.R. (3d) 519, [2003] O.J. No. 2754 (Ont. S.C.J.), at 525 [O.R.]. While these cases were decided in the context of what is known as the "interest stops" rule [6], they are all premised on the common law understanding that claims for principal and interest are provable in liquidation proceedings to the date of the winding-up.

26 Thus, it was of little moment that the provisions of the *Winding-up* Act in force at the time of the March 10, 1993 order did not contain any such term. The 1996 amendment to s. 71(1) of the *Winding-up and Restructuring Act*, establishing that claims against the insolvent estate are to be calculated as at the date of the winding-up, merely clarified and codified the position as it already existed in insolvency law. Any debate in the earlier authorities concerned the appropriate choice of an effective date for the winding-up. Should it be the date of presentation of the petition, or the date the winding-up order is actually made? There was never a debate over the right of creditors to prove their claims in full, including any interest component, as of that effective date, whatever it may be. [7]

27 In giving the directions sought, in light of the unanticipated extra funds available to the Liquidator for distribution, the motion judge was obliged to give effect to the operative legal principles. His conclusion that the provisions of an order made ten years earlier in the liquidation proceeding "trumped" the governing principles of law at the time of the motion for directions — particularly where circumstances had evolved that no one envisioned at the time — constituted an error in principle. The law was, and continues to be, that claimants are entitled to prove their claims for principal and interest to the date of the winding-up. The law also was — and the terms of the respondent's contract expressly provide — that the claims of subordinate noteholders are subsidiary to all other claims in the insolvency. The respondent subordinated noteholder is not entitled to recover any of his principal or interest until those other claims have been paid in full.

28 Finally, in this regard, I note that Justice Houlden did not purport to alter the date for proving claims in the liquidation by his order of March 10, 1993, although his earlier order of August 19, 1992, providing for the liquidation of Shoppers Trust, had specifically provided for a winding-up date of July 31, 1992. The order provided only for an earlier date for calculation of interest, based upon the practical considerations outlined above. Had such an experienced

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insolvency judge as Justice Houlden intended to alter a date as fundamental as the effective date of the winding-up — and, therefore, the date for the proving of claims — for all purposes of the liquidation, regardless of subsequent developments, I would have expected him to say so specifically. He did not.

29 I therefore conclude that the March 10, 1993 order was not intended to, and did not, set a proof of claims date which precluded creditors from proving their claims in full up to the winding-up date. To interpret the order otherwise would be to prevent creditors with interest-bearing claims from proving their full entitlement to pre-winding-up interest and to benefit the subordinate noteholders (whose claims are inferior to all other claims) unfairly, thus contravening the *para passu* principle that is fundamental to insolvency law. Accordingly, the order does not operate as a bar, trumping the rights of the Deposit Creditors and the Ordinary Creditors to be paid out of the unanticipated extra funds in priority to the subordinated noteholders.

The Liquidator's Memorandum

30 The motion judge's third error in principle also flowed from his approaching the proceedings as a motion to vary. He placed unwarranted emphasis on the wording of the memorandum filed by the Liquidator in support of the motion before Justice Houlden. Further, he mistakenly treated the memorandum as if it were, in effect, an agreement precluding the Liquidator from later proposing a scheme of distribution, which did not comply with his interpretation of para. 92, regardless of the funds subsequently available and regardless of the priorities and legal principles governing that distribution.

31 In considering whether the change in circumstances justified a variation of the March 10, 1993 order, he focussed on whether the unanticipated extra funds constituted a "surplus" within the meaning para. 92 of the memorandum. He concluded there was no surplus in that sense because "all other claims" against the Company Fund — that is, the claims of the subordinated noteholders — had not yet been paid. Because he viewed the memorandum as a binding commitment on the part of the Liquidator not to seek to vary the order unless there was such a surplus, he decided that he should not exercise his discretion to vary the order in the circumstances.

32 I see two problems with this approach.

33 First, I do not read the memorandum to be anything other than what it purported to be, namely, a report by the Liquidator recommending a practical solution for the distribution of funds and the calculation of interest, based upon the then existing circumstances. I do not think it can reasonably be interpreted as a covenant on the part of the Liquidator — and inferentially by CDIC — to support a later distribution of then unanticipated extra funds in a fashion that contravenes both the legal principles governing provable claims and the premise of *pari passu* distribution that underlies insolvency proceedings. As an officer of the court responsible for the liquidation of the assets of Shoppers, the Liquidator could not make such a commitment without court approval, and, as I have noted above, if Justice Houlden had intended the order of March 10, 1993, to have had such an effect, he would have said so in it.

34 Secondly, and in any event, while a literal reading of the words "all other claims against the Company Fund" in para. 92 of the memorandum might support the inclusion of the claims of subordinated noteholders, such an interpretation is inconsistent with the language of the paragraph as a whole, and makes no practical sense in the context of the proposed procedure for distribution of the Guaranteed Fund and the Company Fund that was being put forward.

35 Deposit Creditors have resort to the Guaranteed Fund. Their claims were not to be satisfied under either suggested proposal for distribution from the Guaranteed Fund, and the Deposit Creditors were therefore entitled to claim - *pari passu* with other unsecured creditors — against the Company Fund (the Shortfall Claims). Paragraph 91 of the memorandum notes that CDIC is the major creditor claiming against the Company Fund. Paragraph 92 then provides that "if there is a surplus after all other claims on the Company Fund have been satisfied, then claims for interest accruing to July 31, 1992 will be considered". That the reference to "all other claims" was intended to refer to the claims of all other *unsecured creditors* (i.e., the uninsured deposit creditors, the trade creditors and the other ordinary creditors) and not

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the subordinated noteholders, is apparent from the next sentence in para. 92, which states that "the Liquidator expects a recovery *for unsecured creditors* on the Company Fund assets of only 46% under Proposal One and no recovery under Proposal Two and therefore does not expect there to be any surplus" [emphasis added]. The subordinated noteholders are not unsecured creditors. The reality of the context in which the memorandum was drafted is that no one contemplated the chance of any recovery whatsoever for the subordinated noteholders. I conclude the Liquidator did not intend to include them in the reference to "all other claims against the Company Fund" in para. 92 of the memorandum.

36 In my view, therefore, there was a "surplus" as envisaged by para. 92 of the memorandum in the circumstances presented to the motion judge. The directions the Liquidator and CDIC were seeking from him were perfectly consistent with the Liquidator's recommendations in March 1993.

Disposition

37 I therefore conclude that the appeal should be allowed, the order of Ground J. set aside, and in its place an order granted:

> (a) authorizing the Liquidator to calculate the claims of (i) the Deposit Creditors who have Shortfall Claims, and (ii) the ordinary unsecured creditors, all of whom have claims against the Company Fund, including the interest component of such claims, as at the winding-up date of July 31, 1992 (the "Winding-up Date") and to admit such claims as of the Winding-up Date;
>
> (b) authorizing the Liquidator to use an estimated average annual rate of interest in order to calculate the accrued interest component of the claims of depositors attributable to the period from April 24, 1992 to the Winding-up Date; and,
>
> (c) authorizing the Liquidator to use the contractual rates of interest, if any, in order to calculate the accrued interest component of the claims of the other ordinary unsecured creditors of Shoppers attributable to the period from April 24, 1992 to the Winding-up Date.

38 Counsel have agreed that, whatever the outcome of the appeal, there should be no order as to costs.

***Moldaver J.A.*:**

I agree.

***Laforme J.A.*:**

I agree.

Appeal allowed.

Footnotes

1 R.S.O. 1990, c. L-25.

2 R.S.O. 1990, c. C-38.

3 R.S.C. 1985, c.W-11, as amended.

4 The memorandum contained two proposals for the allocation of assets between trust claimants and ordinary creditors.

5 The *Winding-up Act* R.S.C. 1985, c. W-11.

6 At common law, interest on provable claims stops as at the commencement of the winding-up. No interest is payable on claims from that date forward, unless there is a surplus in the estate. In the event of a surplus, post-liquidation interest is payable

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first on debts in respect of which there is a right to interest prior to the liquidation date. See *Canada (Attorney General) v. Confederation Trust Co.*, *supra*, at para. 21.

7 Section 5 of the *Winding-up and Restructuring Act* R.S.C. 1985, c. W-11, as amended, now fixes the date of presentation of the petition as the effective date of the winding-up.

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14

2010 ONSC 5584
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2010 CarswellOnt 8462, 2010 ONSC 5584, 194 A.C.W.S. (3d) 717, 85 C.C.P.B. 161

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: September 29 - October 1, 2010
Judgment: November 9, 2010
Docket: 09-CL-7950

Counsel: Fred Myers, Gale Rubenstein, Melaney Wagner for Ernst & Young Inc., Monitor
Derrick Tay, Alan Merskey, Jennifer Stam for Nortel Networks Corporation, et al.
W.E. Pepall for Former Employees
Thomas McRae for Nortel Canadian Continuing Employees
G. Finlayson for Noteholders
Ken Rosenberg for Superintendent of Financial Services
Alex MacFarlane for Chapter 11 Unsecured Creditors' Committee
Lyndon Barnes, Geoffrey Grove for Board of Directors
Linc Rogers for Northern Trust Company
Kyla Maher for Flextronics (Canada) Inc.
Barry Wadsworth for the CAW
Peter Engelmann, Fiona Campbell for Susan Kennedy, Court Appointed LTD Beneficiaries' Representative
Joel Rochon, Sakie Tambakos for Dissenting LTD Beneficiaries

Subject: Estates and Trusts; Evidence; Employment; Public; Insolvency; Corporate and Commercial

APPLICATION by monitor for approval of distribution of health and welfare trust among certain beneficiaries; CROSS-MOTION by dissenting long-term disability beneficiaries for approval of distribution of health and welfare trust in accordance with different proposal.

***Morawetz J.*:**

Overview

1 Ernst & Young Inc. (the "Monitor"), in its capacity as Monitor of Nortel Networks Corporation, Nortel Networks Limited ("NNL"), Nortel Networks Technology Corporation, Nortel Networks International Corporation and Nortel Networks Global Corporation (collectively, the "Applicants" or "Nortel") applies for approval of a proposed methodology for allocation (the "Proposed Allocation Methodology") of the funds held in the Applicants' Health and Welfare Trust (the "HWT") among certain beneficiaries participating in the HWT.

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2 The Monitor also requests (i) an order declaring December 31, 2010 as the deemed Notice of Termination date under the Trust Agreement (defined below) and dispensing with delivery of a Notice of Termination; (ii) authorization for the HWT Trustee (the "Trustee") to make distributions from the HWT to beneficiaries under participating benefits based on the Proposed Allocation Methodology and as directed by the Monitor or the Applicants; (iii) authorization for payment from the corpus of the HWT of the costs of the Trustee or other service providers retained by it in accordance with the Trust Agreement and of any payment agent appointed by it or by the Applicants incurred in carrying out the provisions of the order; and (iv) approval of the retention of Independent Counsel (defined below) for the purpose of the Retainer (defined below).

3 The Monitor has filed its 51st Report and a Supplement to the 51st Report in support of the requested relief.

Background

4 Nortel filed for and obtained protection under the *Companies' Creditors Arrangement Act* ("CCAA") on January 14, 2009.

5 Although Nortel is insolvent, it continued for more than a year to fund its pre-filing obligations for medical, dental, and certain other benefits to its pensioners, their survivors, and disabled employees; however, it could not continue to do so indefinitely. In the absence of special arrangements, Nortel's benefits payments would have ceased on March 31, 2010.

6 The Applicants, the Monitor, court-appointed employees' representatives and representative counsel and the CAW-Canada ("CAW") reached an agreement regarding outstanding employment issues, including the payment of benefits during 2010 to, among others, Pensioners and LTD Beneficiaries (both defined below). The agreement was amended and restated on March 30, 2010 (as amended and restated, the "Settlement Agreement") and was approved by this court by Order dated March 31, 2010 [2010 CarswellOnt 2077 (Ont. S.C.J. [Commercial List])], and subsequently affirmed by the Court of Appeal for Ontario by Order dated June 3, 2010 [2010 CarswellOnt 3752 (Ont. C.A.)].

7 The Settlement Agreement provides that the parties to it "will work towards a Court approved distribution of the HWT corpus in 2010 to its beneficiaries entitled thereto ... and the resolution of any issue necessarily incident thereto." This provision recognizes the importance and significance of achieving an allocation of the HWT corpus, if possible, before the end of 2010 (when payment of benefits will cease) in order for distributions to be made to individuals based on such an allocation.

8 Nortel established the HWT on January 1, 1980 as a tax-efficient vehicle through which Nortel would continue to provide employee benefits by agreement between Northern Telecom Limited (a predecessor company to NNL) and Montreal Trust Company (as trustee), and amended by subsequent agreements (collectively, the "Trust Agreement").

9 The Trust Agreement provides, among other things, that:

(a) all contributions (from both Nortel and employees) will be held in a single fund (the "Trust Fund"), including all profits, increments, and earnings thereon;

(b) Nortel may designate as the "Health and Welfare Plan" certain of the following health and welfare plans (and such other similar plan or plans as Nortel may from time to time place in effect): health care; management long term disability; union long term disability; a management survivor income benefit; management short term disability; and a group life insurance; and

(c) the Trust Fund is created for the purpose of providing the Health and Welfare Plan benefits for the benefit of the Applicants' active and retired employees.

10 Obligations of the HWT were owed to various beneficiaries with respect to various benefits, including the following:

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• post-retirement medical and dental benefits ("Pensioner M&D") and life insurance benefits ("Pensioner Life") to pensioners of Nortel or their eligible dependants ("Pensioners") (approximately 11,000 pensioners and 6,000 spouses);

• long-term disability benefits to active employees with long-term disabilities and their eligible dependants ("LTD Beneficiaries") (approximately 360 individuals and 318 dependants);

• survivor income benefits ("SIBs") to survivors of certain non-unionized Nortel employees ("SIB Beneficiaries") (approximately 80 survivors); and,

• survivor transition benefits ("STBs") to survivors of certain unionized former Nortel employees ("STB Beneficiaries"), payable for a five-year period (approximately 305 survivors currently receiving STBs and 3,000 Pensioners and LTD Beneficiaries on whose deaths their survivors would be eligible for STBs).

11 This motion concerns the determination of which beneficiaries are entitled to share in the HWT corpus in respect of the following benefits (the "Potential Participating Benefits") on the termination of the HWT:

(a) Pensioner Life;

(b) Pensioner M&D;

(c) life insurance benefits for LTD employees ("LTD Life");

(d) optional life insurance for active employees, where employees pay their own premiums ("Optional Life");

(e) optional life insurance for LTD Beneficiaries, where premiums are waived ("LTD Optional Life Benefit");

(f) medical and dental benefits for LTD employees ("LTD M&D");

(g) income replacement benefits for Nortel employees on LTD ("LTD Income");

(h) SIBs

(i) income benefits currently being paid to survivors of certain unionized former Nortel employees ("STBs - in pay"); and

(j) income benefits being accrued for pensioners and LTD Beneficiaries on whose death their survivors would be eligible for STBs ("STBs - accrued").

12 The total liabilities of the HWT are estimated to be approximately $542.9 million as at December 31, 2010. However, the value of investments held for the HWT at June 30, 2010 is approximately $77.2 million, although the actual amount of cash available at the date of termination of the HWT is subject to change. For the purpose of the illustrative scenarios in the Monitor's materials, the balance available for distribution at December 31, 2010 is assumed to be in the amount of $80 million (including a Pensioner Life insurance premium paid by Nortel for 2010 of $7.8 million).

13 It is clear that an allocation and distribution of the corpus of the HWT has a serious and significant impact on employee and pensioner claims against the Applicants.

14 The assets in the HWT are clearly inadequate to address its liabilities. The claimants have an unsecured claim against Nortel for any shortfall, but sadly, any distribution from the Nortel estate is not expected to fully address the claims or to even come close to fully addressing such claims.

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15 Mercer has prepared a report providing a preliminary valuation of certain non-pension post-retirement benefit plans and post-employment plans, estimated as at December 31, 2010 (the "Mercer 2010 HWT Preliminary Valuation") to assist with the analysis with the Proposed Allocation Methodology. It is the basis for distribution of the HWT corpus.

16 A number of outcomes relating to an allocation of the HWT corpus is possible given:

(a) the Trust Agreement does not provide clear guidance on which individuals are entitled to participate in a distribution on termination of the HWT, and there are a number of possible interpretations and

(b) the evolution of Nortel's practices, business, benefits and recordkeeping over the 30 years of the HWT's existence.

17 The Monitor recommends the Proposed Allocation Methodology based on the advice of counsel with respect to the interpretation of the Trust Agreement. The termination provision of the Trust Agreement (the "Termination Provision") provides:

> Upon receipt of the Notice of Termination the Trustee shall within one hundred twenty (120) days determine and satisfy all expenses, claims and obligations arising under the terms of the Trust Agreement and Health and Welfare Plan up to the date of the Notice Termination. The Trustee shall also determine upon a sound actuarial basis, the amount of money necessary to pay and satisfy all future benefits and claims to be made under the Plan in respect to benefits and clams up to the date of the Notice of Termination. The Corporation and the designated affiliated or subsidiary corporations shall be responsible to pay to the Trustee sufficient funds to satisfy all such expenses, claims and obligations, and such future benefits and claims. The final accounts of the Trustee shall be examined and the correctness thereof ascertained and certified by the auditors appointed by the Trustee. Any funds remaining in the Trust Fund after the satisfaction of all expenses, claims and obligations and future benefits and claims, arising under the terms of the Trust Agreement and the Health and Welfare Plan shall revert to the corporation.

18 The Proposed Allocation Methodology, in brief, provides that those beneficiaries whose claims are in pay (that is, those with income claims presently being paid) and those whose claims are certain to be payable at some future date will share in the distribution.

19 The Proposed Allocation Methodology is as follows:

(a) the HWT is to be treated as one trust;

(b) on termination, the following Potential Participating Benefits share *pro rata* in the HWT corpus (based on each such Potential Participating Benefit's respective share of the present value of all such Potential Participating Benefits):

(i) Pensioner Life;

(ii) LTD Income;

(iii) LTD Life;

(iv) LTD Optional Life Benefit;

(v) STBs - in pay; and

(vi) SIBs;

(collectively, the "Proposed Participating Benefits");

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(c) the following beneficiaries will receive distributions from the Proposed Participating Benefits' *pro rata* share of the HWT corpus:

(i) Pensioners (including those active employees who will vest by the valuation date and LTD Beneficiaries) for Pensioner Life;

(ii) LTD Beneficiaries for LTD Income and LTD Life;

(iii) LTD Beneficiaries participating under Optional Life for LTD Optional Life Benefit;

(iv) STB Beneficiaries currently in pay for STBs; and

(v) SIB Beneficiaries currently in pay for SIBs;

(collectively, the "Proposed Participating Beneficiaries")

(d) the amount of the distribution to each Proposed Participating Beneficiary from the Proposed Participating Benefits' *pro rata* share of the HWT corpus will be calculated pursuant to the assumptions in the Mercer 2010 HWT Preliminary Valuation, with data as of December 31, 2010, and the Pensioner Life premiums paid for the HWT during 2010 will be treated as a reduction only to the allocation otherwise made to Pensioner Life;

(e) the present value of the Proposed Participating Benefits will be calculated pursuant to the assumptions in the Mercer 2010 HWT Preliminary Valuation, with data as of December 31, 2010; and

(f) there will be payment from the HWT on account of any conversion privilege, if any, relating to the Pensioner Life or Optional Life that is exercised by any holder of such right.

20 The Monitor submits that its recommendation is based on its conclusions regarding four legal issues:

(a) the HWT constitutes one trust;

(b) beneficiaries with income claims presently being paid and whose claims are certain to be paid in the future should share in the distribution;

(c) the assets in the reserve account referred to as Group Life - Part II (related to optional life insurance) should be distributed among HWT beneficiaries eligible to participate upon termination; and

(d) beneficiaries should participate *pro rata* in the HWT funds.

21 Counsel to the Monitor prepared a Memorandum of Law (the "Memorandum"), which analyzed how the funds in the HWT were to be distributed pursuant to its interpretation of the Trust Agreement. This Memorandum is attached as Schedule A.

22 The Monitor also prepared a chart illustrating various allocation scenarios (the "Allocation Chart"). The Allocation Chart is attached as Schedule B.

23 The Proposed Allocation Methodology is reflected in Scenario 2.

24 The Monitor is of the view that deeming December 31, 2010 as the date of Notice of Termination of the HWT for the purposes of the Trust Agreement and dispensing with Nortel sending a Notice of Termination to the Trustee will create consistency and avoid confusion between the date of termination of benefits and the LTD Beneficiary termination date of December 31, 2010 pursuant to the Settlement Agreement, the valuation date and the Mercer 2010 HWT Preliminary Valuation and the expected date of termination of the HWT.

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25 Scenario 2 has attracted widespread support. Consents to the proposed allocation have been provided by counsel to the Nortel Canadian Continuing Employees ("NCCE"), to the court-appointed employee representative, counsel to the Former Employees ("Former Employees") and the LTD Beneficiaries representative, and the CAW.

26 Counsel to the Bondholders and to the Unsecured Creditors' Committee in the Chapter 11 proceedings do not oppose the allocation proposed in Scenario 2. However, to the extent that Scenario 2 is not approved, both the Bondholders and the Unsecured Creditors' Committee reserve their rights.

27 The Scenario 2 allocation is opposed by the Dissenting LTD Beneficiaries (defined below). While the Dissenting LTD Beneficiaries largely agree with the structure of the analysis provided by counsel to the Monitor as set out in the Memorandum, they disagree with the conclusion that future Pensioner Life benefits, which they characterize as the payment of annual premiums on one year term life insurance policies, are entitled to participate in an distribution of the HWT.

28 The Dissenting LTD Beneficiaries brought a cross-motion seeking approval of the distribution of the HWT in accordance with Scenario 3 of Schedule B, or other alternative relief as set out in their Notice of Motion.

29 The differences between Scenario 2 and Scenario 3 are significant. The total of all benefit liabilities under the HWT is $548.2 million. The HWT has assets of $80 million. Scenarios 2 and 3 provide for a charge of $7.8 million for Pensioner Life Premiums for 2010 leaving $72.2 million for distribution. Under Scenario 2, the proposed amount payable to Pensioner Life claims is $35.05 million and $26.98 million to LTD Insurance, with smaller amounts paid for other benefits as indicated. Under Scenario 3, there would be no distribution on account of Pensioner Life claims and there would be an increase of $30.59 million for LTD claims to $57.57 million.

30 The motion of the Dissenting LTD Beneficiaries was served the day before the hearing. A number of parties expressed concern over late service and reserved their rights, in the event Scenario 2 was not approved, to submit further evidence and to present further argument. This concern was acknowledged by counsel to the Dissenting LTD Beneficiaries.

31 As stated above, the Monitor's recommendation is based on its conclusions regarding legal issues as set out at [20].

32 The Dissenting LTD Beneficiaries take no issue with [20] (a) and (c).

33 For the reasons set forth in the Memorandum, I accept the conclusions set out at [20] (a) and (c): the HWT constitutes one trust, and Group Life - Part II reserved assets should be included in HWT distribution.

Legal Counsel

34 All but a very few individuals are represented by court-appointed representatives and Representative Counsel for the Former Employees, LTD Beneficiaries and the NCCE, or by CAW counsel.

35 The court orders appointing the employee representatives provide that they may represent their constituents for the purpose of settling or compromising their claims in insolvency proceedings or in any other proceeding that has been or may be brought before this court.

36 The Former Employees' representatives and the LTD Beneficiaries' representative each retained independent counsel (collectively, "Independent Counsel") to advise them with respect to the Proposed Allocation Methodology and to take all steps necessary or desirable with respect to thereto (the "Retainer"). Independent Counsel appear on their behalf on this motion. Nortel has agreed to provide funding for the retention of Independent Counsel for these purposes, subject to a fee cap.

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37 Although only three individuals formally opted out of being represented by Representative Counsel, approximately 40 individuals (the "Dissenting LTD Beneficiaries") have retained Mr. Rochon.

38 The Dissenting LTD Beneficiaries raised an issue of conflict of interest of Representative Counsel. A motion was brought to address the issue, but subsequent to the retention of Independent Counsel, the Dissenting LTD Beneficiaries decided not to proceed with their motion.

39 I am satisfied that any issues relating to conflict in this area have been addressed in a satisfactory manner.

Position of Parties Supporting Scenario 2

40 The Monitor recommends the Proposed Allocation Methodology, submitting that it represents a fair and reasonable balancing of various interests in a trust fund that is clearly inadequate to fully meet all claims and that it is a practical methodology that can be implemented without undue cost and delay. The parties supporting the Monitor adopted the submissions of the Monitor.

41 The Monitor submits that distribution of the HWT should extend not only to beneficiaries with income claims presently being paid (*i.e.*, LTD Income) but also to those whose claims are certain to be paid in the future (*i.e.*, Pensioner Life).

42 The Monitor submits that this interpretation best gives meaning to the Termination Provision and would distribute the HWT to holders of benefits that have been vested so that an employee or former employee receives what is promised to him or her. It submits that the Proposed Allocation Methodology provides that those beneficiaries whose claims are in pay (that is, those with income claims presently being paid) and those beneficiaries whose claims are certain to be payable at some future date will share in the distribution. The Monitor emphasizes that this interpretation is consistent with the Termination Provision in terms of both the requirement to pay all claims and future claims, as well as the limiting words "up to the date of the Notice of Termination".

43 It is uncontroversial that any claims actually made and obligations actually incurred up to the date of the Notice of Termination should participate. On the issue of what future benefits and claims should be paid (given that the phrase "future benefits and claims" is not defined and given that the Termination Provision sets a cut-off date of "up to the date of the Notice of Termination"), the Monitor submits that not all potential contingent future unvested beneficiaries of the HWT are entitled to participate. In this respect, the Monitor argues that the effect of the phrase, "up to the date of the Notice of Termination," is to restrict distribution to "future benefits and claims" that can be considered to have been made or incurred prior to the date of termination.

44 The Monitor further submits that "future benefits and claims" should be interpreted to also include claims that have not been made at the date of termination but that, without termination, would *certainly* be made in the future. The Monitor contends that such benefits can be said to have vested and, therefore, belong among the Proposed Participating Benefits.

45 The NCCE supports the Scenario 2 allocation but does not necessarily agree with any or all of the submissions of the Monitor.

46 The Former Employees representative submits that the outcome proposed by the Monitor is reasonable and warrants court approval. Their support is conditional upon the continued support and agreement of other beneficiary classes and, ultimately, the approval of the court.

47 In this connection, the Former Employees submit that all represented interests have equal status as beneficiaries of the HWT. The Termination Provision does not establish priorities as between beneficiaries, nor does it make specific allocation of trust assets to any particular beneficiary class on trust termination. In absence of any express terms in this

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regard, a trustee is under a duty of "even-handedness" to administer the trust impartially as between beneficiaries and classes of beneficiaries.

48 On the issue of what future benefits and claims should be paid, the Former Employees submit that the specific use by the Termination Provision of the term "benefits" in the phrase "benefits and claims" is significant and that the term has, and must, be given a meaning that is distinct from "claims". The Former Employees submit that the settlor intended to provide for future benefits, as well as future claims at the point of termination.

49 The Former Employees reject the argument that vested retiree life benefits are subordinate to LTD Beneficiaries on trust termination. They submit that very clear language would be required to exclude a beneficiary class having a vested, non-contingent benefit from sharing on termination and that no such language exists in the Trust Agreement.

50 The Former Employees submit that the Monitor's recommendation that Pensioner Life share or participate *pro rata* with the other beneficiary classes represents a reasonable interpretation of the Trust Agreement in light of surrounding circumstances. These include the fact that, *at its creation*, the HWT was funded by $11 million transferred from a Mutual Life Assurance Account representing the surplus in a prior retirement life insurance plan; that each annual HWT financial statement after its formation reported a "Pension Insurance Fund Reserve"; and that Pensioner Life premium were historically paid from HWT assets up to and throughout the CCAA proceedings.

51 The Former Employees disagree with the Dissenting LTD Beneficiaries' characterization of the Pensioner Life benefit as contingent. They submit that it is a permanent life insurance benefit such that - provided premiums were paid - insurance would continue throughout the retiree's life time without subsequent application or examination. *Dayco (Canada) Ltd. v. C.A.W.*, [1993] 2 S.C.R. 230 (S.C.C.) at p. 305. They submit that Pensioner Life benefits vested when a Nortel employee retired, and, as such, Nortel or the HWT assumed an unconditional, binding obligation to make Pensioner Life insurance premium payments for the balance of the retiree's life.

52 The Former Employees submit that, in respect of Pensioner Life, the vesting event is retirement, not death. The ultimate Pensioner Life benefit - payment on death - is not a contingent or speculative event. Consequently, they submit that Pensioner Life is a vested future benefit and certain future claim and plainly within the scope of the Termination Provision.

53 CAW supports the submission of the Monitor and emphasizes that, in accordance with accepted labour law principles, all of the benefits that have accrued to unionized retirees at the time of their retirement under a collective agreement must be seen as having "vested." As such, a retiree who has been subject to a collective agreement has the right to seek through their union the enforcement of those rights that had vested at the time of their retirement, even though the collective agreement in effect at the time of such retirement has, in fact, expired.

54 In a submission unique to its interests, the CAW argues that the Dissenting LTD Beneficiaries who are members of the CAW, and the counsel that purports to represent them, have no standing to oppose that which the union has determined to support. As a result, the submissions of the Dissenting LTD Beneficiaries is incompatible with the union's role as exclusive bargaining agent, which provides it with the authority to resolve disputes arising out of the interpretation, application, or administration of the collective agreement and is subject only to the duty of fair representation.

Dissenting Ltd Beneficiaries

55 The Dissenting LTD Beneficiaries submit that a plain reading of the Termination Provision demonstrates that only claims of the HWT actually incurred prior to the Notice of Termination can participate in the wind-up distribution. Such claims would include the ongoing future income payments that flow from claims incurred up to the date of the Notice of Termination.

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56 They submit that the foregoing interpretation is consistent with tax, actuarial, and insurance rules, principles and practices that apply to health and welfare trusts, in general, as well as the publicly available documentation related to the HWT.

57 The Dissenting LTD Beneficiaries reject as unreasonable an interpretation of the Termination Agreement such that future premium payments owing to a third party insurer in respect of coverage beyond the date of termination should be paid from the HWT. They submit that, in recommending the inclusion of future claims, the Monitor ventures beyond the plain wording of the Termination Provision and advocates for an overly expansive interpretation of these provisions in order to capture future claims, which are contingent, and is contrary to the taxation rules that govern HWTs.

58 They contend that this interpretation fails to give any meaning to the "up to the Notice of Termination" cut-off date set out in the Termination Provision and runs afoul of the basic tenet of contractual interpretation that meaning should be given to provisions in their entirety. They argue that giving meaning to the expression "future benefits" and to the stipulated cut-off date necessarily leads to the conclusion that only "future benefits and claims" incurred prior to the Notice of Termination are payable on wind-up of the HWT.

59 The Dissenting LTD Beneficiaries also challenge the Monitor's characterization of Pensioner Life benefits as relating to permanent insurance. Rather, they submit that these benefits relate to one year renewable term life insurance policies paid monthly by Nortel to Sun Life.

60 The Dissenting LTD Beneficiaries also reject the notion that Pensioner Life benefits are certain to be paid in the future. They submit that their position is supported by the termination provisions of the Sun Life Group Term Life Insurance Policies. These indicate that coverage is automatically terminated upon the receivership or bankruptcy of the policyholder, NNL, and that "the insurance of all members stops on the termination date of this policy and claims incurred after that date are not eligible for payment." They add that it is clear that Nortel is effectively bankrupt and that, therefore, Pensioner Life and other life insurance coverage will terminate. Benefits pursuant to this coverage will not, then, "certainly be made in the future".

61 They further cite as problematic the reading in of an obligation to pay "claims that have not been made but would certainly have been made in the future" because the certainty of the claim being relied upon by the Monitor relates to the certainty of death. They submit that the payment of the death claim is the obligation of Sun Life, a third party insurer, and not of Nortel or the HWT. The benefit provided by Nortel is restricted to the payment of premiums only, which cannot give rise to a claim in the future that would be captured by the Termination Provision.

62 The Dissenting LTD Beneficiaries suggest that the wind-up liabilities should be interpreted in accordance with a funding basis consistent with the tax considerations that apply to the HWT, particularly when such a result best reflects the plain meaning of the Termination Provision and the evidence before the Court regarding actuarial practice.

63 In this respect, they submit that tax rules permit only group term life insurance policies, and not permanent policies, to be held in an HWT. To accede to an interpretation in which Pensioner Life benefits participate on termination would offend the tax rules governing health and welfare trusts and potentially throw into question the tax treatment of the HWT.

64 They submit that tax rules are relevant, in this respect, because the proper interpretation of the Termination Provision should be one that is compliant with tax law and applicable actuarial and insurance standards and principles. This follows from the accepted principle of contractual interpretation that, when faced with two plausible interpretations, one of which will lead to a construction of a contract that is unlawful, courts will prefer the interpretation that is consistent with the law.

65 The Dissenting LTD Beneficiaries submit that, given that Nortel established the HWT in order to secure tax benefits of such trust arrangements, the tax purpose and motivation of the HWT, as well as Nortel's subsequent actions in relation

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to the HWT, should strongly inform the interpretation of the Termination Provision and any prospective allocation methodology. The fact that Nortel was taking tax deductions equal to its contributions encourages the inference that its contributions were in respect of claims that had occurred or were currently occurring, such as disability income payment.

66 They contend that an interpretation allowing Pensioner Life benefits to share in the distribution of HWT assets would imply that Nortel HWT was not tax compliant and would suggest that Nortel had been claiming deductions to which it was not entitled because of the *Income Tax Act*'s prohibition of deducting prepaid insurance considerations.

67 The Dissenting LTD Beneficiaries also reject the Monitor's emphasis on the fact that Pensioner Life benefits were part of a reserved plan. They submit that but for an $11 million initial contribution at the HWT's inception from a Mutual Life Assurance Account, the nature of the Pensioner Life benefit suggests that benefits pursuant to it would be treated as pay-as-you-go claims for which no pre-funding was permitted and which would not have required a bookkeeping reserve.

68 They argue that the $11 million transfer does not constitute evidence that the pensioners are beneficiaries of the HWT today on its wind-up and should have no bearing on the interpretation of the Termination Provision.

69 The Dissenting LTD Beneficiaries urge the conclusion that the notional reserve for the Pensioners' Life Insurance Plan is distinguishable from the reserve for the LTD and Survivor Income Plans for which Nortel recognized an obligation to accumulate funds. This reserve ought not to have any significance on the interpretation of the Termination Provision.

70 Moreover, the Dissenting LTD Beneficiaries urge that *pro rata* distribution of funds is not appropriate in this case. In this respect, they submit that the Termination Provision does not specify how the Trust Fund is to be shared on the dissolution of the Nortel HWT. They reject the Monitor's proposal that the Court apply the maxim "equality is equity" on the grounds that it is a principle of last resort and not a *prima facie* presumption. The Dissenting LTD Beneficiaries submit that "equality is equity" can apply only if there is not some good reason in law and equity why it ought not to apply.

71 They submit that a determination of the appropriate allocation should reflect the intention of the parties at the time the transactions were entered into and the necessity for fairness in the ultimate result.

72 The Dissenting LTD Beneficiaries suggest that equal treatment of incurred claims of the LTD Beneficiaries and survivors and the contingent claims of pensioners in respect of future Pensioner Life benefits is inconsistent with the purpose for which Nortel established the Nortel HWT. They submit that such equal treatment would be patently unfair to the LTD Beneficiaries, who have a profound interest in the HWT and who were the ones most harshly impacted by the Settlement Agreement, which, among other things, prevents them from seeking legal redress the funding shortfall.

73 They submit that an equitable distribution of the Nortel HWT is one that will take into account the compelling reasons why this court should not apply the "equality is equity" principle in this case, such as the disproportionate impact of the distribution on LTD Beneficiaries.

Analysis

Preliminary Issue - Expert Evidence

74 Scenario 3 provides for an enhanced recovery for the Dissenting LTD Beneficiaries - at the expense of the of the Pensioner Life claimants. The situation facing the Dissenting LTD Beneficiaries and the Pensioner Life claimants is that of a "zero sum game". Increased allocation for one group corresponds with a diminished allocation and recovery for another group.

75 There is no doubt that the position of the Dissenting LTD Beneficiaries has been severely compromised by Nortel's insolvency. However, the Dissenting LTD Beneficiaries are not alone in this respect. All of the parties claiming entitlement to the HWT have been adversely impacted by Nortel's insolvency.

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76 Counsel to the Dissenting LTD Beneficiaries submits that the proper distribution of the assets of the HWT upon wind-up depends on the Termination Provision, read in the context of the Trust Agreement as a whole, and with a view to the intention of Nortel as the settlor *at the time it entered into the Trust Agreement*.

77 Counsel further submits that evidence of such intention may be gleaned from various sources, *including the factual matrix at the time* and other documents relating to the HWT, employee benefits and employee communications (see *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611 (S.C.C.) at p. 670).

78 Counsel further submits that a trust document should be construed using rules of contractual interpretation and rules of statutory interpretation. The goal of contractual interpretation is to discover, objectively, the parties' intentions *at the time the contract was made* (see *Gilchrist v. Western Star Trucks Inc.*, [2000] B.C.J. No. 164 (B.C. C.A.) at para. 17. Second, the agreement must be construed as a whole with meaning given to all its provisions (see *Pass Creek Enterprises Ltd. v. Kootenay Custom Log Sort Ltd.*, [2003] B.C.J. No. 2508 (B.C. C.A.) at para. 17. Third, the court should interpret the agreement having regard to *the business context in which the agreement was concluded* (see *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, [2007] O.J. No. 1083 (Ont. C.A.) at para. 24.

79 However, the submissions at [77-79] have to be contrasted with the position put forth by the Dissenting LTD Beneficiaries, who contend that, as a result of the changes to the *Income Tax Act* from 1986 onward, no deductible contributions could have been made for life insurance unless they were in the form of premiums actually paid to an insurer during the year. Counsel to the Dissenting LTD Beneficiaries then concludes that wind-up liabilities should be interpreted in accordance with a funding basis consistent with the tax considerations that apply to HWTs of this type - particularly when the result best reflects the plain meaning of the Termination Provision - rather than the evidence before the court regarding actual practice.

80 If the submissions at [77-79] are accepted, it brings into question the Dissenting LTD Beneficiaries' reliance upon the 1986 amendments to the *Income Tax Act*, concerning the deduction of prepaid insurance consideration, and upon Interpretation Bulletin IT-428 on this subject. It also puts into issue the admissibility of the affidavits of Joann Williams, sworn August 9, 2010 (the "Williams Affidavit") and September 24, 2010 (the "Supplementary Williams Affidavit"); of Jeremy Bell, sworn September 3, 2010 (the "Bell Affidavit") and September 23, 2010 (the "Supplementary Bell Affidavit"); and of Diane A. Urquhart, sworn September 26, 2010 (the "Urquhart Affidavit").

81 In my view, the position put forth by the Dissenting LTD Beneficiaries that the 1980 Trust Agreement should be interpreted in light of post-1986 tax regime is flawed.

82 First, it ignores that Nortel has certain obligations as set out in the Plans, as there is clear language that establishes its obligations.

83 Second, it ignores the fact that Pensioner Life obligations vest on retirement.

84 Third, there is an absence of any contractual provision that could be interpreted as disentitling certain claimants, such as Pensioner Life claimants, from receiving their vested entitlement to a share of the trust.

85 Fourth, although the Dissenting LTD Beneficiaries submit that the distribution of the HWT is to be governed by legal interpretation of the Trust Agreement, the evidence put forth by the Dissenting LTD Beneficiaries by and large ignores the obligation of Nortel in the Trust Agreement and focuses on funding issues affected by subsequent events.

86 In my view, the position at [80] is inconsistent with the argument put forth at [77-79].

87 The Trust Agreement dates from 1980. According to the submissions of the Dissenting LTD Beneficiaries, it follows that questions of interpretation of the Trust Agreement must be based on the situation as it existed at the time the Trust Agreement was executed. I agree with this submission.

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88 The contractual obligations of Nortel are set out in the various benefit plans that form part of the Record (the "Plans"). It is clear that retirement is the point at which certain obligations result in benefits for the claimants. The HWT, therefore, should be seen as the funding vehicle that delivers the benefit provided by Nortel to the claimants.

89 The Trust Agreement establishes the basis upon which the HWT was established and is to be funded, as well as the basis upon which benefits are to be paid to claimants. Nortel has contractual obligations to the claimants. It may be that certain obligations may be amended from time to time; nevertheless, once certain promises and obligations of Nortel give rise to vested benefits in favour of certain beneficiaries, they cannot be unilaterally withdrawn or eliminated.

90 Counsel to the Monitor and parties supporting the Monitor identified numerous concerns with the evidence submitted by the Dissenting LTD Beneficiaries.

91 With respect to the Williams and Bell Affidavits, the Monitor submits that neither should be given any consideration, as both affidavits fail to meet the required criteria to overcome their presumptive inadmissibility, being based on arguments and theories irrelevant to the HWT, and neither affidavit deals with the Termination Provision. Counsel also submits that issues of both admissibility and weight arise with respect to the Williams and Bell Affidavits. They argue that the evidence is not relevant because both expert witnesses purport to express opinions and opine on the ultimate issue before the Court, insofar as they express views on the terminal distribution of the HWT.

92 Specifically, counsel submits that the affidavits speak to matters of tax and insurance law that are beyond the expertise of Williams and are, in any event, irrelevant; that their opinions in respect of other trusts or benefit administrators reserved for LTD claims are irrelevant; that how the HWT could have been funded is irrelevant; that Williams uses undefined terms that are not referred to in the Termination Provision; and that the tax deductibility of contributions by Nortel is unreferenced in the trust document as a factor in allocation or termination.

93 It is further submitted that the affidavits do not pass the test for necessity, either, because Williams and Bell have no qualifications or experience in the construction of trust documents and their evidence does not inform or assist in any meaningful way how the trust instrument is to be interpreted on termination.

94 There is no evidence that Canada Revenue Agency has challenged or disallowed any tax deductions relating to the HWT taken by Nortel post-1986. There is no evidence that the 1986 changes to the *Income Tax Act* resulted in any alteration of the obligations of Nortel in the Plans and, specifically, to the Pensioner Life claimants. There is no evidence that the changes to the *Income Tax Act* somehow invalidate the HWT, in whole or in part.

95 In this context, I have concluded that evidence relating to the 1986 tax changes and evidence relating to current actuarial practice that reflects the 1986 tax changes is not relevant to the issue to be determined, namely an interpretation of the Trust Agreement. Simply put, legal developments in 1986 do not affect or alter the factual matrix as it was in 1980, and the Trust Agreement has to be interpreted on the basis of facts existing in 1980.

96 The Williams Affidavit expresses a "belief" that the LTD Beneficiaries' Income Replacement Benefits is required to be paid in priority to Pensioner Life benefits on the distribution of assets from the HWT on its wind-up. In my view, in the Williams Affidavit and the Supplementary Williams Affidavit, Ms. Williams attempts to introduce current standards based on contemporary tax practice to change the facts as they were in 1980. It seems to me that her conclusions are derived from evidence that is not relevant to the interpretation of the 1980 Trust Agreement. Further, her conclusions are tantamount to her opining on questions of law.

97 The Bell Affidavit is submitted to provide Mr. Bell's opinion on the generally accepted actuarial principles and practices used to determine sufficient contributions to fund long-term disability wage replacement benefits. Mr. Bell also asserts, as a "belief", that "claims not incurred at the time of the bankruptcy of a company should be funded from health and welfare trust *after* incurred claims are provided for" (emphasis in original). It seems to me that, in the Bell Affidavit and the Supplementary Bell Affidavit, Mr. Bell, like Ms. Williams, has drawn conclusions from evidence that

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is not relevant to the interpretation of the 1980 Trust Agreement. His conclusion also results in Mr. Bell opining on questions of law.

98 The criteria for admissibility of expert opinion evidence has been, in my view, accurately summarized at Schedule C of the factum submitted by counsel to the Monitor, in particular, at paragraphs 3 - 6. Schedule C is attached.

99 Schedule C was composed before the filing of the Williams Supplementary Affidavit and Bell Supplementary Affidavit, the Urquhart Affidavit, and the affidavit of Michael McCorkle (the "McCorkle Affidavit"). In my view, these affidavits add no relevant evidence to the issue to be determined: the interpretation of the Trust Agreement. In fact, the second Bell affidavit comments on a different and unrelated healthcare benefit trust and the McCorkle Affidavit relates to events in 2005 and 2006.

100 The Williams Supplementary Affidavit again relies on facts from 1986 to buttress her opinion on the question of law that is before the court.

101 In substance, I am in agreement with the content of Schedule C insofar as it relates to the law and, particularly, to both affidavits of Ms. Williams and Mr. Bell, as well as those of Ms. Urquhart and Mr. McCorkle.

102 With respect to the Urquhart Affidavit, it is included in the responding Motion Record of the Dissenting LTD Beneficiaries, a document dated September 27, 2010 and filed in court September 28, 2010, the day before the hearing commenced.

103 The Urquhart Affidavit proffers an opinion that there cannot be claims or benefits prior to the HWT wind-up that enable the pensioners to qualify for participation in the HWT distribution, other than to receive the Pensioner Life insurance premiums for 2010 provided for the Settlement Agreement. There are two difficulties with this affidavit. It attempts to recast the facts at the time the Trust Agreement was executed to a post-1986 era. Secondly, the opinion goes to the legal issue to be determined in this motion. The affidavit does not meet the required criteria to overcome the presumptive inadmissibility as a matter of law. In addition, I seriously question whether this affidavit can be considered "fair, objective, and non-partisan" as required by rule 4 of the *Rules of Civil Procedure*.

104 The Urquhart Affidavit, to the extent that it is intended to support the conclusions of Ms. Williams and Mr. Bell, is inadmissible for the same reasons provided relating to the affidavits of Williams and Bell.

105 Furthermore, I question the appropriateness of Ms. Urquhart providing her opinion that new evidence in the 51st Report of the Monitor establishes a misappropriation of assets on the part of Nortel. There is evidence that trust monies were used to pay benefits. There may have been inadequate contributions by Nortel and a shortfall, but this does not necessarily result in the conclusion that there has been a misappropriation of assets. To suggest misappropriation of assets, without referencing an evidentiary foundation is, at best, a questionable use of the word "misappropriation" and, at worst, reckless.

106 Additional concerns were also raised as a result of comments in [13] of the Urquhart Affidavit. Ms. Urquhart states that Nortel had a right to *terminate* Pensioner Life insurance coverage. This statement is not accurate: the information booklet excerpt that forms the basis of this conclusion - and which is reproduced in her affidavit at [13] - clearly states that Nortel had only a right to *amend* the coverage.

107 While I can appreciate there may have been a degree of haste in preparing this affidavit, concerns are raised when such inaccurate statements are made.

108 The Urquhart Affidavit is for the most part irrelevant to the determination of the issues at hand. It does not provide any assistance to the court, and it is not, in my view, necessary or appropriate to consider it.

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109 Counsel to the Dissenting LTD Beneficiaries submits that, given the seriousness of the issues, this is not the time to invoke technical arguments or make unfounded attacks on well-regarded and suitably qualified experts so as to avoid an honest debate of the issues on their merits. The issues on this motion are clearly serious, but it centres on the interpretation of the 1980 Trust Agreement. The deponents may very well be regarded as experts in their field, but that does not necessarily result in their evidence having to be considered when it is not, in my view, relevant. Accordingly, I decline to give any consideration to their affidavits.

Disposition

110 As I have indicated above, there is no question that the impact of the shortfall in the HWT is significant. This was made clear in the written Record, as well as in the statements made by certain Dissenting LTD Beneficiaries at the hearing. However, the effects of the shortfall are not limited to the Dissenting LTD Beneficiaries and affect all LTD Beneficiaries and Pensioner Life claimants. The relative hardship for each claimant may differ, but, in my view, the allocation of the HWT corpus has to be based on entitlement and not on relative need.

111 All parties are in agreement that the HWT corpus must be distributed having regard to those benefits and claims that can be considered to have been made or incurred before the date of termination. The parties disagree as to whether that distribution of the HWT corpus should also include claims that, without termination, would certainly have been made in the future, including Pensioner Life benefits. The Monitor and supporting parties submit that the latter category should share in the distribution while the Dissenting LTD Beneficiaries argue that it should not.

112 It seems to me that the phrase "all future benefits and claims" in the Termination Provision allows for the possibility that claims otherwise certain to be made in the future are to be satisfied upon termination. The use of "all future benefits and claims" reveals that the HWT is not absolved of its responsibility to settle valid expenses, claims or obligations for reason only that they are future claims. It is permissive of Pensioner Life benefits but not determinative of the issue.

113 Ultimately, what is needed is a determination of what constitutes a valid claim against the HWT at the date of termination of the trust. In this respect, I agree with the Applicants that any claim that can be said to have vested at the date of termination can share on the wind-up distribution; therefore, it must be considered whether Pensioner Life benefits can be said to have vested at the relevant point in time.

114 It is settled that a permanent pensioner life benefit becomes vested on the date of an employee's retirement notwithstanding any uncertainty as to date on which the life insurance claim will be realized, *i.e.*, death: *Dayco (Canada) Ltd. v. C.A.W.*, *supra*. The Dissenting LTD Beneficiaries urge me to make the finding that Pensioner Life benefits under the HWT are not permanent life benefits but rather term life benefits, conceptualized as the payment of annual premiums on one year term life insurance policies.

115 I decline to do so. Any such interpretation of the agreement requires the assistance of tax, actuarial and insurance principles and practices developed in a time period subsequent to 1980. The proper interpretation of the Trust Agreement must have regard to the intentions and reasonable expectations of the parties that signed it, which cannot be ascertained from practices and regulations introduced years after the Agreement was concluded. There is no indication or evidence, either in the Agreement itself or elsewhere, that the Trust Agreement should incorporate subsequent developments in tax, actuarial, or insurance principles and practices. It would be inappropriate to interpret the Termination Agreement with reference to considerations that could not possibly have been contemplated by the parties when the Agreement was drafted in 1980.

116 I find that the parties to the Trust Agreement had both the intention and reasonable expectation that Pensioner Life benefits would manifest as permanent life benefits. Permanent pensioner life benefits vest on retirement. These Pensioner Life benefits must, therefore, be considered vested future benefits and, thus, certain future claims that are within the scope of the Termination Provision and subject to distribution upon wind-up.

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117 It is necessary to focus on the obligations of Nortel, as opposed to the funding challenges faced by it. The obligation of Nortel to provide Pensioner Life benefits remains constant: claimants have a contractual right to certain entitlements and Nortel has a corresponding contractual liability. The argument of the Dissenting LTD Beneficiaries at [61-62] is misguided because it takes Nortel's contemporary funding shortfall to alter a contractual relationship that was determined and fixed by the Trust Agreement in 1980. In the words of counsel to the Former Employees, the obligations of Nortel cannot be decoupled from the Trust Agreement.

118 There is no basis to disentitle Pensioner Life claimants from sharing in the distribution of the HWT. In particular, the language of the Trust Agreement in no way provides for the ousting of their rights. I have concluded that their vested ownership rights cannot be abrogated in the manner suggested by the Dissenting LTD Beneficiaries. It is one thing for changing circumstances to result in a diminished recovery for all entitled parties; it is something entirely different to conclude that Pensioner Life claimants should receive no distribution from the HWT Trust. I see no grounds in law, equity, contract, or otherwise to conclude that one unfortunate party - Pensioner Life claimants - should be required to subsidize the misfortunes of another -the LTD Beneficiaries. I view *pro rata* distribution to be the only principled and fair manner of resolving this unfortunate scenario.

119 In the result, the Monitor's motion is granted, approving Scenario 2, being the proposed methodology for the allocation of the corpus of the HWT. The consequential relief requested in the Notice of Motion as set out at [2] is also granted.

120 In light of this disposition, in my view, it is not necessary to address standing issues in respect to certain dissenting LTD Beneficiaries.

121 It follows that the cross-motion of the Dissenting LTD Beneficiaries is dismissed.

122 An order shall issue to give effect to the foregoing.

123 I wish to express my appreciation to all court-appointed representatives who have worked diligently in fulfilling their mandate in what is clearly a very difficult situation.

Schedule "A"

Memorandum

August 27, 2010

Introduction

This memorandum is filed in conjunction with the Fifty-First Report of Ernst & Young Inc., the monitor of Nortel Networks Limited ("Nortel") (the "Monitor's Report") and refers to documents appended thereto. For the purposes of this memorandum we rely upon the facts set out in the Monitor's Report and the documents referred to in such report. In addition, capitalized terms that are not defined in this memorandum have the meanings set out in the Monitor's Report.

Issues

The issue to be determined in this motion is how the funds remaining in Nortel's Health and Welfare Trust (the "HWT") are to be distributed upon termination of the HWT. This determination requires consideration of the following questions:

Does the HWT constitute one trust or several trusts?

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Who is entitled to the assets in the reserve account on the financial statements referred to as Group Life- Part II (related to optional life insurance)?

Which claims participate on a termination of the HWT?

How should the Trust Fund be shared among participating beneficiaries?

Discussion

Before addressing the appropriate distribution of the Trust Fund, it is important to appreciate that Nortel has contractual obligations to its employees and pensioners to provide certain health and welfare benefits. Employees and pensioners have claims for those benefits against Nortel on the basis of their contracts of employment. Claims that do not participate on a termination of the HWT can nevertheless be made against the estate of Nortel.

The creation of such contractual relations does not in itself create trust relationships between the parties, nor is a trust required to fund or deliver health and welfare benefits. Nortel elected to create the HWT as a funding medium through which to fund at least some of the Plans.

The HWT was established as a health and welfare trust for tax purposes. Health and welfare trusts are subject to classic trust law principles.

Determining the proper distribution of the Trust Fund on termination of the HWT depends on the interpretation of the termination provisions of the Trust Agreement, read in the context of the Trust Agreement as a whole, and with a view to the intention of Nortel as the settlor at the time the Trust Agreement was entered into. Evidence of such intention may be gleaned from various sources, including the factual matrix at the time and other documents relating to the HWT, employee benefits and employee communications.

Does the HWT Constitute One Trust or Several Trusts?

The first issue that must be addressed in order to determine the appropriate distribution of the Trust Fund is whether the HWT constitutes one trust or several trusts. The issue arises because the language of the Trust Agreement indicates a single trust but administrative and accounting practices may suggest an intention to create a number of separate trusts, as explained below.

The HWT was administered historically as having separate accounting and "reserves" for certain of the benefit plans covered under the trust (the "Reserved Plans"). Amounts were notionally reserved on the HWT financial statements for the Reserved Plans, but the benefits were not fully pre-funded. There was no actual segregation of trust assets; rather, all assets were commingled. Benefits under benefit plans other than the Reserved Plans were paid by Nortel through the HWT on a pay-as-you-go basis.

Trust Law Principles

As stated above, classic trust law principles apply to health and welfare trusts. Under trust law, a trust is established if the so-called three certainties are present: certainty of objects, certainty of subject matter and certainty of intention.

Certainty of objects requires that the beneficiaries be clear and ascertainable. If the HWT is one trust, the objects are all the beneficiaries of all the Plans. If the HWT consists of separate trusts for the Reserved Plans, the beneficiaries for each Reserved Plan (other than optional life, as discussed in Part B below) would be the objects of each respective trust. Therefore, there is certainty of objects (other than with respect to optional life) whether there is one trust or several trusts.

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Certainty of subject matter requires clarity as to which property forms part of the trust fund. If the HWT is one trust, the subject matter would be the Trust Fund. If the HWT consists of several trusts, the trust fund for each Reserved Plan would be the reserved amount of the fund in respect of such Plan. Therefore, there is certainty of subject matter whether there is one trust or several trusts. However, if there are several trusts, as there is a deficiency in the HWT and the funds have been commingled, there would be a tracing issue to address.

Certainty of intention requires a consideration of the intention of the settlor. That is, was the intention of Nortel, as the settlor of the HWT, to establish one trust in respect of all the Plans or separate trusts for each of the Reserved Plans?

In considering Nortel's intention, we have reviewed (i) the Trust Agreement; (ii) Nortel's representations to Revenue Canada (as it then was) in respect of the tax ruling; (iii) and, to a lesser extent, the subsequent administrative and accounting practices of the Trustee and of Nortel acting as settlor and administrator of the HWT.

The Trust Agreement

The Trust Agreement refers to the establishment of a single Trust Fund. There is no indication in the Trust Agreement of an intent to create a separate trust in respect of each Plan. No provision in the Trust Agreement authorizes or directs the Trustee to segregate assets generated by contributions made on account of different Plans or different classes of beneficiary, and in fact the Trust Fund assets have always been commingled without allocation to separate Plans.

The recitals in the Trust Agreement state that *a* trust fund "to be known as the Health and Welfare Trust" is established to give effect to the Health and Welfare Plan. The purpose of the Trust Fund is "to provide the Health and Welfare Plan benefits for the benefit of the Employees".

"Trust Fund" is defined as

> The term "Trust Fund" as used herein shall mean all of the assets of the "Health and Welfare Trust" including all funds received by way of *contributions from the Corporation* and those of its designated affiliated or subsidiary corporations in accordance with the provisions of the Health and Welfare Plan and of this Trust Agreement, *and all employees' contributions* together with all profits, increments, and earnings thereon.
>
> (Emphasis ours.)

The Recitals in the Trust Agreement Provide That Additional Plans May Be Added to the HWT from Time to Time

> The Corporation has established for the benefit of certain of its employees and the employees of such affiliated or subsidiary Corporations as the Corporation may designate, certain Health and Welfare plans, and such other similar plan or plans as the Corporation may from time to time place in effect, as follows:
>
> (a) a Health Care Plan;
>
> (b) a Management Long Term Disability Plan;
>
> (c) a Union Long Term Disability Plan;
>
> (d) a Management Survivor Income Benefit Plan;
>
> (e) a Management Short Term Disability Plan;
>
> (f) a Group Life Insurance Plan;

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> *all of which are hereinafter collectively referred to as the "Health and Welfare Plan."*
>
> (Emphasis ours.)

The Trust Agreement does not specify that any additional plans constitute separate trusts.

The Trust Agreement does, however, require the Trustee to keep separate records in respect of each of the separate Plans. Article 3, paragraph (2)(p) of the Trust Agreement provides:

> The Trustee shall keep accurate and detailed accounts of all investments and transactions made by it pursuant to this Agreement and shall keep separate records for each of the separate Plans.

a. Representations to Revenue Canada

Evidence of Nortel's intention may also be gathered from its representations to Revenue Canada for the tax ruling. These representations refer to *a single trust fund* with "sub-accounts" created expressly for the purpose of record-keeping. In the overall description of the arrangement, in its letter to Revenue Canada dated December 16, 1979 (the "Ruling Request Letter"), Nortel states that Nortel (with related companies) proposes "to *establish a Health and Welfare Trust Fund.*"

In describing the Long Term Disability Plan, the Ruling Request Letter states

> Under this plan eligible claims by employees will be submitted to the administrator for settlement. The administrator will then issue a draft to the claimant(s) drawn on the trust's account.

In the description of the Group Life Insurance Plan (Part I - Basic & Part II - Optional), the Ruling Request Letter states

> Contributions (both the active employees' and the Company's) not immediately applied against claims & expenses of the Carrier will be deposited/transferred to a sub-account of the Trust called the "Pensioners Insurance Fund". [With respect to Part I - Basic.]
>
> . . . . .
>
> Group Life Insurance (Part II) is paid totally by the employees and is optional. These employees' contributions will form part of the trust fund but will be kept in a separate sub-account.
>
> Under this plan (both Part I and Part II) the Carrier will receive and settle all claims and receive settlement of its premium at that time from the Trust. As a matter of record keeping claims together with the Carrier's claim expense charges will be charged to the respective sub-accounts.

b. Administrative and Accounting Practices

The manner in which Nortel administered the HWT and performed financial reporting may also be relevant.

During the administration of the HWT in the normal course, the Trustee accounted for the assets in the HWT in part by distinguishing between pay-as-you-go benefit plans and funded benefit plans with notional reserve accounts.

The reports prepared by actuaries and accountants for the purposes of determining Nortel's funding policy with respect to the Health and Welfare Plan and preparing financial statements of Nortel and the HWT refer to "reserves" or "sub-accounts" in respect of certain of the Plans.

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On the other hand, Nortel files only one federal tax return in respect of the HWT. In addition, it appears that Nortel did not instruct the Trustee to establish separate bank accounts and no separate bank accounts were maintained in respect of each Reserved Plan.

Analysis

It may be possible to argue that, because separate records were maintained in respect of each of the Plans, Nortel intended to "earmark" the funds for specific purposes. The notes to the financial statements set out the funded status of each Reserved Plan separately (i.e., long-term disability plan, survivor income benefit plan, pensioners' insurance plan and employee-financed group life plan (Part II)). In addition, both the ruling and the Ruling Request Letter refer to sub-accounts of the Trust Fund, which could suggest an intention on the part of Nortel to create separate trusts.

However, as stated above, there is no express term of the Trust Agreement creating separate trusts and thus no clear statement of intent to create separate trusts. Instead, there are clear provisions stating that the sub-accounts were for record-keeping purposes only, and separate bank accounts were not established or maintained.

We have been unable to find any case where a court has held that there was an intention to create separate trusts on the basis of record-keeping alone. The fact that the accounting and actuarial valuations were performed on a "plan-by-plan" basis indicates nothing more than compliance with Article 3, paragraph (2)(p) of the Trust Agreement.

In conclusion, given the provisions of the Trust Agreement, other relevant documents and Nortel's administrative practices, the HWT constitutes one trust providing a number of different benefits for the beneficiaries.

Who is entitled to the assets in the reserve account on the financial statements referred to as Group Life- Part II (related to optional life insurance)?

The 2009 financial statements refer to an amount of $17,906,000 in the reserve account in respect of the group life-part II (optional life) benefit (the "Optional Life Account") and there is no corresponding liability. There are three possibilities for the allocation and distribution of the Optional Life Account:

- Payment to optional life participants;
- Reversion to Nortel; or
- Inclusion of these funds as part of the Trust Fund to be distributed to those beneficiaries eligible to participate in the corpus of the HWT at the time of termination and distribution of the HWT.

Payment to optional life participants

All of the contributions to the optional life insurance plan (i.e., the premiums) were made by the participants (except for those persons on long-term disability whose premiums were contributed by Nortel). Term life insurance was provided by Sun Life, and Nortel was the policyholder.

If the HWT establishes separate trusts, the employees participating in optional life may argue that they are entitled to the Optional Life Account, as they are its only beneficiaries. However:

> On the plain language of the Trust Agreement, Nortel would be entitled to these funds because Article VI of the Trust Agreement provides that, on termination, any surplus remaining reverts to Nortel.
>
> The employees received what they bargained for. Based on the employee communications provided to us, the employees participating in optional life had no expectation that they would receive anything other than

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> term life insurance protection and a conversion privilege in the event of termination. [1] It is unlikely that these reserved funds were contemplated by anyone other than Nortel and Sun Life, and there is no evidence of an intention on the part of the participants not to part outright with the premiums when they paid them. Indeed, the participants in the optional life plans changed from year to year, and any participant who elected not to participate in a following year received no refund.
>
> Even if there are separate trusts for the Reserved Plans, there is an issue with respect to certainty of objects for the Optional Life Account. The Optional Life Account historically was used to pay optional life claims when there was a year of negative experience and used to reduce premiums in the next year if premiums in respect of a year were set too high. In other words, it was used to benefit not past participants but current and future optional life participants, who are unknown. As a result, there does not appear to be certainty of objects. Therefore, it is arguable that there cannot be a separate trust in respect of the Optional Life Account.

Nevertheless, whether there is a single trust or several trusts, optional life participants may argue they should be the beneficiaries of the Optional Life Account on the basis of resulting or constructive trust.

Resulting Trust

The authors of Oosterhoff on Trusts divide resulting trusts into two broad categories

> The first occurs when a settlor transfers assets to trustees and thereby creates or intends to create an express trust. If the express trust fails to arise or fails to dispose of the entire beneficial ownership of the trust assets, the remainder normally results to the settlor or to his or her estate.
>
> Resulting trusts in the second category arise when one person (A) voluntarily transfers an asset to another person (B) or when A purchases an asset and directs the vendor to transfer the asset to B. In these situations, equity usually presumes that A did not intend that B should take the asset beneficially, and therefore, B will hold the asset on resulting trust for A unless the presumption is rebutted. [2]

Because the employees participating in the optional life insurance plan paid all of the premiums for the life insurance benefits, they could argue that, in effect, they overpaid the original premiums, and should be reimbursed under a resulting trust. However, since the optional life policy is only between Nortel and Sun Life, the participants would have to establish that Nortel acted as their agent in procuring the life insurance from Sun Life and wrongfully kept any surpluses, for which there is no evidence. Among other things, there is no evidence of:

- any understanding or intention that Nortel would act as an agent of the employees in purchasing the insurance;
- separate policies, certificates or accounts in the names of specific employees;
- liability on the part of employees for any shortfall (which would be expected if they were the principals);
- an expectation of receiving a refund of premium based on favourable claims experience; or
- any right of employees to require a return or transfer of the funds or the delivery of policies.

To the contrary, the evidence is that Nortel and Sun Life treated Nortel as the principal, including the cross-rating of claims between basic and optional life. Accordingly, we do not think a Court would impose a resulting trust.

c. Constructive Trust

A constructive trust is a remedy that a court may impose where necessary to prevent the unjust enrichment of the defendant at the expense of the plaintiff, or to compensate the plaintiff for a wrong. [3] The participants in the optional life insurance plan may claim that a constructive trust should be imposed on the Optional Life Account.

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Each of the following elements must exist to warrant the imposition of a constructive trust:

- enrichment,
- corresponding deprivation, and
- the absence of any juristic reason for the enrichment. [4]

The courts have also recognized that a constructive trust may be appropriate more generally to prevent persons from retaining property which, in "good conscience," they should not be permitted to retain. [5]

In *I.U.O.E., Local 894 v. Smurfit-Stone Container (Canada) Inc.*, [6] the employer had received demutualization proceeds in respect of life insurance plans. The employer was the policyholder and paid the premiums. The New Brunswick Court of Appeal held that there was no unjust enrichment or fiduciary obligation and therefore it was not appropriate to impose a constructive trust. Although the demutualization benefit had enriched Smurfit-Stone, the Union had not suffered a corresponding deprivation. The employees had not been deprived of any of the defined benefits they bargained for. In addition, since the policy carried with it an ownership interest in Sun Life and Smurfit-Stone was the policyholder, there was a juristic reason for it to retain the demutualization benefit.

Similarly, the optional life participants may be unable to establish a deprivation because they obtained exactly what they had bargained for (i.e., term life insurance coverage). As all of the elements required to make out a case for unjust enrichment are not present, a constructive trust should not be imposed.

The situation of the optional life participants is distinguishable from the situation of the annuitants in *Re Nortel Networks Corporation*, [7] where a constructive trust was imposed on individual annuity contracts held by Sun Life. In that case:

- separate accounts were kept by Sun Life relating to each individual annuitant;
- upon retirement, the annuitants had a right to the amounts in their accounts through one of four available methods;
- although Nortel was named as owner and beneficiary, each annuity also recorded the name of a particular individual as "annuitant";
- the annuitants did not receive the payments from Nortel to which they were entitled; and
- but for the constructive trust, the assets would have gone to Nortel's general creditors, which the Court considered would be a windfall.

The optional life participants, by contrast, received the coverage they bargained for. Separate accounts were not kept by Sun Life for named individuals; the participants had no right to receive refunds of premium or direct a delivery or transfer of surplus funds; and there is no concern about a windfall, since under the Proposed Allocation Methodology the funds will be used for payments to other beneficiaries who are suffering a shortfall on their claims.

Where all the elements described in paragraph 35 above are not present, a court may nevertheless impose a constructive trust on the basis that it would not be in good conscience to allow the legal owner of specific assets to retain them. In *N.A.I.T. Academic Staff Association v. N.A.I.T.*, [8] a significant portion of the premiums had been paid by the participants. N.A.I.T. was the owner of the policy and received the demutualization proceeds. The union

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took the position that a fiduciary relationship existed between the employer and the employees because N.A.I.T. acted as the employees' agent in obtaining the policy and remitting the premiums.

The Court found that an agency existed sufficient to be the foundation for the fiduciary duty claimed, and that N.A.I.T. had profited as a result of that relationship. N.A.I.T.'s breach of its fiduciary duties by keeping the money (even in the absence of misconduct) was remedied by imposing a constructive trust.

While it might not be in good conscience for Nortel to retain the Optional Life Account, the same cannot be said if the Optional Life Account remains in the Trust Fund for distribution to the other HWT beneficiaries who are suffering a shortfall on their claims. Further, as discussed in paragraph 33 above, there are no indicia of agency in this case.

Reversion to Nortel

If the Optional Life Account is a separate trust fund and there is no constructive or resulting trust, under the terms of the Trust Agreement, Nortel is entitled to surplus funds on the termination of the HWT. However, given the tax rules related to health and welfare trusts (i.e., there can be no reversion), this result is not tenable and would potentially throw into question the tax treatment of the HWT since inception. In addition, the financial statements in respect of the HWT disclose a debt to the HWT due from the sponsoring company (Nortel). The financial statements do not indicate to which of the reserved funds the debt due from the sponsoring company relates. Accordingly, it could be allocated a number of different ways, including a set off in respect of any entitlement of Nortel to excess optional life funds. Finally, the Trust Agreement does not provide for any reversion to Nortel unless "all expenses, claims and obligations and future benefits and claims arising under the terms of the Trust Agreement and the Health and Welfare Plan" have been satisfied. Given the large deficit in the Trust Fund, and with respect to the Plan, there can be no reversion to Nortel regardless of whether there is one trust or several trusts.

Inclusion in the Trust Fund

Whether the HWT is one trust or several trusts, the result would be the inclusion of the Optional Life Account in the corpus of the HWT to be distributed to those beneficiaries eligible to participate at the time of termination.

Which claims participate on a termination of the HWT?

In order to determine which claims participate on termination, we will consider:

the beneficiaries of the HWT;

the termination provision in Article VI of the Trust Agreement (the "Termination Provision"); and

application of the Termination Provision to claims of the beneficiaries.

The Beneficiaries of the HWT

"Beneficiaries" is not expressly defined in the Trust Agreement. Instead, Article II of the Trust Agreement states that the Trust Fund is "created for the purpose of providing the Health and Welfare Plan benefits for the benefit of Employees". "Employees" are "those active and retired employees of the Corporation and designated affiliated or subsidiary corporations which have adopted the Health and Welfare Plan, including dependents as defined in Schedule A, on whose behalf contributions are or have been made to the Trust Fund and who are eligible for benefits under the Health and Welfare Plan".

The first recital to the Trust Agreement refers to components of the "Health and Welfare Plan". These include a health care plan, management long-term disability plan, union long term disability plan, management survivor income benefit plan, management short-term disability plan and group life insurance plan. In the Trust Agreement,

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all of these separate arrangements are defined collectively to be the "Health and Welfare Plan". The definition of Health and Welfare Plan also includes "such other similar plan or plans as the Corporation may from time to time place in effect."

Therefore, under the Trust Agreement, the beneficiaries of the HWT are defined widely as those employees and former employees of Nortel and their dependants who are eligible for benefits under a health or welfare benefit arrangement that is funded by or through the Trust Fund, and, where there is a surplus on wind-up of the HWT, Nortel itself.

d. The Termination Provision

The Trust Agreement provides that Nortel may terminate the HWT on sixty days' notice to the Trustee. Upon receipt of notice of termination, the Trustee must take certain steps:

> Upon receipt of the Notice of Termination the Trustee shall within one hundred twenty (120) days determine and *satisfy all expenses, claims and obligations arising under the terms of the Trust Agreement and Health and Welfare Plan up to the date of the Notice of Termination.* The Trustee shall also determine upon a sound actuarial basis, the amount of money necessary to *pay and satisfy all future benefits and claims to be made under the Plan in respect to benefits and claims up to the date of the Notice of Termination.* The Corporation and the designated affiliated or subsidiary corporations shall be responsible to pay to the Trustee sufficient funds to satisfy all such expenses, claims and obligations, and such future benefits and claims. The final accounts of the Trustee shall be examined and the correctness thereof ascertained and certified by the auditors appointed by the Trustee. Any funds remaining in the Trust Fund after the satisfaction of all expenses, claims and obligations and future benefits and claims, arising under the terms of the Trust Agreement and the Health and Welfare Plan shall revert to the Corporation.
>
> (Emphasis ours.)

Whether the HWT is one trust or consists of several separate trusts, lack of clarity in the Termination Provision raises an issue of precisely which benefits and claims participate on termination. Specifically:

> • It is clear that any claims actually made and obligations actually incurred up to the date of the Notice of Termination should participate. These would include, for example, reimbursement of medical bills actually incurred, life insurance payments to the estates of people who died and income payments due to LTD beneficiaries.
>
> • What is not clear is which *future* benefits and claims should be paid from the HWT. The phrase "future benefits and claims" is not defined in the Trust Agreement and occurs only in the Termination Provision. While some meaning must be given to the word "future", meaning must also be given to the expression "up to the date of the Notice of Termination".

The next section offers an interpretation of the Termination Provision that gives meaning to the language as a whole, and explains how this interpretation would be applied to different types of benefits.

e. Application of the Termination Provision to claims of the beneficiaries

It is first necessary to consider generally whether future benefits would be available to ALL beneficiaries of the HWT, which in turn requires a consideration of the concept of vested rights. Some beneficiaries have vested rights and benefits under the Plans. Benefits vest when an employee or former employee becomes absolutely entitled to receive what is promised; that is, the promise to provide the benefits is not subject to any contingency. Vested benefits cannot be reduced or eliminated.[9] The beneficiaries with vested benefits are pensioners and people in receipt of LTD benefits, survivors' income benefits and survivor transition benefits.

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By contrast, the benefits of active employees may be amended or terminated at any time, as may the employment itself. Claims in respect of these types of benefits (health, dental and life (basic and optional, subject to the discussion above) for active employees other than those on LTD) are not vested and therefore should not participate unless they have been incurred by the date of the Notice of Termination. Claims in respect of future benefits for active employees are uncertain and contingent and cannot be said to have arisen before the date of the Notice of Termination.

If the Trust Agreement is interpreted to provide that, on termination, all beneficiaries with vested rights under all Plans participate for future benefits, then all such claims would be included. However, this interpretation gives no meaning to the cut-off date stipulated in the Trust Agreement: "up to the date of the Notice of Termination."

If, by contrast, the Trust Agreement is interpreted to give meaning to both the expression "future benefits" and to the stipulated cut-off date, the Trustee should pay only "future benefits and claims" that can be considered to have been made or incurred *prior to the notice of termination*. "Future benefits and claims" may further be interpreted to also include claims that have not been made at the date of the Notice of Termination but that, without termination, would certainly have been made in the future. Applying this interpretation to each category of benefit:

> Pensioner Medical/Dental: *Only claims that were actually incurred prior to the Notice of Termination would be included, since future benefits (being contingent and uncertain) cannot be said to have existed prior to the cut-off date.*
>
> Pensioner Life Insurance: *As pensioner life is permanent (and not term) insurance, it may be argued that the present value of this future benefit for all pensioners should be included, as there is no contingency with respect to the ultimate payment of this benefit. This benefit may therefore be considered to have existed before the cut-off date.*
>
> LTD Income: *The present value of the future benefit for LTD income already in pay prior to the Notice of Termination should be included on the basis that a claim was made before the Notice of Termination and the ongoing stream of income constitutes future benefits in respect to that claim.*
>
> LTD Medical/Dental: *Only claims that were actually incurred prior to the Notice of Termination would be included, on the same basis as (i), above.*
>
> LTD Life Insurance: *It may be argued that the present value of this future benefit for all LTDs should be included, as those individuals who are on permanent disability will either die while on LTD or after retirement, so that they are covered in any event, and the claims are not contingent.*
>
> SIBs: *The present value of the future benefit for SIB income already in pay prior to the Notice of Termination should arguably be included, on the same basis as (iii) above.*
>
> STBs: *The present value of the future benefit of STBs in pay prior to the Notice of Termination should arguably be included, on the same basis as (iii) above.*

As noted previously, claims that do not participate on a termination of the HWT may nevertheless remain valid claims in the Nortel estate.

Although we do not believe that the existence of the Reserved Plans demonstrates an intention to establish separate trust funds, regard may be had to Nortel's practice to assist in interpreting the Termination Provision. Other than with respect to optional life, our analysis leads to the conclusion that the claims entitled to participate on termination are in fact claims for benefits with respect to the Reserved Plans. [10] This strongly suggests that there was a perceived difference between these types of claims and claims that Nortel paid on a pay-as-you-go basis. In other words, these were treated as claims that were certain to occur and therefore required the keeping of reserves. This supports our conclusions with respect to which claims participate on termination and which do not.

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In conclusion, as discussed above, there are difficulties in interpreting the Termination Provision. However, based on the Trust Agreement, other relevant documents and Nortel's administrative practices, the following categories of claims should participate:

> *claims of all beneficiaries of the HWT actually incurred before the Notice of Termination; and*
>
> *claims in respect of future benefits where those benefits have vested and meet the test of the cut-off date as described above, being pensioner life insurance, LTD income, SIBs and STBs. In addition, on balance, LTD life insurance should be included.*

How should the Trust Fund be shared among participating beneficiaries?

Under any interpretation of the Trust Agreement, an actuary would determine the present value of the participating claims. Nortel would be required to pay the Trustee sufficient funds to satisfy this obligation.

As set out above, the Termination Provision does not specify how the Trust Fund is to be shared on the dissolution of the HWT. Since there are insufficient funds to satisfy all claims against the HWT, an issue arises as to how to allocate the Trust Fund among the competing claims.

It is a well-established maxim that "equality is equity". This means that, in the absence of sufficient reason for dividing property on any other basis, the courts will order equal division.[11] This principle has been applied by Canadian courts in many different circumstances, including distributions of funds to investors in an insolvency and to beneficiaries of a pension plan being wound up.

If the Reserved Plans were treated as involving separate trusts, the beneficiaries under each Reserved Plan (other than optional life) would share *pro rata* in the funds reserved for that Plan. Beneficiaries of plans without reserves would not receive anything from the HWT.

If there is a single trust, the Trust Fund should be distributed *pro rata* among the claims entitled to participate on termination.

Summary of Conclusions

The HWT is a single trust fund.

The optional life participants are not entitled to the Optional Life Account and these assets do not revert to Nortel. As the HWT is a single trust fund, these assets should be distributed among the HWT beneficiaries who are eligible to participate at the time of termination.

All claims and obligations arising up to the Date of Termination participate on a termination of the HWT.

With regard to future claims, it may be argued that (i) all claims for all future benefits vested under the Plans should be present valued and participate; or that (ii) only claims made prior to the date of the Notice of Termination, including the present value of future income payments for benefits already in pay, should participate. Given the language of the Trust Agreement as supported by Nortel's funding practices, the better view is that claims that have not been made but would certainly have been made in the future should participate in addition to those in (ii) above. Therefore, the following would participate for the actuarial value of future benefits: pensioner life insurance, LTD income, SIBs and STBs in pay and, on balance, LTD life insurance.

The Trust Fund should be distributed *pro rata* among those entitled to benefit (under either interpretation set out above) under the HWT on termination.

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Schedule "B"

Nortel Health and Welfare Trust REVISED Appendix D-1
REVISED Illustrative Allocation Scenarios Scenarios 1 to 4
Scenario: Optional Life does not participate
Cdn Millions

Type of Benefit	Benefit Liabilities {6}	1 All Benefits Share Pro Rata [Distribution %: 14.6%]	2 Proposed Participating Benefits Share Pro Rata [Distribution %: 33.8%]	3 Benefits in Pay Share Pro Rata [Distribution %: 72.1%]	4 Reserved Asset Method {3,5} [Distribution %: N/A]
Pensioner Life (including ADB){1}	$ 126.9	$ 10.72	$ 35.05	$ -	$ 33.53
Pensioner M&D	251.3	36.67	-	-	-
Pensioner Benefit Total	**378.2**	**47.39**	**35.05**	**-**	**33.53**
LTD Income (including IBNR)	79.9	11.66	26.98	57.57	21.47
LTD M&D{2}	29.7	4.33	-	-	-
LTD - STB accrued	0.3	0.04	-	-	-
LTD Life{2}	4.5	0.66	1.52	-	0.65
LTD Optional Life Benefit (including IBNR)	5.3	0.78	1.80	-	-
LTD Benefit Total	**119.7**	**17.47**	**30.30**	**57.57**	**22.12**
SIB{4}	16.2	2.36	5.47	11.67	16.55
STB - in pay	4.1	0.60	1.38	2.95	-
STB - accrued	30.0	4.38	-	-	-
Optional Life	-	-	-	-	-
Total Benefits	**$ 548.2**	**$ 72.2**	**$ 72.2**	**$ 72.2**	**$ 72.2**
Pensioner Life 2010 Premiums{1}	NA	7.80	7.80	7.80	7.80
Total	**$ 548.2**	**$ 80.0**	**$ 80.0**	**$ 80.0**	**$ 80.0**

Notes: 1. Pensioner Life Premiums for 2010 have been treated as charge against the distribution in respect of the Pensioner Life Benefit (if any)2. LTD Life and LTD M&D includes $2.0 million and $5.2 million, respectively, related to LTD individuals who are assumed to proceed to retirement and become eligible as pensioners.3. Optional life reserved asset of $18.7 million has been allocated pro rata amongst the other reserved assets based on asset value4. The pro-rata allocation of the optional life reserved asset amongst the other remaining reserved asset categories results in the SIB reserved asset allocation exceeding the total benefit claim attributable to this category. No adjustments have been made to limit the SIB distribution under the reserved asset method5. The Reserved Asset Method allocates HWT Assets using the reserved asset mix as at December 31, 2009 (as disclosed in the 2009 Health Welfare Trust Financial Statements)6. Source: Mercer 2010 HWT Preliminary Valuation

Nortel Health and Welfare Trust REVISED Appendix D-2
REVISED Illustrative Allocation Scenarios Scenarios 5 to 8
Scenario: Optional Life is a participating benefit
Cdn Millions

Type of Benefit	Benefit Liabilities {4}	5 All Benefits Share Pro Rata	6 Proposed Participating	7 Benefits in Pay Share Pro Rata	8 Reserved Asset Method {3}

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		[Distribution %: 11.2%]	Benefits Share Pro Rata [Distribution %: 25.9%]	[Distribution %: 53.3%]	[Distribution %: N/A]
Pensioner Life (including ADB){1}	$ 126.9	$ 6.38	$ 25.01	$ -	$ 23.85
Pensioner M&D	251.3	28.08	-	-	-
Pensioner Benefit Total	**378.2**	**34.46**	**25.01**	**-**	**23.85**
LTD Income (including IBNR)	79.9	8.93	20.66	42.63	16.44
LTD M&D{2}	29.7	3.32	-	-	-
LTD - STB accrued	0.3	0.03	-	-	-
LTD Life{2}	4.5	0.50	1.16	-	0.50
LTD Optional Life Benefit (including IBNR)	5.3	0.60	1.38	-	-
LTD Benefit Total	**119.7**	**13.38**	**23.20**	**42.63**	**16.94**
SIB	16.2	1.81	4.19	8.64	12.67
STB - in pay	4.1	0.46	1.06	2.19	-
STB - accrued	30.0	3.35	-	-	-
Optional Life	-	18.74	18.74	18.74	18.74
Total Benefits	**$ 548.2**	**$ 72.2**	**$ 72.2**	**$ 72.2**	**$ 72.2**
Pensioner Life 2010 Premiums{1}	NA	7.80	7.80	7.80	7.80
Total	**$ 548.2**	**$ 80.0**	**$ 80.0**	**$ 80.0**	**$ 80.0**

Notes: 1. Pensioner Life Premiums for 2010 have been treated as charge against the distribution in respect of the Pensioner Life Benefit (if any)2. LTD Life and LTD M&D includes $2.0 million and $5.2 million, respectively, related to LTD individuals who are assumed to proceed to retirement and become eligible as pensioners.3. The Reserved Asset Method allocates HWT Assets using the reserved asset mix as at December 31, 2009 (as disclosed in the 2009 Health Welfare Trust Financial Statements)4. Source: Mercer 2010 HWT Preliminary Valuation

Nortel Health and Welfare Trust REVISED Appendix D-3
REVISED Illustrative Allocation Scenarios Scenarios 9 to 11
Scenario: STB Liability is excluded and Optional Life does not participate
Cdn Millions

Type of Benefit	Benefit Liabilities{3}	**9** All Benefits Share Pro Rata [Distribution %: 15.6%]	**10** Proposed Participating Benefits [Distribution %: 34.4%]	**11** Benefits in Pay Share Pro Rata [Distribution %: 75.1%]
Pensioner Life (including ADB){1}	$ 126.9	$ 11.96	$ 35.80	$ -
Pensioner M&D	251.3	39.13	-	-
Pensioner Benefit Total	378.2	51.08	35.80	-
LTD Income (including IBNR)	79.9	12.44	27.45	60.03
LTD M&D{2}	29.7	4.62	-	-
LTD - STB accrued	EXCLUDED	-	-	-
LTD Life{2}	4.5	0.70	1.55	-
LTD Optional Life Benefit (including IBNR)	5.3	0.83	1.83	-
LTD Benefit Total	**119.4**	**18.60**	**30.83**	**60.03**
SIB	16.2	2.52	5.57	12.17
STB - in pay	EXCLUDED	-	-	-

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STB - accrued	EXCLUDED	-	-	-
Optional Life	-	-	-	-
Total Benefits	**$ 513.8**	**$ 72.2**	**$ 72.2**	**$ 72.2**
Pensioner Life 2010 Premiums{1}	NA	7.80	7.80	7.80
Total	**$ 513.8**	**$ 80.0**	**$ 80.0**	**$ 80.0**

Notes: 1. Pensioner Life Premiums for 2010 have been treated as charge against the distribution in respect of the Pensioner Life Benefit (if any)2. LTD Life and LTD M&D includes $2.0 million and $5.2 million, respectively, related to LTD individuals who are assumed to proceed to retirement and become eligible as pensioners.3. Source: Mercer 2010 HWT Preliminary Valuation (excludes STB Liability)

Nortel Health and Welfare Trust REVISED Appendix D-4
REVISED Illustrative Allocation Scenarios Scenarios 12 to 14
Scenario: STB Liability Is Excluded and Optional Life Is a Participating Benefit
Cdn Millions

Type of Benefit	Benefit Liabilities {3}	**12** All Benefits Share Pro Rata [Distribution %: 11.9%]	**13** Proposed Participating Benefits [Distribution %: 26.3%]	**14** Benefits in Pay Share Pro Rata [Distribution %: 55.6%]
Pensioner Life (including ADB){1}	$ 126.9	$ 7.33	$ 25.59	$ -
Pensioner M&D	251.3	29.96	-	-
Pensioner Benefit Total	**378.2**	**37.29**	**25.59**	**-**
LTD Income (including IBNR)	79.9	9.53	21.02	44.45
LTD M&D{2}	29.7	3.54	-	-
LTD - STB accrued	EXCLUDED	-	-	-
LTD Life{2}	4.5	0.54	1.18	-
LTD Optional Life Benefit (including IBNR)	5.3	0.64	1.40	-
LTD Benefit Total	**119.4**	**14.24**	**23.61**	**44.45**
SIB	16.2	1.93	4.26	9.01
STB - in pay	EXCLUDED	-	-	-
STB - accrued	EXCLUDED	-	-	-
Optional Life	-	18.74	18.74	18.74
Total Benefits	**$ 513.8**	**$ 72.2**	**$ 72.2**	**$ 72.2**
Pensioner Life 2010 Premiums{1}	NA	7.80	7.80	7.80
Total	**$ 508.5**	**$ 80.0**	**$ 80.0**	**$ 80.0**

Notes: 1. Pensioner Life Premiums for 2010 have been treated as charge against the distribution in respect of the Pensioner Life Benefit (if any)2. LTD Life and LTD M&D includes $2.0 million and $5.2 million, respectively, related to LTD individuals who are assumed to proceed to retirement and become eligible as pensioners. 3. Source: Mercer 2010 HWT Preliminary Valuation (excludes STB Liability)

Schedule "C" — The Williams and Bell Affidavits

Part I - The Opinions and Beliefs Expressed in the Affidavits

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1. The Williams Affidavit expresses a "belief" that the LTD Beneficiaries' income replacement benefits are required to be paid in priority to Pensioner Life benefits on the distribution of assets from the HWT on its wind-up. [2]

Affidavit of Joann Williams, affirmed August 9, 2010, para. 2 (the "**Williams Affidavit**"); Opposing LTD Beneficiaries' Motion Record ("**Opposing Record**"), Tab 2

2. The Bell Affidavit states that it is submitted to provide Mr. Bell's "opinion on the generally accepted actuarial principles and practices used to determine sufficient contributions to fund long term disability wage replacement benefits." Mr. Bell also asserts, as a "belief," that "claims not incurred at the time of the bankruptcy of a company should be funded from a Health and Welfare Trust **after** incurred claims are provided for."

Affidavit of Jeremy Bell, sworn September 3, 2010 paras. 1 and 54 (emphasis in original) (the "**Bell Affidavit**"); Opposing LTD Beneficiaries' Supplementary Motion Record ("**Opposing Supp. Record**"), Tab 1

Part II - The Affidavits Should Not Be Considered in This Motion

A. Criteria for Admissibility

3. Expert opinion evidence is presumptively inadmissible and the Opposing LTD Beneficiaries have the burden of establishing its admissibility. *R. v. Abbey*, 2009 ONCA 624at para. 71 (C.A.); leave to appeal refused [2010] S.C.C.A. No. 125 (S.C.C.) ("***R. v. Abbey***"); BOA, Tab G.

4. The preconditions to overcoming the inadmissibility of expert opinion evidence are:

• the witness must be a properly qualified expert;

• the proposed opinion must be necessary in assisting the trier of fact and must relate to a subject matter that is properly the subject of expert opinion evidence;

• the proposed opinion must be logically relevant to a material issue; and

• the absence of any exclusionary rule.

R. v. Abbey, *supra*, at paras. 75 and 80; BOA, Tab G

5. To be admissible, the expert opinion evidence must provide technical information that is outside the experience and knowledge of the trier of fact. Expert opinion evidence that brings no added benefit to the process inevitably will be excluded. As stated by the Supreme Court of Canada:

With respect to matters calling for special knowledge, an expert in the field may draw inferences and state his opinion. An expert's function is precisely this: to provide the judge and jury with a ready-made inference which the judge and jury, due to the technical nature of the facts, are unable to formulate. "[...] If on the proven facts a judge or jury can form their own conclusions without help, then the opinion of the expert is unnecessary".

R. v. Mohan, [1994] 2 S.C.R. 9 at para. 25 (S.C.C.) (emphasis added, citing *R. v. Abbey*, [1982] 2 S.C.R. 24 at 42 (S.C.C.) that in turn cites *Turner* (1974), 60 Crim. App. R. 80 at 83); BOA, Tab H

R. v. Abbey, *supra*, at para. 94; BOA, Tab G

Tavernese v. Economical Mutual Insurance, 2009 CarswellOnt 3204at paras. 13 and 15 (S.C.J.); BOA, Tab I

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6. The *Rules* further codify that experts have a duty to provide opinion evidence "that is related only to matters that are within the expert's area of expertise," and that it must be "fair, objective and non-partisan". The Court of Appeal has stated that overreaching by expert witnesses is probably the most common fault leading to reversals on appeal.

Rules 4.1.01(1)(a) and (b), *Rules of Civil Procedure R. v. Abbey*, *supra*, para. 62; BOA, Tab G

B. The Affiants are Not Qualified Experts

7. It is apparent from the Affidavits that:

• neither Ms Williams nor Mr. Bell have any legal qualifications or legal expertise, including qualifications or expertise to interpret the Trust Agreement or to reach legal conclusions on the terms of the Trust Agreement or priorities with respect to the HWT;

• they have no published or academic works, peer-reviewed or otherwise, including in respect of health and welfare trusts or plans or legal, actuarial or insurance principles in relation to them;

• they have had no experience with the termination, wind-up or distribution of assets on wind-up in respect of any health and welfare trust;

• they have had no experience or involvement with the HWT itself; and

• Mr. Bell's experience with health and welfare trusts is extremely limited, being in respect of a singular multi-employer trust in British Columbia, whose liabilities are backed by public-institutions.

8. Accordingly, the affiants of the Affidavits do not demonstrate the requisite expert qualifications for the expressed beliefs or opinions.

C. Legal Opinion is Not the Proper Subject of Expert Evidence

9. It is firmly established that purported expert opinion evidence on the issues of domestic law before the Court is not of assistance to the Court, does not meet the criterion of necessity, and as a matter of law is outside the scope of proper expert evidence.

Pente Investment Management Ltd. v. Schneider Corp., [1998] CarswellOnt 5952 at paras. 4-5 and 10 (Gen. Div.), aff'd (1998), 42 O.R. (3d) 177 at paras. 40-43 (C.A.); BOA, Tab J

Royal Bank of Canada v. Société Générale (Canada), 2005 CarswellOnt 2201 at para. 1 (S.C.J.); BOA, Tab K

Webb v. Waterloo Regional Police Services Board (2002), 95 C.R.R (2d) 297 at paras. 7-14 (C.A.); BOA, Tab L

10. Expert witnesses take information accumulated from their own work and experience, combine it with evidence offered by other witnesses, and present an opinion as to a *factual inference* that should be drawn from the material.

R. v. Abbey, *supra* at para. 71; BOA, Tab G

11. Here, the opinions or "beliefs" expressed by Ms Williams and Mr. Bell purport to be expert opinion (or "belief") precisely as to how the Court should answer the very legal question of law before it: namely, how the HWT assets are distributable upon wind-up and whether any "priorities" are applicable.

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D. Lack of Relevance to the Subject Matter - Williams Affidavit

12. As well as being inadmissible as expert opinion evidence on a matter of law, the Williams Affidavit on its own terms does not logically bear on the Proposed Allocation Methodology for the HWT wind-up.

13. The issue on the motion is the appropriate allocation of the assets in the HWT upon termination of the HWT.

14. Ms Williams posits that actuarial principles (and, in some cases, insurance principles) mandate that the liabilities of the HWT are to be calculated "in respect of all claims for insured events occurring up to the date of the wind-up", and that, by contrast, they require that premiums payable after wind-up for "group term life insurance" not be considered "incurred expenses" or liabilities of the HWT on wind-up. Ms Williams also suggests that Nortel was required by actuarial practice to maintain a present value reserve for the LTD Beneficiaries' income benefit, and so on wind-up a reserve amount must be given priority in the distribution of HWT assets.

Williams Affidavit, paras. 2, 21 and 29; Opposing Record, Tab 2

15. However, it is the Trust Agreement that provides for the determination (upon termination) of all expenses, claims and obligations arising under the terms of the Trust Agreement and the HWT, and for the inclusion or exclusion of future benefits and claims. The Trust Agreement makes no reference to a priority for "insured" claims over non-insured claims, or a priority for liability for "insured events" having occurred over liability for "future premiums" for group life premiums not yet incurred. Ms Williams' thesis fails to take this into account, and is premised on alleged actuarial or insurance principles that the Trust Agreement's termination provision does not reference or invoke. [3]

16. Further, this motion is not an inquiry into what "could" have or "should" have been done by way of funding the HWT. How it was in fact funded, and whether particular reserves were in fact set up, is a simple historical, factual question on which Ms Williams offers no evidence.

17. Ms Williams' thesis in other parts of her affidavit turns on various CRA published statements (Interpretation Bulletins and other publications) about the taxation of health and welfare trusts and other benefit programs. However, CRA statements are not law and do not prescribe any legal requirements for any transactions or arrangements.

Caballero v. R., 2009 TCC 390at para. 8 (T.C.C.); BOA, Tab M

18. As the CRA itself emphasizes in one of the very documents cited in the Williams Affidavit:

Notice to the reader

• Bulletins do not have the force of law.

Interpretation Bulletin IT 85R2, dated July 31, 1986, attached as Exhibit "B" to the Williams Affidavit at pg. 1 (emphasis in the original); Opposing Record, Tab 2(B)

19. CRA's publications bear no logical relevance, in any event. These are non-binding statements from CRA as to the tax treatment that it *may* afford to certain arrangements or transactions *if* specified factual conditions exist and/or certain arrangements are in place. The characteristics of a benefit plan such as the HWT are whatever they are in fact, and their reality is not changed by virtue of CRA's income tax treatment. Rather, it is the characteristics of a benefit plan that determine the tax treatment.

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20. The current and historical reality of any funding for the HWT does not change as a result of any CRA criteria, and any speculation about what the funding would or might have been if certain approaches had been taken is irrelevant.

21. In any event, the conclusion that "as a result [of various CRA statements], there would be no accumulation of assets in an HWT to fund life insurance coverage into the future" is contradicted by Ms Williams' own statement that "[t]he nature of the employer's legal obligation to make contributions is governed by the terms of the trust agreement."

Williams Affidavit, paras. 11 and 15; Opposing Record, Tab 2

22. This primacy of the trust agreement is in fact also recognized by Deloitte & Touche LLP in its report on another trust that Mr. Bell cites:

> A trust is created by a formal written document known as a Trust Agreement. The Trust Agreement outlines all matters relating to governance such as the number of trustees, the manner in which they are appointed, trustee responsibilities and powers, requirements for meetings, provisions for amending and terminating the trust, for example.
>
> Deloitte & Touche LLP Report, dated January 29, 2004, attached as "B" to the Bell Affidavit, p. 14 ("**Deloitte Report**"); Opposing Supp. Record, Tab 1(B)

23. Moreover, the HWT was established in the context of a (very specific) "Ruling Request Letter" and a ruling from CRA (the "**Ruling**"), as opposed to any other CRA statements. If any inferences are to be drawn from CRA's treatment of the HWT, it is the Ruling (and the Ruling Request Letter), and CRA's treatment of the HWT since then, that constitute the relevant context. As set out in the Monitor's 51st Report, pursuant to the Ruling (and consistent with the express provisions of the Trust Agreement) there was no requirement for funding of all expected future LTD Beneficiaries' income benefits and no prohibition on the funding of future premiums for Pensioner Life benefits.

Monitor's 51st Report, paras. 36-38; Monitor's Record, Tab 2, pp. 52-54

24. The Williams Affidavit further expresses a thesis based on a misconception of the Pensioner Life benefit and the nature of Nortel's liability for this benefit, and an ensuing flawed contrast of the Pensioner Life benefit to the LTD Beneficiaries' income benefit (and the nature of Nortel's liability for it). The Williams Affidavit asserts that "future premiums paid to third party insurers for group term life insurance are not incurred expenses" (i.e., they are "contingent" only) and accordingly are not deductible under the CRA's criteria for health and welfare trusts, leading to a conclusion that "there would be no accumulation of assets in [a health and welfare trust] to fund life insurance coverage into the future."

Williams Affidavit, para. 15; Opposing Record, Tab 2

25. Ms Williams conflates funding theories with Nortel's obligation to provide the Pensioner Life benefit, which is a non-contingent liability. Once a Pensioner retires, he or she has met all the eligibility requirements for the life insurance and the coverage continues for life, unless he or she ceases to be a Canadian resident. The life insurance policies themselves expressly provide that there is no termination of their benefits.

Sun Life Policies, attached as Appendix "L" to the Monitor's 51st Report; Motion Record, Vol. III, Tab 2(L), pp. 792-93, 795, 797-98 and 861-65

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26. Ms Williams' thesis is further premised on lump-sum, reserve-type funding in respect of future years' life insurance premiums being characterized as funding in respect of "contingent" benefits, within the meaning as set out in a 1998 Ontario Court of Appeal decision.

Canadian Pacific Ltd. v. Ontario (Minister of Revenue) (1998), 114 O.A.C. 217 at para. 11 (C.A.) ("***Canadian Pacific***"); BOA, Tab N

27. However, the Pensioner Life benefits in the HWT fall squarely within the criteria for a non-contingent liability as set out in the holding in *Canadian Pacific*. Nortel's pensioners are entitled to Pensioner Life benefits for their lifetime with the insurance proceeds payable on death (at any age). That entitlement is not contingent, but rather is certain since the triggering events (namely, retirement and death) are certain (one having occurred and the other certain to occur). The precise total amount of future annual group life premiums to be paid may not be certain, but, as stated in *Canadian Pacific*, that uncertainty does not make the liability a contingent one.

Canadian Pacific, *supra*, at para. 43; BOA, Tab N

28. Further, Ms Williams' statements to the effect that CRA recognizes a distinction between (i) lump-sum funding of future expected LTD income benefits (as being fully deductible when the funding is made); and (ii) future expenses for life insurance premiums (as not being fully deductible when made as a lump sum) is incorrect. In fact, CRA's stated position (whether correct or not, as a matter of income tax law) is that lump-sum funding of future expected LTD income benefits is not deductible in the year of contribution.

CRA Technical News - Health and Welfare Trusts 10302002, p.6, attached as Exhibit "C" to the Williams Affidavit; Opposing Record, Tab 2(C)

E. Lack of Relevance to the Subject Matter - Bell Affidavit

29. As submitted above, the Bell Affidavit, as purported expert evidence on a legal principle, is *ipso facto* not admissible as a matter of law. In any event, it is respectfully submitted, the evidence proffered by the Bell Affidavit on its own terms does not bear on the issue before the Court, being the Proposed Allocation Methodology for the HWT wind-up.

30. In the case of the Bell Affidavit, the entire discussion concerns Mr. Bell's experience with the funding of disability benefits under an ongoing, publicly sponsored, multi-employer trust in British Columbia. His evidence does not address, concern or take into consideration the HWT or the Trust Agreement. Further, the B.C. trust is not only entirely unrelated to the HWT, but it is not distributing its assets or being wound-up.

31. This motion is not about the B.C. trust. The terms and practices of the B.C. trust are not in issue before this Court. Mr. Bell's evidence is not logically relevant to the matters in issue in the motion.

32. The Bell Affidavit further appears to suggest that principles for a wind-up of all health and welfare trusts can be drawn from certain specific employers' "exits" from the ongoing B.C. trust, whereby coverage stops and no payments are made "related to any event occurring after the date of termination". While this may be an accurate description of the one health and welfare plan that Mr. Bell is familiar with, it bears no logical connection to the HWT or the terms of the Trust Agreement that address the parameters of claims upon termination of the HWT.

Bell Affidavit, paras. 48-52; Opposing Supp. Record, Tab 1

33. In addition, the Bell Affidavit, in suggesting that general actuarial principles and practices can be drawn from certain specific practices relating to the B.C. trust, is inherently flawed as there are no actuarial standards or practice requirements in respect of the funding of self-insured long-term disability income benefits. The Actuarial Standards Board's own criteria for what constitutes accepted actuarial practice states that the ***only***

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explicit articulation of accepted actuarial practice are the Board's "rules and standards." Mr. Bell himself admits that he has identified no "useful public written account providing direction on accepted actuarial practice as it pertains to funding self-insured long-term disability income benefits." Nortel's actuaries, Mercer, confirm that they too are not aware of any actuarial standards or practice requirements specifically designed for settlement of non-pension benefits.

Bell Affidavit, para. 15; Opposing Supp. Record, Tab 1

Mercer Valuation, pg. 4; Monitor's Record, Vol. I, Tab 2(C), p. 109

Standards of Practice - General Standards for the Canadian Institute of Actuaries, pg. 1013, section 1210, attached as Exhibit "A" to the Bell Affidavit; Opposing Supp. Record, Tab 1(A)

Application granted; cross-motion dismissed.

Appendix "A" — List of Authorities in Schedule "C"

1. *Caballero v. R.*, 2009 TCC 390 (T.C.C.)

2. *Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 114 O.A.C. 217 (C.A.)

3. *Pente Investment Management Ltd. v. Schneider Corp.*, [1998] CarswellOnt 5952 (Gen. Div.), aff'd (1998), 42 O.R. (3d) 177 (C.A.)

4. *R. v. Abbey*, 2009 ONCA 624 (C.A.); leave to appeal refused [2010] S.C.C.A. No. 125 (S.C.C.)

5. *R. v. Mohan*, [1994] 2 S.C.R. 9 (S.C.C.)

6. *Royal Bank of Canada v. Société Générale (Canada)*, 2005 CarswellOnt 2201 (S.C.J.)

7. *Tavernese v. Economical Mutual Insurance*, 2009 CarswellOnt 3204 (S.C.J.)

8. *Webb v. Waterloo Regional Police Services Board* (2002), 95 C.R.R (2d) 297 (C.A.)

Appendix "B" — Statutory References in Schedule "C"

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

4.1.01(1) It is the duty of every expert engaged by or on behalf of a party to provide evidence in relation to a proceeding under these rules,

(a) to provide opinion evidence that is fair, objective and non-partisan;

(b) to provide opinion evidence that is related only to matters that are within the expert's area of expertise; and

(c) to provide such additional assistance as the court may reasonably require to determine a matter in issue.

Footnotes

1 In *Canadian Dental Association v. Association des Chirurgiens-Dentistes du Quebec*, 1994 CLB 4402, 17 O.R. (3d) 817, the Ontario Court of Appeal considered a similar fact scenario. The national association of dentists ("CDA") developed an insurance program for dentists. Coverage was provided on an experience-rated basis. Surpluses were declared in several consecutive years with respect to the life and disability plans, and such surpluses were paid to CDA. The trial court determined that surplus funds belonged to the participants who had paid the premiums. The Court of Appeal allowed the appeal. It relied

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on the fact that, when a participant pays a premium in respect of an insurance policy, the expectation is that he or she will have protection against the insured risk under the policy and nothing further.

2 A.H. Oosterhoff *et al.*, *Oosterhoff on Trusts: Text, Commentary and Materials*, 7th ed. (Toronto: Carswell, 2009) at 590.

3 Roy Goode, "Property and Unjust Enrichment" in Andrew Burrows, ed., *Essays on the Law of Restitution* (Oxford: Clarendon Press, 1991) 215 at 217; *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 at para. 43.

4 *Pettkus v. Becker*, [1980] 2 S.C.R. 834; *Sorochan v. Sorochan*, [1986] 2 S.C.R. 38 at para. 9.

5 *Soulos v. Korkontzilas, Supra* Note 3 at paras. 17, 29-34.

6 *I.U.O.E., Local 894 v. Smurfit-Stone Container (Canada) Inc.*, 2005 CarswellNB 209 (C.A.).

7 *Nortel Networks Corp. (Re)*, 2010 ONSC 3061.

8 *Northern Alberta Institute of Technology Academic Staff Assn. v. Northern Alberta Institute of Technology*, 2002 ABQB 750; the Alberta Court of Appeal affirmed the decision, but sent the matter back to the Court of Queen's Bench to recalculate the amount of money for which NASA should have its constructive trust, 2004 ABCA 42 (leave to appeal to the SCC refused, 2004 SCCA 154)

9 In *Dayco (Canada) Ltd. v. CAW-Canada*, [1993] 2 S.C.R. 230 at para. 87, the Supreme Court expressed the view, in *obiter*, that retirement rights that survive expiration of the underlying agreement vest at the time of retirement and cannot be taken away.

10 Other than the special case of STBs in pay.

11 John McGhee Q.C., *Snell's Equity*, 31st ed. (London: Sweet and Maxwell, 2005) at paras. 5-20 to 5-23.

2 The Williams Affidavit uses the term "Retiree Life Benefits" instead of "Pensioner Life benefits".

3 Indeed, even if they were relevant, none of the alleged actuarial or insurance principles asserted by Ms Williams prescribe any priorities upon termination of a health and welfare trust. There are no actuarial principles cited that mandate that a reserve be set up to fully fund expected LTD Beneficiaries' income benefits.

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2011 ONCA 10
Ontario Court of Appeal [In Chambers]

Nortel Networks Corp., Re

2011 CarswellOnt 11, 2011 ONCA 10, [2011] O.J. No. 22, 196 A.C.W.S. (3d) 923, 86 C.C.P.B. 178

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

In the matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

K.M. Weiler J.A.

Judgment: January 7, 2011
Docket: CA M39469

Proceedings: refusing leave to appeal *Nortel Networks Corp., Re* (2010), 2010 ONSC 5584, 2010 CarswellOnt 8462, 85 C.C.P.B. 161 (Ont. S.C.J. [Commercial List])

Counsel: Joel P. Rochon, Sakie Tambakos, John Archibald for Moving Party, Dissenting LTD Beneficiaries
Derrick Tay, Jennifer Stam for Nortel Networks Corporation et al.
Fred Myers, Gale Rubenstein for Monitor, Ernst & Young Inc.
William E. Pepall for Former Employees' Representatives
Fiona Campbell, Peter Engelmann for LTD Beneficiaries' Representative
Janice Payne, Steven Levitt, Arthur O. Jacques, Thomas McRae for Nortel Canadian Continuing Employees
Barry E. Wadsworth for CAW-Canada et al.

Subject: Estates and Trusts; Evidence; Employment; Public; Insolvency; Corporate and Commercial

MOTION for leave to appeal judgment reported at *Nortel Networks Corp., Re* (2010), 2010 ONSC 5584, 2010 CarswellOnt 8462, 85 C.C.P.B. 161 (Ont. S.C.J. [Commercial List]).

***K.M. Weiler J.A.*:**

1 The moving party has brought a motion in writing seeking leave to appeal the order of the motion judge sanctioning the monitor's application for approval of the methodology for distributing funds in Nortel's Health and Welfare Trust (HWT), scenario 2 of the "Illustrative Allocation Scenarios" (see: Schedule "B" of the motion judge's decision).

2 The test for leave to appeal in proceedings ongoing under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, is that there be a serious and arguable issue of real and significant interest with reference to the following four factors:

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

(b) whether the point raised is of significance to the action itself;

(c) whether the appeal is prima facie meritorious; and

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

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3 The moving party has not satisfied me in relation to factors a, c, and d that the test is met.

4 The interpretation of the specific termination clause in issue in the HWT, especially when viewed in the context of the unique factual matrix giving rise to the dispute, is not of significance to the practice.

5 Nor is the appeal *prima facie* meritorious. The judge at first instance did not read words into the termination clause. He correctly applied principles of construction of documents and did not reverse the onus of proof. His reasons for rejecting the proffered "expert" evidence do not disclose any error in principle.

6 In addition, granting leave to appeal would unduly hinder the progress of the action. In the event that leave to appeal were granted and the appeal were to be allowed, the motion judge's approval of the distribution in accordance with scenario 2 would be overturned. A number of outcomes relating to the allocation of the HWT corpus would then be possible. The bondholders and the unsecured creditors' committee reserved their rights if the distribution was not made in accordance with scenario 2. The responding parties all requested an opportunity to make submissions respecting the moving party's preferred option, scenario 3, as that scenario was not before the motion judge and it was acknowledged that a further hearing would be required if scenario 2 was not approved. Any subsequent order for distribution of the corpus of the HWT could, in turn, become the subject of a further application for leave to appeal. The restructuring of Nortel would be unduly delayed.

7 For these reasons, the motion for leave to appeal is dismissed with costs to the Monitor, the only party requesting costs. Subject to the Monitor and the moving party wishing to make further submissions in writing respecting the amount of costs, I would fix those costs in the amount of $2500.

Motion dismissed.

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2011 CarswellOnt 4527
Supreme Court of Canada

Nortel Networks Corp., Re

2011 CarswellOnt 4527, 2011 CarswellOnt 4528, [2011] S.C.C.A. No. 124, 425 N.R. 390 (note)

Dissenting Nortel LTD Beneficiaries v. Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, Monitor, Ernst & Young Inc., Former Employees' Representatives, Nortel Canadian Continuing Employees, Informal Nortel Noteholder Group, CAW-Canada and George Borosh, et al. and LTD Beneficiaries' Representative

Cromwell J., Fish J., LeBel J.

Judgment: June 9, 2011
Docket: 34171

Proceedings: Leave to appeal refused, 2011 ONCA 10, 2011 CarswellOnt 11, [2011] O.J. No. 22, 86 C.C.P.B. 178 (Ont. C.A. [In Chambers]); Leave to appeal refused, 2010 ONSC 5584, 2010 CarswellOnt 8462, 85 C.C.P.B. 161 (Ont. S.C.J. [Commercial List])

Counsel: None given

Subject: Estates and Trusts; Evidence; Labour; Employment; Public; Insolvency; Corporate and Commercial

Per curiam:

1 The application for leave to appeal from the judgment of the Court of Appeal for Ontario, Number M39469, 2011 ONCA 10, dated January 7, 2011, is dismissed with costs to all respondents except for Nortel Canadian Continuing Employees and the Informal Nortel Noteholder Group.

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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

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

***Morawetz J.*:**

Introduction

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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;

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(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.

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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;

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(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.

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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.

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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.

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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

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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

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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.

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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

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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.

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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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16

2010 ONSC 1977
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re [Employee Settlement Approval Motion #2

2010 CarswellOnt 2077, 2010 ONSC 1977, 187 A.C.W.S. (3d) 396, 66 C.B.R. (5th) 77

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 31, 2010
Judgment: March 31, 2010
Written reasons: April 8, 2010
Docket: 09-CL-7950

Counsel: Derrick Tay, Jennifer Stam for Applicants
J.A. Carfagnini, G. Rubenstein, M. Wagner, C. Armstrong for Monitor, Ernst & Young Inc.
Susan Philpott for Former Employees and Disabled Employees
Kevin Zych for Informal Nortel Noteholder Group
Arthur Jacques for Nortel Canada Current Employees
Deborah McPhail for Superintendent of Financial Services (non-PBGF)
Alex MacFarlane for Official Unsecured Creditors' Committee of Nortel Networks Inc.
Ken Rosenberg, Lily Harmer for Superintendent of Financial Services of the Pension Benefit Guarantee Fund (PBGF)
Rupert Chartrand, Adam Hirsh for Nortel Board of Directors
Robin Schwill for Nortel Networks UK Limited (In Administration)
Pamela Huff for Northern Trust Company, Canada
Barry Wadsworth for CAW-Canada
Joel P. Rochon, Sakie Tambakos for Opposing Long-Term Disability Employees
Guy Martin for Marie Josee Perrault

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

MOTION by insolvent corporation under *Companies' Creditors Arrangement Act* for approval of settlement agreement regarding pension and benefit payments.

***Morawetz J.*:**

1 At the conclusion of argument, the record was endorsed:

> Motion granted. Settlement Agreement approved. Reasons will follow. Order to go in the form presented, as amended.

2 These are those reasons.

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3 The motion was brought by the Applicants to approve the Amended and Restated Settlement Agreement, dated as of March 30, 2010 (the "Amended and Restated Settlement Agreement"), entered into by the Settlement Parties.

4 The Amended and Restated Settlement Agreement was entered into following the release of my decision on March 26, 2010, in which I did not approve the original Settlement Agreement, which included the "No Preclusion Clause" found in Clause H.2.

5 The Amended and Restated Settlement Agreement is identical to the Settlement Agreement, except that Clause H.2 has been deleted and the schedules to the Settlement Agreement have been updated to account for the deletion of Clause H.2.

6 The court was advised that in connection with the Amended and Restated Settlement Agreement, the Applicants and the Superintendent, in his capacity as Administrator of the PBGF, also entered into a letter agreement with respect to certain matters pertaining to the Pension Plans.

7 In view of obvious overlap between the Settlement Agreement and the Amended and Restated Settlement Agreement, it is appropriate to incorporate, by reference, the March 26, 2010 reasons (the "March 26 Reasons") into this endorsement. The March 26 Reasons are reported at *Nortel Networks Corp., Re*, 2010 ONSC 1708 (Ont. S.C.J. [Commercial List]).

8 The defined terms in this endorsement have the same meaning as set out in the March 26 Reasons.

9 In addition to the motion to approve the Amended and Restated Settlement Agreement, ancillary issues were raised, including issues of sufficiency of notice, an adjournment request and certain alternatives to the Amended and Restated Settlement Agreement.

Sufficiency of Notice

10 Concerns have been raised with respect to the short service of this motion. Counsel to the Monitor supports the expedited approval of the Amended and Restated Settlement Agreement and urges that the abridged notice be approved for two reasons. First, the pending cessation of benefits on March 31, 2010, in the absence of approval of the Amended and Restated Settlement Agreement, necessitated a hearing on an urgent basis, and second, the March 26 Reasons found that the Monitor (i) undertook a comprehensive notice process, (ii) gave the opportunity for any affected person to file a notice of appearance and appear before the court and, (iii) properly implemented the notice process.

11 In my view, this motion did not raise any new issues in respect of Clause H.2. Arguments with respect to Clause H.2 were detailed at the hearings from March 3 - 5, 2010 and were referenced in the March 26 Reasons commencing at [83]. Furthermore, all parties were represented in court and counsel were in a position to argue the matter on March 31, 2010. I accept that there was a degree of urgency to hear the motion.

12 In addition, there was a comprehensive notice process for the March 3, 2010 settlement approval motion properly implemented by the Monitor. Given that the only change from the Settlement Agreement, that was the subject of the March 3, 2010 settlement approval motion, and the Amended and Restated Settlement Agreement, is the removal of Clause H.2, notice and service with respect to the March 3, 2010 settlement approval motion is, in my view, sufficient for all purposes including, validating service of this motion.

13 In my view, it was both necessary and appropriate to hear the motion on short notice. Short service is validated.

Motion to Adjourn

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14 Counsel for the Opposing LTD Employees requested an adjournment of this motion. The adjournment request was denied, with reasons to follow. The reasons for the denial are the same reasons which I rely upon to approve short service: urgency, full representation of employees in court and counsel were in a position to argue the motion on the merits.

Alternative Relief

15 Counsel for the Opposing LTD Employees also requested that the benefits in place at the time of the hearing be continued for another 60 days while the parties, including representatives from the Opposing LTD Employees, participate in court-ordered negotiations with Campbell J. This alternative requested relief is addressed in these reasons.

The Amended and Restated Settlement Agreement

16 Counsel to the Applicants makes four points:

> 1. Unless the Amended and Restated Settlement Agreement was approved, the Applicants had no authority to continue making preferred payments to the employees.
>
> 2. Without the settlement, the Applicants would wind up or terminate the Pension Plan and medical, dental and other benefits in the near future.
>
> 3. The approval of the Amended and Restated Settlement Agreement provides clarity and certainty to the parties who depend on receiving benefits on a daily basis.
>
> 4. The Amended and Restated Settlement Agreement is not only the best deal available, it is the only deal.

17 Counsel to the Applicants also submits that the concerns expressed by the court in the March 26 Reasons have been addressed in the Amended and Restated Settlement Agreement, and that this motion does not provide for an opportunity to re-argue the settlement approval motion heard on March 3, 4, and 5, 2010. Effectively, counsel submits that there is nothing new to consider in this motion.

18 The Applicants' position is supported by the Former and LTD Employees, the CAW, the Superintendent, in all capacities, the Nortel Canada Continuing Employees, the Nortel Board of Directors, the Noteholders, the Unsecured Creditors' Committee, and the Monitor.

19 The record in support of the motion includes the affidavit of Ms. Elena King, the Forty-Second Report of the Monitor, affidavits from Mr. Donald Sproule and Mr. Michael Campbell, two of the three court-appointed Former Employees' Representatives who were appointed on behalf of all Former Employees, including pensioners of Nortel, and the affidavit of Ms. Susan Kennedy, the court-appointed LTD Representative.

20 The affidavits stressed the importance of the continuation of the members' medical benefits and pension plans for a further period of time, as well as the anxiety of employees concerned with the imminent cessation or reduction in payments. The affidavits establish that the certainty associated with the preservation and continuation of benefits negotiated in the Settlement Agreement outweigh the limited concession associated with the deletion of Clause H.2.

21 In its recommendation in support of the requested relief, the Monitor states that it believes the Amended and Restated Settlement Agreement and the Settlement Approval Order take into account the March 26 Reasons, and represents a fair balancing of the interests of the Applicants' stakeholders. The Monitor is of the view that the Amended and Restated Settlement Agreement represents an important step in the implementation of the Applicants' restructuring, which was arrived at after extensive negotiations.

22 The Opposing LTD Employees request the continuation of benefits for another 60 days, and court-ordered mediation with Campbell J., or alternatively that the Amended and Restated Settlement Agreement not be approved.

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The motion record of the Opposing LTD Employees consists of the affidavit of Ms. Urquhart and various exhibits. Ms. Urquhart also swore an affidavit March 1, 2010 in support of the Opposing LTD Employees in respect of the hearing for the approval of the Settlement Agreement.

23 Counsel to the Opposing LTD Employees submits that the stated urgency of the March 31, 2010 "cutting off" of benefits was exaggerated and that the reality is that, while the income replacement benefits for the disabled may cease to be funded from Nortel's operations, the HWT remains in place as a source of funding for income replacement benefits for the LTD Employees.

24 Counsel also submits that, in terms of extending the payment of benefits from Nortel's operations, the evidence demonstrates that there are sufficient assets to do this. No specifics were provided in support of this statement.

25 Further, counsel submitted that there are additional facts to justify rejection of the deal and he summarizes from Ms. Urquhart's affidavit that there are legislative initiatives regarding the status of LTD Employee creditor claims that may be addressed by way of amendments to both the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*.

26 Mr. Rochon also stated that the Opposing LTD Employees rely upon and incorporate by reference the submissions made in their factum submitted in opposition to the Settlement Agreement. These submissions primarily relate to the issue of Third Party Releases.

27 Submissions were also made in person by Mr. Guy Martin on behalf of Ms. Marie Josee Perrault. Mr. Martin also made submissions on the settlement approval motion. He remains passionate in his opposition to the Amended and Restated Settlement Agreement, for similar reasons to those expressed on the earlier settlement approval motion.

28 I cannot accept the Opposing LTD Employees' proposal to extend benefits for 60 days while court-ordered negotiations transpire as being an acceptable outcome. There is no evidence to suggest the March 31, 2010 deadline is not genuine. Further, ordering payments out of the HWT corpus will deplete the corpus of the trust, to the potential detriment of the LTD Employees. In addition, the payment by the Applicants of any benefits to the LTD Employees outside of the Amended and Restated Settlement Agreement would be preferential in nature and ignores the fact that there is no statutory priority for the Former and LTD Employees.

29 Circumstances require that the position of the Former and LTD Employees be considered in light of the current reality. The current reality is that Nortel is insolvent and the benefits and payments promised by Nortel cannot continue indefinitely. Absent approval of the Amended and Restated Settlement Agreement, benefits can cease as at March 31, 2010.

30 There is uncertainty as to what would occur if the Amended and Restated Settlement Agreement was not approved.

31 Counsel to the Opposing LTD Employees was specifically asked whether he had any assurances that the Amended and Restated Settlement Agreement, supported by a $57 million charge, would be on the table at the end of a 60-day extension period. Counsel could provide no such assurances.

32 In contrast, counsel to the Noteholders was emphatic in stating that either the Amended and Restated Settlement Agreement be approved or benefits should cease. This position was supported by counsel to the Unsecured Creditors' Committee. These two groups are significant creditors of the Applicants.

33 The reality is that, absent approval of the Amended and Restated Settlement Agreement, the Former and LTD Employees face cessation of benefits, or at best, uncertainty, a position that was consistently stated by Representative Counsel to be unacceptable.

34 It seems to me that the Former Employees' Representatives and the LTD Representative fully considered the impact of the March 26 Reasons and, after consultations with Representative Counsel and communications with a significant

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number of Former and LTD Employees, came to the conclusion that the Amended and Restated Settlement Agreement represented an acceptable compromise. The Amended and Restated Settlement Agreement does provide the Former and LTD Employees with preferential treatment, at the expense of the remaining unsecured creditors of the Applicants, in exchange for certain concessions.

35 The Opposing LTD Employees constitute between 37 and 39 people, all of whom, with one or two possible exceptions, are represented by Representative Counsel or the CAW, the latter of who particularly asserts exclusive representation rights for its members. The total number of former employees is approximately 20,000 and the total number of LTD Employees is about 350. The Opposing LTD Employees consist of approximately 10% of all LTD Employees. I have not been persuaded by the arguments of counsel to the Opposing LTD Employees that the matters in issue be deferred or that approval of the Amended and Restated Settlement Agreement be denied. In my view, it is not appropriate for the objections of a 10% minority override the views of 90% of the LTD Employees, who support the settlement through their court-appointed representative.

36 The Settlement Agreement and the Amended and Restated Settlement Agreement are products of extensive negotiations between the parties. The Settlement Parties participated in "best efforts" negotiations that resulted in these agreements. In my view, the very existence of the Amended and Restated Settlement Agreement indicates that effective mediation has occurred.

37 In the March 26 Reasons, I recognized that the Settlement Agreement was arrived at after hard-fought and lengthy negotiations and that the parties to the Settlement Agreement considered it to be the best agreement achievable under the circumstances. In my view, the same can be said with respect to the Amended and Restated Settlement Agreement.

38 In particular, I note that Representative Counsel consulted with the representatives immediately after the March 26 Reasons were released and there was significant communication with a number of the members of the group. There is strong evidence of support from the employees to the Amended and Restated Settlement Agreement. On the other hand, there are approximately 37 to 39 employees opposing court approval.

39 Finally, I note that this endorsement does not directly address the third party releases in the Amended and Restated Settlement Agreement, which the Opposing LTD Employees referenced in their submissions. The issue of third party releases was fully argued in the earlier motion and the March 26 Reasons reflect my findings. Nothing in the Amended and Restated Settlement Agreement alters these findings or conclusions.

Disposition

40 The Amended and Restated Settlement Agreement is not perfect but, in my view, under the circumstances, it balances competing interests of all stakeholders and represents a fair and reasonable compromise, and accordingly, it is appropriate to approve same.

41 A formal order giving effect to the foregoing was prepared by counsel to the Applicants. Nothing in the order granted, including in particular paragraphs 5 and 11, is intended to prevent the Northern Trust Company, Canada, from claiming and recovering its fees and expenses from the trust funds, as it may be entitled pursuant to law and the trust agreements. All rights of the Northern Trust Company, Canada to recover its fees and expenses and any right of indemnification from the HWT and Pension Plan trust assets that it may have under the terms of the HWT trust or the Pension Plan trusts or under applicable law are not affected or prejudiced by the order.

42 I would again like to express my appreciation to all counsel for the quality of their written and oral submissions. The efforts of the Former Employees' Representatives, the LTD Representative and Representative Counsel are specifically recognized for the dignified manner in which they have discharged their responsibilities.

Motion granted.

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2010 ONCA 402
Ontario Court of Appeal

Nortel Networks Corp., Re

2010 CarswellOnt 3752, 2010 ONCA 402, 68 C.B.R. (5th) 232

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

Winkler C.J.O., Goudge, MacPherson JJ.A.

Judgment: June 3, 2010
Docket: CA M38748

Proceedings: refused leave to appeal *Nortel Networks Corp., Re* ((2010)), 2010 ONSC 1977, 2010 CarswellOnt 2077, 66 C.B.R. (5th) 77 ((Ont. S.C.J. [Commercial List]))

Counsel: Joel P. Rochon, Sakie Tambakos for Objecting LTD Beneficiaries
Joel P. Rochon, John Archibald, Sakie Tambakos
Mark Zigler, Susan Philpott, Andrea McKinnon for Former Employees, Disabled Employees of Nortel
Barry E. Wadsworth for CAW-Canada, George Borosh et al
Lyndon Barnes, Adam Hirsh for Boards of Directors of Nortel Netwroks Corpiration, Nortel Networks Limited
Alex MacFarlene for Official Committee of Unsecured Creditors
Fred Myers, Gale Rubenstein, Melaney Wagner for Monitor, Ernst & Young Inc.

Subject: Insolvency; Civil Practice and Procedure

MOTION by creditors for leave to appeal approval of proposal under *Companies' Creditors' Arrangement Act*.

***Per curiam*:**

1 Leave to appeal is denied.

2 The moving parties have not demonstrated that they have been subjected to any procedural unfairness. They have been represented throughout in a case that has been carefully judicially managed from the beginning. Their counsel accepts the settlement. No other LTD beneficiaries assert any unfair process, and the applicants can show none that they have been exposed to.

3 Nor have they been able to show any substantive unfairness in the settlement. The motion judge exercised his discretion to carefully balance the various interests at stake in approving the settlement. In our view he made no demonstrable error in doing so. The settlement cannot be said to be unreasonable.

4 The motion is dismissed. No costs are sought by the respondent and none are ordered.

Motion dismissed.

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2016 ONSC 7965
Ontario Superior Court of Justice

Urlin Rent a Car Ltd. v. Furukawa Electric Co.

2016 CarswellOnt 20732, 2016 ONSC 7965

URLIN RENT A CAR LTD. and FADY SAMAHA (Plaintiffs) and FURUKAWA ELECTRIC CO. LTD., AMERICAN FURUKAWA INC., FUJIKURA LTD., FUJIKURA AMERICA INC., FUJIKURA AUTOMOTIVE AMERICA LLC, LEONI AG, LEONI KABEL GMBH, LEONI WIRING SYSTEMS, INC., LEONISCHE HOLDING, INC., LEONI WIRE INC., LEONI ELOCAB LTD., LEONI BORDNETZ-SYSTEME GMBH, SUMITOMO ELECTRIC INDUSTRIES, LTD., SEWS CANADA LTD., SUMITOMO WIRING SYSTEMS, LTD., SUMITOMO ELECTRIC WIRING SYSTEMS, INC., SUMITOMO WIRING SYSTEMS (U.S.A.), INC., YAZAKI CORPORATION, YAZAKI NORTH AMERICA, INC., S-Y SYSTEMS TECHNOLOGIES EUROPE, GMBH, G.S. ELECTECH, INC., G.S.W. MANUFACTURING, INC., and G.S. WIRING SYSTEMS INC. (Defendants)

SHERIDAN CHEVROLET CADILLAC LTD., THE PICKERING AUTO MALL LTD., and FADY SAMAHA (Plaintiffs) and SUMITOMO ELECTRIC INDUSTRIES, LTD., SEWS CANADA LTD., SUMITOMO WIRING SYSTEMS, LTD., SUMITOMO ELECTRIC WIRING SYSTEMS, INC., SUMITOMO WIRING SYSTEMS (U.S.A.), INC., DENSO CORPORATION, DENSO INTERNATIONAL AMERICA, INC., DENSO MANUFACTURING CANADA, INC., DENSO SALES CANADA, INC., MITSUBISHI ELECTRIC CORPORATION, MITSUBISHI ELECTRIC AUTOMOTIVE AMERICA, INC., MITSUBISHI ELECTRIC SALES CANADA INC., HITACHI, LTD., HITACHI AUTOMOTIVE SYSTEMS, LTD. and HITACHI AUTOMOTIVE SYSTEMS AMERICAS, INC. (Defendants)

SHERIDAN CHEVROLET CADILLAC LTD., PICKERING AUTO MALL LTD., and FADY SAMAHA (Plaintiffs) and DENSO CORPORATION, DENSO INTERNATIONAL AMERICA INC., DENSO MANUFACTURING CANADA, INC., DENSO SALES CANADA, INC., TOKAI RIKA CO., LTD., TRAM, INC., TRMI, INC., TRIN, INC., CALSONIC KANSEI CORPORATION, CALSONIC KANSEI NORTH AMERICA, INC., SUMITOMO ELECTRIC INDUSTRIES LTD., SUMITOMO WIRING SYSTEMS LTD., SUMITOMO ELECTRIC WIRING SYSTEMS INC., SUMITOMO ELECTRIC WINTEC AMERICA, INC., SUMITOMO WIRING SYSTEMS (U.S.A.) INC., K&S WIRING SYSTEMS, INC., ALPS ELECTRIC CO., LTD., ALPS ELECTRIC (NORTH AMERICA), INC., and ALPS AUTOMOTIVE INC. (Defendants)

Edward P. Belobaba J.

Heard: December 19, 2016
Judgment: December 29, 2016
Docket: CV-12-446737-CP, CV-13-482967-CP, CV-12-449233-CP

Counsel: Charles M. Wright, Jean M. LeClerc for Plaintiffs
Neil Campbell, Lindsay Lorimer for Sumitomo Defendants
Paul J. Martin for G.S. Electech Defendants
Kevin Wright for Furukawa Defendants
Katherine L. Kay, Mel Hogg for SY Systems Defendants
Kelly Friedman for Hitachi Defendants
Chantelle Spagnola for Denso Defendants

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Donald Houston for Alps Defendants
James Gotowiec for Leoni and Mitsubishi Defendants
David Klein, Angela Bespflug for four out-of-province objectors

Subject: Civil Practice and Procedure

SETTLEMENT of class actions reached with two groups of defendants with respect to certain car components.

***Edward P. Belobaba J.*:**

Background

1 I am case-managing some 30 class actions alleging price-fixing in the auto parts industry. The actions are at various stages of litigation and involve a variety of auto parts including automotive wire harness systems ("AWHS"), electronic control units ("ECU") and heating control panels ("HCP").

2 The class actions materialized in the aftermath of high-profile criminal and regulatory investigations and prosecutions in the United States, Canada and Europe. Several international auto parts suppliers pleaded guilty to the charges against them and agreed to pay hefty fines, some in the hundreds of millions of dollars. In the U.S. prosecutions, 31 executives have been sentenced to significant prison terms and another 30 have been indicted. The class actions in the U.S. and Canada have been brought on behalf of direct purchasers, automobile dealers and/or end-payors.

Sumitomo and GS Electech

3 The class actions against the Sumitomo and GS Electech defendants were certified for settlement purposes on November, 2, 2016 and the required notices were posted.

4 Class counsel now advise that settlements have been reached with these two groups of defendants with respect to the AWHS, ECU and HCP components. The action against Sumitomo has settled for $11 million ($10.7 for AWHS, $150,000 for ECU and $150,000 for HCP.) The action against GS Electech has settled for $120.000 (for AWHS.) The settlements also contain the usual bar orders, broad releases and promises of continuing co-operation on the part of the defendants.

Settlement approval

5 The applicable law is well known. The court must be satisfied that the proposed settlement is fair and reasonable and in the best interests of the class. [1] In making this determination, the court must look beyond the self-serving "boiler plate" that still pervades the typical settlement approval factum ("*we're experienced class counsel - we know what we're doing — trust us*") and look for objective evidence that the proposed settlement is indeed in the best interests of the class. As I noted in *Sheridan Chevrolet*: [2]

> If class action judges are to do their job (and be more than rubber-stamps) in the settlement approval process, and ensure that the settlement amount is indeed fair and reasonable and in the best interests of the class (and not just class counsel) then at the very least class counsel should provide affidavit evidence explaining why the actual settlement amount is fair and reasonable or more specifically, clear reasons why the settlement amount is in the "zone of reasonableness." [3]

6 In this case, class counsel took my admonition to heart and provided the court with focused affidavit evidence, explaining why the Sumitomo and GS Electech settlements fall within a zone of reasonableness and are in the best interests of the class.

Sumitomo AWHS settlement

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7 I begin with the largest settlement. I am satisfied, for the reasons set out below, that the Sumitomo AWHS $10.7 million settlement falls within a zone or reasonableness.

8 Sumitomo was primarily involved in unlawful activity in respect of RFQs for AWHS sold to Honda and Toyota. Honda and Toyota have opted out of the Ontario AWHS Action. As such, the class in Canada is primarily made up of indirect purchasers.

9 Sumitomo settled with the indirect purchaser class in the U.S. (i.e. the equivalent of the Canadian class) for US $47,127,920. This sum includes amounts paid for ECU claims since there is no separate ECU case in the U.S. Given that the U.S. comparator is often used as one measure of the zone of reasonableness, it would follow that any Canadian settlement over and above $4.7 million would fall within said zone. The $10.7 million settlement herein is more than two times larger. This is certainly evidence that the settlement is fair and reasonable.

10 There is also intangible but real value in the fact that Sumitomo was one of the key participants in the AWHS conspiracy and was the first co-conspirator to co-operate with authorities. This co-operation likely facilitated timely settlements and the payment of significant compensation to settlement class members and others.

Sumitomo ECU and HCP settlements

11 The Sumitomo ECU and HCP settlements are quite small - $150,000 in each case. But here again, I am satisfied that the settlements fall within a zone of reasonableness.

12 Sumitomo had very little in the way of direct ECU sales in Canada and a significant portion of the parts sold here were exported to the U.S. Sumitomo provided volume of commerce data with respect to several RFQs. If one applies the assumptions relied on by this court previously in the Furukawa and Fujikura settlements [4] the total amount of potential damages justify a payment of no more than $150,000.

13 As for HCP, the evidence is that there were no direct HCP sales into Canada. Sumitomo has also agreed to provide cooperation in respect of the HCP and ECU proceedings involving the other defendants. Here again a $150,000 settlement is not unreasonable.

14 In short, I am satisfied on the evidence that the relatively modest $150,000 amounts agreed to in the Sumitomo ECU and HCP settlements were fair and reasonable.

GS Electech AWHS Settlement

15 GS Electech has agreed to pay $120,000 in settlement of the AWHS claim. This is a modest settlement amount but it is an amount that makes sense given the following.

16 GS Electech was a minor player in the AWHS market with a likely market share of less than one per cent during the class period. It was only fined $2.75 million (all numbers in U.S. dollars) by the U.S. Department of Justice. This fine is small compared to other defendants. The stipulated global volume of commerce in GS Electech's guilty plea was only $11 million. If one applies the usual one-tenth proportion between Canada and the U.S., the total Canadian VOC would have been $1.1 million. Applying the price-fixing expert's damage estimate methodology, this would translate into a potential damages estimate of only $55,000. Seen in this light, the $120,000 settlement (in Canadian funds) is certainly reasonable.

17 In sum, I am satisfied that the Sumitomo and GS Electech settlements should be approved as fair and reasonable and in the best interests of the class.

The Klein objections

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18 The Klein law firm ("Klein") is counsel to four individuals who have commenced two proposed class actions in the spring of this year - one in Manitoba and the other in Saskatchewan - alleging price-fixing in auto-parts, including AWHS and HCP. The two actions have not yet been certified as class proceedings.

19 Klein advanced two objections at the hearing, one jurisdictional and the other about the reasonableness of the Sumitomo AWHS settlement. (Klein was not concerned with the modest ECU and HCP settlements.)

20 Class counsel and Sumitomo agreed with Klein that this court does not have the jurisdiction to dismiss actions commenced outside of Ontario such as the two just noted. The impugned provision in the settlement agreement has now been corrected to reflect this obvious point. As to the objection about the reasonableness of the $10.7 million settlement, Klein could not point to any aspect of the settlement that was unfair or unreasonable or outside "the zone or reasonableness." In its final written submission, Klein, to its credit, made clear that it was taking "no position as to the reasonableness of the settlement."

21 In a post-hearing written submission, Klein suggested that its four clients may want to opt out of the Sumitomo AWHS settlement. Class counsel responded with the reminder that all class members in the AWHS Action were given the opportunity to opt out of the AWHS Action in 2014 when the action against the Lear defendants was settled. Indeed, the applicable court-approved notice clearly stated that "[t]his is your only chance to exclude yourself or opt out of the Automotive Wire Harness Systems Action."

22 The opt-out deadline has long passed. It follows that Klein's clients, all of whom are class members in the AWHS Action and eligible for compensation under the settlement herein, can no longer opt out of the AWHS Action or the Sumitomo settlement. The case law in Ontario on this point is clear and was succinctly summarized in the Winkler and Perell text as follows:

> The case law establishes that where there are progressive or partial certifications of a class action, a class member will only have one opportunity to opt out of the action. Practically speaking, this means that once an action has been certified against any of the multiple defendants and a settlement is subsequently reached with some but not all of the defendants, the class member may not opt out of the settlement . . . [5]

23 After reviewing the Lear certification order and long-form notice, Klein advised the court that it would not be advancing the opt-out position.

Legal fees approval

24 Based on the retainer agreements, class counsel are entitled to a 25 per cent contingency plus disbursements and taxes. As discussed in *Cannon*, [6] this contingency amount is presumptively valid and on the facts herein should be approved. Class counsel are thus entitled to their requested legal fees in the amount of $2,579,840, disbursements in the amount of $52,102 and applicable taxes.

Disposition

25 The Sumitomo and GS Electech settlements, totalling $11 million and $120,000 respectively, are approved. In my view, the settlements are fair and reasonable and in the best interests of the class. Class counsels' legal fees are also approved.

26 Orders to go as per the draft Orders that were signed by me at the conclusion of the hearing on December 19, 2016 and the draft Order that was signed today.

Order accordingly.

Footnotes

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1 *Dabbs v. Sun Life Assurance Co. of Canada* (1998), 40 O.R. (3d) 429 (Ont. Gen. Div.), aff'd (1998), 41 O.R. (3d) 97 (Ont. C.A.), leave to appeal to refused Oct. 22, 1998.

2 *Sheridan Chevrolet Cadillac Ltd. v. Furukawa Electric Co.*, 2016 ONSC 729 (Ont. S.C.J.). Also see the discussion in *AFA Livförsäkringsaktiebolag v. Agnico-Eagle Mines Ltd.*, 2016 ONSC 532 (Ont. S.C.J.) and *Rosen v. BMO Nesbitt Burns Inc.*, 2016 ONSC 4752 (Ont. S.C.J.).

3 *Supra*, note 2, at para. 12.

4 *Urlin Rent A Car Ltd. v. Furukawa Electric Co.*, 2016 ONSC 5736 (Ont. S.C.J.).

5 Winkler, Perell, Kalajdzic and Warner, *The Law of Class Actions in Canada*, (2014) at 315.

6 *Cannon v. Funds for Canada Foundation*, 2013 ONSC 7686 (Ont. S.C.J.).

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2015 ONSC 4170
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2015 CarswellOnt 10304, 2015 ONSC 4170, 256 A.C.W.S. (3d) 688, 27 C.B.R. (6th) 51

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

Newbould J.

Heard: June 25, 2015
Judgment: July 6, 2015
Docket: 09-CL-7950

Counsel: Sheila Block, Scott A. Bomhof, Jeremy Opolsky for US Debtors
Gavin H. Finlayson, Jonathan Bell for Ad Hoc Bondholder Group
R. Shayne Kukulowicz, Stephanie Holland for U.S. Unsecured Creditors Committee
Benjamin Zarnett, Jessica Kimmel, Peter Ruby, Peter Kolla for Monitor and Canadian Debtors
Ken Rosenberg, Paul Steep, Massimo Starnino, Lily Harmer, Barbara Walancik for Canadian Creditors' Committee
Michael E. Barrack, D.J. Miller, Michael Shakra for UK Pension Claimants
Matthew P. Gottlieb, Matthew Milne-Smith for Joint Administrators of the EMEA Debtors
John Salmas, Sara-Ann Van Allen for Wilmington Trust, National Association
Daniel S. Murdoch for Conflicts Administrator of NNSA
Edmund F.B. Lamek for Law Debenture Trust Company of New York

Subject: Evidence; Insolvency; International

MOTIONS by US interests seeking reconsideration or clarification of US and Canadian decisions with respect to double counting of bond claims for allocation purposes, bondholder shortfall claim issue, proceeds of sale of subsidiaries of company, intercompany claims and allocation to debtor estates, and tax claims.

***Newbould J.*:**

1 On May 12, 2015, I released my reasons for judgment in the joint trial held with Judge Kevin Gross of the U.S. Bankruptcy Court for the District of Delaware to determine how to allocate the $7.3 billion held in escrow (the "lockbox funds"). On the same day Judge Gross released his opinion. We came to the same conclusion as to how the lockbox funds were to be allocated. No signed judgment has been signed in this Court. Judge Gross signed an order making his ruling final.

2 Motions have now been brought by different U.S. interests seeking reconsideration or clarification of both decisions, as follows:

> (i) NNI and certain of its affiliates (the "U.S. Debtors") have moved in this Court for "clarification, reconsideration or amendment of the May 12, 2015 reasons for judgment". In the U.S. Bankruptcy Court

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the U.S. Debtors have moved "to clarify and/or reconsider" the opinion and order of Judge Gross. Several aspects of the decisions have been raised in both motions. These motions are supported by the U.S. Unsecured Creditors Committee.

(ii) The Ad Hoc Group of Bondholders (the "bondholders") have moved in this Court "for clarification, or if necessary, amendment of" the reasons for judgment with respect to one aspect of the decision. They have moved in the U.S. Bankruptcy Court "for reconsideration" of the same one aspect of the opinion and order of Judge Gross and thereby seek clarification and if necessary modification of the opinion and order.

Test for reconsideration

3 There is no doubt that a court has jurisdiction to change or amend a judgment in Canada before it is formally drawn up and signed, but a court should be most reluctant to do so and should exercise the jurisdiction only in an exceptional case. See *Burke v. Sitser*, 2002 NSCA 115 (N.S. C.A.), para. 7 and *Holmes Foundry Ltd. v. Point Edward (Village)*, [1963] 2 O.R. 404 (Ont. C.A.). In the leading case of *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, [2001] 2 S.C.R. 983 (S.C.C.), Major J. for the Court stated:

> Further, the case law dictates that the trial judge must exercise his discretion to reopen the trial "sparingly and with the greatest care" so that "fraud and abuse of the Court's processes" do not result (citations omitted).

4 In *Schmuck v. Reynolds-Schmuck* (2000), 46 O.R. (3d) 702 (Ont. S.C.J.), Himel J. referred to the confines of the jurisdiction to reopen a case as follows:

> **22** ... It is extremely rare for there to be a request to re-open a trial on the grounds of a reconsideration of the case.
>
> **25** It is my view that a party who wishes a reconsideration alone would have to establish that the integrity of the litigation process is at risk unless it occurs, or that there is some principle of justice at stake that would override the value of finality in litigation, or that some miscarriage of justice would occur if such a reconsideration did not take place.

5 In *Risorto v. State Farm Mutual Automobile Insurance Co.* (2009), 70 C.P.C. (6th) 390 (Ont. Div. Ct.) at para. 55, Gray J. stated:

> **35** ...Litigation by instalments is not to be encouraged. There is a strong interest in finality, which should only be departed from in exceptional circumstances. Parties make strategic decisions in the course of litigation, and except in narrow circumstances they must be held to those decisions.

6 Motions for reconsideration are not the venue for new arguments that could have been made initially. See *Mujagic v. Kamps*, 2015 ONCA 360 (Ont. C.A.) per Doherty J.A. at para. 13. In *Kay v. Wirstiuk*, [1977] A.J. No. 690 (Alta. T.D.) Steer J. stated:

> In my view, one potential for abuse that must clearly be kept in mind is that there is a fundamental rule which requires a litigant to have the facts of his case fully prepared to prove those matters that must be proved and to present it once and for all at the time of trial. This rule is fundamental because it is only in this way that endless wrangling and never-ending re-hearings and never-ending re-openings to hear new evidence can be avoided.

7 Clarification is a less contentious matter. Clarification may be given where the original judgment "was so expressed as to lead to uncertainty and confusion" or contains a latent ambiguity. See *Fame Construction Ltd. v. 430863 B.C. Ltd.*, [1997] B.C.J. No. 1053 (B.C. S.C.) at para. 4 and *Buckley v. B.C.T.F.*, [1995] B.C.J. No. 2971 (B.C. C.A.) at para. 17.

No double counting of the bond claims for allocation purposes

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8 In the allocation decision, it was ordered that in determining what the claims are against the Debtor Estates, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once for allocation purposes. This principle is applicable to all such claims, including claims by the bondholders against the issuer and the guarantor Debtor Estates and possible claims by the UKPC against NNUK and other EMEA Debtors.

9 In the allocation decision, it was ordered that claims on bonds are to be made on the Debtor Estate of the issuer. Claims on those bonds may also be made on the Debtor Estate of the guarantor but those claims will not be taken into account in determining the claims against the Debtor Estates for allocation purposes. The U.S. Debtors and the UCC contend that the allocation decision should be changed to provide that the claims by the bondholders on the guaranteed bonds against both the issuer and guarantor Debtor Estates should be included in the claims for allocation purposes. As nearly all of the $4 billion in bonds were guaranteed by NNI, that would result in a much higher figure of claims for allocation purposes recognized in the U.S. Debtors Estates.

10 In my view, there is no basis for that argument to be made on a reconsideration motion such as this.

11 It is contended that without such a change, there would be a manifest injustice or miscarriage of justice to the unsecured creditors of the U.S. Debtors other than the bondholders. The U.S. Debtors point to evidence of Mr. Britven, an expert witness at the trial called on behalf of the CCC who gave estimates of recoveries to various creditor classes based on the different allocation theories advanced by the other parties. They say that the result would be that the creditors of the U.S. Debtors would recover only 14 cents on the dollar from the lockbox funds, which amount they say would be manifestly unjust.

12 However, this figure is misleading. It ignores the cash on hand in the U.S. Debtors Estates available to their creditors and the $2 billion admitted claim of the U.S. Debtors against NNL. In exhibit A to the U.S. Debtors' motion, it is stated that the recovery to unsecured creditors of the U.S. Debtors from all sources will be 40% of claims if the bondholders are entitled to claim all of their outstanding bonds against the guarantor NNI and 62% if the bondholders claims against the guarantor NNI may only be made on the shortfall after partial recovery from the issuer NNL. I see no basis to conclude that such a recovery would be manifestly unjust or constitute a miscarriage of justice.

13 The primary argument of the U.S. Debtors in the allocation trial, based on their expert witness Jeffery Kinrich, was that the proceeds should be allocated on a revenue basis. The calculations of Mr. Britven at the trial indicated that if the U.S. Debtors position were to be accepted, the Canadian unsecured creditors would recover 11% of their claims. It hardly lies in the mouth of the U.S. Debtors to now say that the recovery of 40% or 62% of their claims, let alone 14%, would be manifestly unjust. Exhibit A to the U.S. Debtors' motion states that recovery to the unsecured creditors of the Canadian Debtors will be 49% and to the EMEA Debtors 65%.

14 The U.S. Debtors do not adopt or validate the assumptions that Mr. Britven used in his analysis and they did not do so at the trial. However they rely on these assumptions in their argument now except for changes they have with respect to cash and claims since the date of his report [1] . It is somewhat ironic in that the U.S. Debtors had nothing good to say at the trial about the Britven report and filed no evidence of potential creditor recoveries. They took the position at the trial, and before the trial on a motion to strike the reports of Mr. Britven and Dr. Bazelon, called on behalf of the UKPC, that what a particular allocation methodology yielded in terms of creditor recoveries was not relevant to the question of the allocation that the estates are entitled to. They assert in their brief now that the analysis of Mr. Britven is unreliable but that it shows a "directional and proportional impact" of the allocation decision. The fact is that there is not sufficient evidence for any meaningful calculation of the likely actual returns to individual pensioners, taken their recoveries from various government plans. That lack of evidence was the result of tactical decisions taken by the U.S. Debtors and other U.S. interests in presenting their cases at the trial that creditor recoveries were not relevant to how the lockbox funds should be allocated. That tactical decision cannot be ignored on a motion to reconsider and instead is one that the U.S. Debtors and the UCC should be held to.

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15 The U.S. Debtors contend that the Court did not have the benefit of briefing by the parties or expert analysis "to confirm the critical assumptions underlying this Court's decision" or to illustrate the effects of the structure of its methodology and that the fact that the modified pro rata allocation methodology was not before the parties, and thus no party had an ability to make submissions on the effect of any inconsistencies or ambiguities it contained, is itself sufficient grounds for reconsideration.

16 I do not agree and would make two points. The first is that it was clear that the issue of the treatment of bondholder claims was an issue in the pro rata allocation method proposed by the UKPC's expert. The second is that any lack of briefing by the U.S. Debtors and the UCC was a deliberate tactic taken by them in attacking the pro rata allocation method proposed at the trial. Even if I were to reconsider the issue, I do not accept that the U.S. Debtors have established any manifest injustice.

17 As to the first point, the issue of the treatment of the guaranteed bonds and whether they should be counted once or twice in a pro rata allocation was a live issue in evidence at the trial. Dr. Bazelon was called as an expert witness by the UKPC in support of its pro rata allocation approach. During his examination in chief, and in connection with exhibit 41, he testified as to the pro rata allocation method he was proposing. He had different formulae about how to calculate a pro rata distribution rate. Included in his formulae was a scenario to recognize the guaranteed bonds twice. He was expressly asked about how bond guarantee claims could be dealt with and said that it was for the courts to decide whether to allocate the claims once or in multiple Debtor Estates. His preference was that the bonds be recognized only once, which he said was a true pro rata allocation approach, but he acknowledged that it was up to the Courts to decide. He was cross-examined on this evidence by Mr. Qureshi on behalf of the UCC. Counsel for the U.S. Debtors chose not to cross-examine Dr. Bazelon at all.

18 As to the second point, the U.S. Debtors and the UCC took the position that creditor recoveries were irrelevant. While their pre-trial motions to strike the expert reports of the UKPC and the CCC advocating for a pro rata allocation were dismissed, it was without prejudice to their right to renew the motions at the end of the trial, and in its closing brief, the U.S. Debtors renewed their motions to strike the reports they asserted were irrelevant.

19 The U.S. Debtors and the UCC in their closing briefs attacked the pro rata allocation theory on several basis, including arguing that it was an impermissible global substantive consolidation, a "sub rosa" plan of distribution, and that there was no reliable method for its implementation. The U.S. Debtors criticized Dr. Bazelon's evidence and argued in their closing brief that the various experts could not figure out how to treat guarantee claims and claims against multiple debtors. It was quite open to the U.S. Debtors to explore the issue at the trial, which they did not do presumably for tactical reasons, or to offer their view in their closing brief as to how guaranteed bonds should be treated in a pro rata allocation. Any failure to brief was a decision taken by the U.S. Debtors and the UCC.

20 Even if I were to reconsider this issue, I could not find that the decision to permit claims on the guaranteed bonds to be calculated only once for allocation purposes should be changed. As stated, I see no injustice in the result. I need not repeat what is contained in the reasons for judgment released on May 12, 2015. Nothing argued on this motion leads me to consider that I erred in any way in those reasons. There must also be considered other claims that could be made against more than one Debtor Estate, including the pension claim by the UKPC against NNUK that could be made against other EMEA Debtors and claims that could be made on bonds issued by NNL and guaranteed by NNC. The allocation decision precludes the double counting of any such claims for allocation purposes. The U.S. Debtors and UCC do not suggest that any of these other claims should be permitted to be claimed twice for allocation purposes. I see no basis to treat the guaranteed bonds any differently for allocation purposes. The principles that govern allocation should be applied consistently to each debtor.

Bondholder shortfall claim issue

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21 There are $4 billion in outstanding guaranteed bonds, mostly issued by NNL and guaranteed by NNI. One is the reverse, issued by NNCC, a subsidiary of NNI and guaranteed by NNL. The bondholders have asked for clarification as to what they are entitled to claim against the guarantor for amounts not collected from the primary debtor. They are concerned that the decisions permit them to claim only for the shortfall against the guarantor rather than the full amount of the bonds. That was not what was intended and on reflection, clarification is warranted. The confusion arises from the following paragraphs in the reasons for judgment:

> [225] The bondholders who hold bonds with covenants of both NNL and NNI contend that they would be unduly prejudiced by a pro rata allocation of the lockbox funds as they are entitled to look to both NNL and NNI for payment of their claims and if one of these companies did not have sufficient funds to pay the bonds in full, they could look to the other. I agree that they are entitled to claim against both companies and this will be recognized in the pro rata allocation that will be ordered.
>
> [251] In determining what the claims against a Debtor Estates are, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once. The one that is known is the bondholder claim for $4 billion, referred to as the claim on cross-over bonds. All but one of such bond issues was issued by NNC or NNL and guaranteed by NNI. One bond issue for $150 million was issued by NNCC, a subsidiary of NNI, and guaranteed by NNL. The claims on the bonds in determining the claims are to be made on the Debtor Estate of the issuer. *If a claim on a guaranteed bond is not paid in full by the issuer Debtor Estate, a claim for the shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates.* (Italics added)
>
> [258] A judgment is to go that the lockbox funds are to be allocated on a pro rata allocation basis with the following principles to govern:
>
> > . . .
> >
> > (2) In determining what the claims are against the Debtor Estates, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once in accordance with these reasons for judgment. Claims on bonds are to be made on the Debtor Estate of the issuer. *A claim for any shortfall can be recognized by the Debtor Estate that guaranteed the bond, but that shortfall claim will not be taken into account in determining the claims against the Debtor Estates.* If the UKPC makes a claim against more than one Debtor Estate, such additional claims will not be taken into account in determining the claims against the Debtor Estates. (Italics added)

22 As can be seen, it was stated in para. 225 that the bondholders were entitled to claim against both the debtor and guarantor companies. However as seen in the in paras. 251 and 258(2) it was stated that "a claim for any shortfall" could be recognized by the guarantor company. Judge Gross stated the same thing in his opinion.

23 The concern of the bondholders is that the language could be construed to limit the claim to be filed against a guarantor to only to the shortfall caused by the payment of only so many cents on the dollar of the company that issued the bond. That is, if a bondholder of a bond in the face amount of $1,000 issued by NNL received for example only 40 cents on the dollar from the estate of NNL, or $400, could that bondholder claim only $600 against the estate of the guarantor NNI and collect only so many cents on the dollar for the $600 from NNI? That was not the intent. The intent was that in that circumstance, the bondholder could claim $1,000 against NNI as well but collect from both NNL and NNI together a maximum of $1,000 on the bond. That is, the shortfall of $600 could be collected from the guarantor company NNI, assuming it had sufficient money to pay the shortfall, on a claim filed by the bondholder against NNI for the face amount of the bond of $1,000.

24 In the circumstances, I think it preferable to clarify or amend paragraphs 251 and 258(2) by deleting the reference to a shortfall, so that these paragraphs will read as follows:

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251. In determining what the claims against a Debtor Estates are, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once. The one that is known is the bondholder claim for $4 billion, referred to as the claim on cross-over bonds. All but one of such bond issues was issued by NNC or NNL and guaranteed by NNI. One bond issue for $150 million was issued by NNCC, a subsidiary of NNI, and guaranteed by NNL. The claims on the bonds in determining the claims are to be made on the Debtor Estate of the issuer. If a claim on a guaranteed bond is not paid in full by the issuer Debtor Estate, a claim can be recognized by the Debtor Estate that guaranteed the bond, but that claim will not be taken into account in determining the claims against the Debtor Estates.

258. (2) In determining what the claims are against the Debtor Estates, a claim that can be made against more than one Debtor Estate can only be calculated and recognized once in accordance with these reasons for judgment. Claims on bonds are to be made on the Debtor Estate of the issuer. A claim can be recognized by the Debtor Estate that guaranteed the bond, but that claim will not be taken into account in determining the claims against the Debtor Estates. If the UKPC makes a claim against more than one Debtor Estate, such additional claims will not be taken into account in determining the claims against the Debtor Estates for allocation purposes.

NGS and Diamondware

25 NGS and Diamondware were two subsidiaries of NNI. The U.S. Debtors contend that the proceeds from the sale of those companies, sold as part of the sale of the Enterprise line of business, should not be part of the assets taken into account in the allocation process but rather should be the sole property of the NNI estate. They raise this as part of their reconsideration request in this motion.

26 The U.S. Debtors say that these two subsidiaries were not integrated into the Nortel Group and therefore should not be included in the allocation made under the "one Nortel" principle. This issue was not raised by the U.S. Debtors at the trial and there is no evidence supporting the statement that the two subsidiaries were not integrated into the Nortel Group.

27 What is in the trial record appears to confirm that NGS and Diamondware were treated as part of Nortel's global Enterprise Business, and that they were marketed and sold by the Nortel group as such:

(a) NGS and Diamondware were sold pursuant to a September 14, 2009 Amended and Restated Asset and Share Sale Agreement among various Nortel sellers and Avaya. This sale was approved by both Courts and the entirety of the sale proceeds were placed in the lockbox.

(b) The evidence of George Riedel, a former senior officer of NNI, was that "NGS performed the role of a systems integrator and channel for Nortel's Enterprise products in the US Federal government markets."

(c) The U.S. Debtors expressly acknowledged that NGS and Diamondware were part of the Enterprise Line of Business when they sought "orders... (ii) authorizing and approving (a) the sale of certain assets (including the stock of certain subsidiaries of the Debtors) of the Debtors' Enterprise Solutions Business." The U.S. Debtors agreed to place the proceeds of the sale of these assets into the lockbox.

28 The U.S. Debtors point to the expert evidence of Mr. Green, the valuation expert called by the Monitor, who on an ownership approach to valuing the lines of business sales attributed the proceeds of the sale of NGS and Diamondware to NNI as it owned those subsidiaries. This however is no reason to allocate the proceeds of sale to NNI on the pro rata allocation method ordered in the allocation decision. The ownership approach of Mr. Green and the Monitor on behalf of NNC and NNL was rejected. Moreover, the U.S. Debtors' approach to allocation did not purport to allocate the value of NGS and Diamondware to the U.S. Debtors.

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29 If the U.S. Debtors' argument were correct, it would have to be applied consistently to all debtors and not just NNI. All parties recognized at trial that certain debtors owned outright certain tangible assets that were transferred in the business sales. The parties also recognized that certain individual debtors owned intangible assets outright. For example, two EMEA entities, Nortel Germany and Nortel France SAS, former joint ventures that were never parties to the MRDA, owned valuable patents when they were acquired by Nortel and continued to hold those assets in their own names. If the U.S. Debtors were correct, and debtors were entitled to an allocation in respect of their wholly owned assets notwithstanding the pro rata approach adopted in the allocation decision, then sale proceeds attributable to these wholly-owned assets would have to be carved out as well.

30 The U.S. Debtors also point to a lien given to the U.S. government's Public Benefit Guaranty Corporation on the proceeds of the sale of the two subsidiaries and contends that it would be inequitable to and contrary to the court orders permitting this lien arrangement to allocate to any other Debtor Estates the proceeds of sale upon which a U.S. creditor has a lien. The Monitor however points out in its brief at fn. 107 that the PBGC claims settlement provides for an allocation procedure to determine what proceeds from the lockbox should be subject to the lien, to be conducted by the U.S. Court alone. In argument counsel for the Monitor pointed to other provisions that he asserts means that the PBGC claims settlement was without prejudice to the allocation to be made to the Debtor Estates.

31 The U.S. Debtors could have raised all of these issues regarding NGS and Diamondware at the trial in the face of the arguments of the UKPC, CCC and Wilmington Trust [2] contending for a pro rata allocation approach, but they did not do so. They took the position that the fact that Nortel operated through employees worldwide that collaborated with each other and had business lines that operated across legal entities i.e. was "one Nortel", was irrelevant. Moreover, the argument of the U.S. Debtors is not unique to the pro rata allocation method, but would have applied under any of the allocation theories advanced at the trial, including the U.S. Debtors' revenue-based theory of allocation.

32 These issues are not now a proper matter for reconsideration.

Intercompany claims and allocation to Debtor Estates

33 In the allocation decisions, it was ordered that intercompany claims against a Debtor Estate are to be included in the determination of the claims against that Estate. The U.S. Debtors seek confirmation or clarification that the intercompany claims that are included in calculating the allocation are claims between Debtors across different Debtor groups (i.e., the U.S. Debtors, the Canadian Debtors and the EMEA Debtors) rather than within Debtor groups. This clarification is said to be necessary to ensure that allocation of the lockbox proceeds would not be subjected to a risk of significant distortion by claims allowed between Debtors within the same Debtor group.

34 I would not have thought that this is an issue for clarification at all, but interestingly the parties differ as to what was decided. The Monitor on behalf of the Canadian Debtors sides on this point with the U.S. Debtors and asserts that "plainly" the Courts decided that intercompany claims within Debtor Estates do not count toward allocation. The EMEA Debtors and the UKPC on the other hand say that it was clear from the allocation decisions that all intercompany claims would be taken into account for allocation purposes and not just those claims within each Debtor group.

35 The U.S. Debtors also seek clarification that the allocation of the lockbox funds is to be made to individual Debtors rather than to the three Debtor groups (i.e., the U.S. Debtors, the Canadian Debtors and the EMEA Debtors). I would have thought that this too was not an issue for clarification, but again the parties differ as to what was decided. The Monitor on behalf of the Canadian Debtors takes the position that the allocation decisions established principles for allocation to the three regional groups (i.e., the U.S. Debtors, the Canadian Debtors and the EMEA Debtors). The CCC adopts this view. The EMEA Debtors and the UKPC on the other hand say that the allocation decisions made clear that allocation would be made to individual debtors, not to the three regional groups.

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36 To be clear, the allocation decisions were intended to permit all intercompany claims to be recognized in the allocation process, not just claims among the three regional groups, and the principles established for the allocation were intended to apply to all debtors and not just provide an allocation to the three regional groups, with the amounts allocated to be paid directly to each debtor.

37 Regarding the allocation process, Mr. Coleman for the Monitor contended that after the allocation to the three regional groups, it would be up to "the relevant court" to make a further allocation to individual estates. I cannot agree with such an approach. First of all, each debtor is a distinct entity. Although the insolvency proceedings of individual debtors in the same geographic area are being administered together for procedural purposes in the interests of efficiency, these debtor groups (*i.e.*, the Canadian Debtors, the U.S. Debtors and the EMEA Debtors) are post-petition constructs. Nothing about these joint administration arrangements impacts the separate identity of each debtor.

38 Secondly, the allocation trial resulted from the IFSA that was signed by 38 Nortel debtor entities in Canada, the U.S. and EMEA. The IFSA recognized that the funds would be put into a single fund undifferentiated as to the debtor estates and then allocated to them on some basis to be agreed or determined in this litigation. The end result of the IFSA process was that an allocation protocol was approved by both Courts requiring a joint trial of the Superior Court of Justice (Commercial List) and the U.S. Bankruptcy Court for the District of Delaware to determine the allocation of the lockbox funds [3] . Included in those reasons was a reference to section 16(b) of the IFSA that provided:

> 16(b) To the fullest extent permitted by applicable law, each Party...(ii) agrees that any claim, action or proceeding by such Party seeking any relief whatsoever to the extent relating to the matters agreed in this Agreement must be commenced in ... a joint hearing of both the Canadian and US Courts conducted under the Cross-Border Protocol if such claim, action or proceeding would affect the Canadian Debtors and the US Debtors or the EMEA Debtors ...

39 In light of this process, there is no room now for some other court acting alone to allocate the proceeds of the lockbox funds. That responsibility lies with the Canadian and US Court which has now been exercised.

40 Regarding intercompany claims to be recognized, it would be inconsistent to have allocations made to each individual estate, as required by the IFSA, based on claims against that estate, but only permit such claims that are between two or more of the three regional groups. There is no principled basis for the contention that only such intercompany claims and not claims between two debtors within any regional group should be permitted for allocation purposes. The effect of the U.S. Debtors' clarification, and the position of the Monitor, would be to disregard valid claims in an individual debtor's estate solely because, post-filing, the debtors were aligned in broad geographic groups for administrative convenience. There is no legal basis for excluding valid claims between separate debtors.

41 In the circumstances, there is no basis for reconsideration or clarification of these two issues. The judgment provided in paragraph 258 of my reasons for judgment is clear. The reference to a Debtor Estate in that paragraph is to a single debtor estate and not to the Canadian Debtors, the U.S. Debtors or the EMEA Debtors.

Recognition of settled and paid claims

42 The allocation decisions made clear that settled court-approved claims will be taken into account in determining the claims against a debtor estate. The U.S. Debtors seek "clarification or confirmation" that the U.S. Debtors' prior court-approved settlements with the EMEA Debtors and the U.K. Pension Claimants (granting them administrative claims, which were then paid in cash) will be included in the calculation of the allocation owed to the U.S. Debtors. The U.S. Debtors also refer to the various other claims that the U.S. Debtors not only successfully resolved, but paid, including without limitation their settlement of certain retiree claims, their 2009 settlement with the IRS, and their cash settlements with the Canadian Debtors pursuant to the IFSA and FCFSA.

43 These issues were not raised by the U.S. Debtors at the trial, which should have been done had they sought what is now being requested.

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44 There is however some logic to the principle raised by the U.S. Debtors. Why they ask should a claim recognized against a debtor but unpaid be included in the claims against such a debtor while other claims against a debtor and paid should not? I accept the principle. However, it should be restricted to court approved settlements of pre-filing claims and restricted to the amounts actually paid under the settlements and not to the claimed amounts. It should also not apply to post-filing claims. I am not aware of all of the particulars of the claims referred to by the U.S. Debtors in their argument, but it seems to me clear that payments made to NNL under the IFSA and FCFSA were not to settle pre-filing claims. The settlement of claims of course is a matter for the Court dealing with each debtor.

45 The principle that court approved settlement of pre-filing claims, i.e. claims that are provable under the CCAA, that have been paid may be taken into account in calculating the claims against a debtor for allocation purposes should of course apply to all debtors to the extent that the settled claim has been paid by the debtor.

46 Whether this is a clarification or reconsideration of this issue, I would make a change to paragraph 258 to add a new subparagraph (2A) as follows;

> (2A) In determining what the claims are against the Debtor Estates, pre-filing claims of the kind provable under the CCAA that have received court approval and which have been paid may be taken into account to the extent that they have been paid under the settlement.

Tax claims

47 The U.S. Debtors seek "clarification" that they are entitled to seek an allocation based on paying applicable U.S. federal and state taxes on the sales proceeds allocated to them. This issue was not raised by the U.S. Debtors at the trial.

48 I see no basis to clarify, or for that matter to reconsider, this issue. Apart from not raising it at the trial, which should have been done in the face of the pro rata claim asserted against them, it would be to permit a post-filing claim to be used for allocation purposes. The inclusion of post-petition tax claims would result in an allocation partly based on tax attributes, rather than the principles on which modified pro rata is based. The allocation decisions dealt with only pre-filing claims.

49 There is no difference in principle between legal fees incurred post-filing and tax liabilities incurred post-filing. Under Canadian law, neither of these are provable claims. As I understand it, under the U.S. Bankruptcy Code, taxes incurred by an estate and legal fees are both considered to be an administrative expense and not a provable claim. It would be quite inconsistent with the pro rata allocation decision to start permitting these types of claims to be considered. If they were, other debtors in other countries might well have tax issues and all would have legal fees to a lesser or greater extent.

Court supervision of claims

50 The U.S. Debtors seek "clarification" that effective protection will exist to prevent debtors in other jurisdictions from increasing their lockbox allocation by "undue claims inflation". They seek clarification to set forth the process and schedule by which claims, particularly the UKPC claim, will be measured by the Canadian and U.S. Courts for allocation purposes. They assert that "policing" of the UKPC claim will be required by the Canadian and U.S. Courts. They seek an order that the two Courts "shall retain oversight of and adopt procedures as necessary to measure the amount of the disputed claims" including any claim not allowed prior to the allocation decisions.

51 I see no basis to make such an order. In my reasons for judgment, I stated at para. 253:

> [253] I understand that for the Canadian Debtors and the U.S. Debtors, the claims for the most part are generally known although there are some claims still unresolved, such as the SNMPRI claim. The U.K. Administrator has not yet instituted a claims procedure, apparently awaiting a determination of this allocation proceeding. In my view, the process should be undertaken now and I expect this will happen.

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52 Judge Gross in his opinion stated at page 62:

> The Court has every confidence that the tribunals overseeing the Nortel insolvency proceedings across the globe will adjudicate the claims at issue therein in a just, efficient manner. The Court is prepared to act if they do not.

53 As now advised, the reason for no claims procedure having being undertaken in the U.K. was that under the U.K. *Insolvency Act 1986*, the Joint Administrators appointed by the English Court had no authority to commence a formal claims process until there were funds available for distribution. Nevertheless an informal claims process was undertaken in 2010 and sanctioned by the High Court of England and Wales.

54 Following the release of the allocation decisions, an application in the U.K. was made to the Chancellor of the High Court of England and Wales for the appointment of a supervisory judge in this matter. The Chancellor has now appointed Mr. Justice Snowden, a judge of the Chancery Division of the High Court of England and Wales, as the supervisory judge in relation to the various EMEA Debtors. Justice Snowden will deal with any hearings in relation to the EMEA Debtors including contested claims and will be the appropriate judge to engage in any judicial co-operation with the Canadian and U.S. Courts that is deemed necessary and appropriate. The Joint Administrators intend to apply shortly to Justice Snowden to have the claims process move along.

55 The Joint Administrators are officers of the English Court who are duty-bound to act in good faith and in accordance with applicable law in those proceedings. The UKPC's claim against NNUK, as with every claim in each of the nineteen EMEA jurisdictions, will be subject to a formal claims process which is subject to appeal rights available to creditors and shareholders. Creditors and shareholders of the EMEA entities will have the opportunity to review and contest the allowance or rejection of any proof of claim as noted above. Disputes will be heard by Justice Snowden in a full evidentiary hearing.

56 I think too much is made of the suggestion of inflated claims being made by the UKPC. The claim is one made under section 75 of the U.K. *Pensions Act, 1995*. Under that section, when a company which sponsors a defined benefit pension plan becomes insolvent and the assets in the plan are insufficient to meet its liabilities, a debt for the shortfall automatically arises against the plan's sponsoring employer, in this case NNUK. Regulations have been issued by the U.K. Government that stipulate precisely how a section 75 debt must be calculated.

57 The "Scheme Actuary" (which is a recognized statutory role or office) is required by the regulations to calculate and verify the liabilities of the pension plan based on the benefits that are provided under the rules of the plan. The prescribed statutory basis for this calculation is the cost of buying out the plan's benefits by purchasing annuity policies from an insurance company that match the benefits payable under the plan. The regulations expressly anticipate that the costs will be evaluated by the Scheme Actuary, based on market data at the applicable time. The Scheme Actuary has an independent professional duty to conduct the calculation and estimate the debt as the regulations prescribe. The trustees of a plan are unable, as a matter of law, to negotiate the section 75 debt with the employer.

58 On January 6, 2015, the Scheme Actuary issued the section 75 certificate detailing the amount of the employer debt against NNUK in the amount of £2.147 billion. This is remarkably similar to the £2.1 billion figure estimated as early as September 30, 2009 and made available to the parties including NNI.

59 To make the order sought by the U.S. Debtors would fly in the face of the principles of comity which Canadian courts have long shown respect to in insolvency proceedings and which are now promulgated in the CCAA that has adopted the UNCITRAL model law provisions regarding recognition of foreign insolvency proceedings. See *MtGox Co., Re* (2014), 20 C.B.R. (6th) 307 (Ont. S.C.J. [Commercial List]) at paras. 11 and 12.

60 I would not make the order sought by the U.S. Debtors.

Motions dismissed.

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Footnotes

1 The changes are not based on admitted evidence. See the critique of the changes in paragraph 36 of the Monitor's brief in opposition to this reconsideration motion.

2 In the allocation decisions, Wilmington Trust, National Association was omitted as being a proponent of the pro rata allocation method. The record should be clarified to make it clear that Wilmington Trust joined the UKPC and CCC in this position at the trial as an alternative argument in addition to its first argument that the MRDA should govern the allocation.

3 See *Nortel Networks Corp., Re* (2013), 2 C.B.R. (6th) 1 (Ont. S.C.J. [Commercial List]); aff'd, (2013), 5 C.B.R. (6th) 254 (Ont. C.A.); 2013 WL 1385271; aff'd 737 F.3d 265 (U.S. C.A. 3rd Cir. 2013).

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19

2001 CarswellOnt 2299
Ontario Superior Court of Justice [Commercial List]

Canada (Attorney General) v. Confederation Life Insurance Co.

2001 CarswellOnt 2299, [2001] O.J. No. 2610, [2001] O.T.C. 486, 106 A.C.W.S. (3d) 245

In the Matter of Confederation Life Insurance Company

In the Matter of the Insurance Companies Act, S.C. 1991, as Amended

In the Matter of the Winding-Up Act, R.S.C. 1985, C. W-11, as Amended

The Attorney General of Canada, Applicant and Confederation Life Insurance Company, Respondent

Blair R.S.J.

Heard: April 5, 2001
Judgment: June 25, 2001
Docket: 97-CL-000543

Counsel: *Joseph M. Steiner*, *Edward A. Sellers*, for Appellant, Chase Manhattan Bank
James Doris, *Matthew Milne-Smith*, for Appellant, UBS AG
Graham Smith, *Gale Rubenstein*, for KPMG Inc., Respondent Liquidator of Confederation Life Insurance Company

Subject: Corporate and Commercial; Contracts

APPEALS by creditors from decision of liquidator appointed under *Winding-up Act* disallowing claims for discount portion of promissory notes.

***R. A. Blair R.S.J.*:**

Overview

1 Two financial institutions — The Chase Manhattan Bank and UBS AG — purchased commercial paper in the form of discount notes from Confederation Life Insurance Company prior to the winding-up order made with respect to that Company on August 12, 1994. The Notes had a total face value of approximately $160 million (Cdn). They did not mature until after the date of the winding-up.

2 These appeals raise a relatively narrow point, albeit an interesting and complex one. How are the discount portions of those promissory notes ("the Notes") to be treated in winding-up proceedings for purposes of an unsecured creditor's proof of claim? Is the creditor entitled to claim for the full face amount of the Note, or is the unearned discount portion of it to be treated as post-insolvency interest (in which case it becomes unrecoverable on the basis of what is known in some circles as the "interest stops rule")?

3 Chase and UBS [1] filed proofs of claim with the Respondent Liquidator in the full face amount of their Notes. The Liquidator partially disallowed the claims, the disallowed portion representing the difference between the face amount of the Notes and the discounted price paid by the purchaser for the Notes. The disallowance was based on the theory that those portions of the Notes were effectively payment of interest and that "interest is only payable to the commencement of the liquidation, August 12, 1994".

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4 Chase and UBS now appeal the partial disallowance of the Liquidator, in accordance with a proof of claims procedure authorized by Order of this Court dated May 5, 2000. Chase claims an additional $494,948.35 to its allowed unsecured claim of $75,492,052. UBS claims an additional $833,477.72 to its allowed unsecured claim of $82,896,000. [2]

5 The issue to be determined, then, is whether the discount portion of a bearer note — payable subsequent to the effective date of liquidation — constitutes a future payment of "interest" for purposes of a winding-up proceeding, and is therefore unrecoverable by an unsecured creditor as a claim provable in the proceeding by virtue of the provisions of subsection 71(1) of the *Winding-Up Act* [3], unless there is a surplus in the estate.

6 I have concluded that the answer to that question is "Yes". My reasons for coming to that conclusion follow.

Background

7 Counsel filed an Agreed Statement of Facts, and the appeals were argued on that basis. The pertinent facts, in addition to those summarized above, are the following.

8 Confederation Life issued the debt instruments before the commencement of the winding-up proceedings on August 12, 1994. They were in the form of promissory notes payable to "Bearer" in the face amount of a fixed sum and on due dates which all post-dated the commencement of the winding-up. The Notes were purchased by Chase and UBS from Confederation Life at discounts from their face amounts.

9 Representative samples of the Notes and of the confirmation slips provided to Chase and UBS at the time of purchases were attached to the Agreed Statement. The Notes themselves did not contain any reference to interest or to yield dates. The terms and pricing of each purchase were set out in the confirmation slips.

10 It is agreed that commercial instruments similar to the Notes may trade subsequent to their original issuance.

11 Confederation Life has made no payments on the Notes, other than through the partial distributions to creditors made by the Liquidator during the course of the winding-up. There is no surplus within the Confederation Life estate, as that term is used in s. 95 of the *Winding-Up Act*.

Arguments

The Appellants

12 On behalf of Chase and UBS, respectively, Mr. Steiner and Mr. Doris argue that the debt owing to their clients by Confederation Life at the date of the winding-up was the full face amount of the Notes, notwithstanding that the amounts were not payable until later dates. They submit that no portion of the face amount of the Notes constitutes interest, and point to the fact that there is no reference to interest or to yield dates on the face of the Notes themselves. They therefore contend that the debt reflected in the Notes is a future debt or future claim which may be the subject of a proof of claim by an unsecured creditor in accordance with subsection 71(1) of the *Winding-Up Act*. [4] It falls into that category, they say, because it is a claim for a liquidated sum owing by the debtor (Confederation Life) as at the legally relevant date (the date of the winding-up Order), which by its terms is not payable before that legally relevant date.

13 Subsection 71(1), prior to the 1996 amendment, read:

> When the business of a company is being wound up under this Act, all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, and for liquidated or unliquidated damages, are admissible to proof against the company.

14 Counsel for the appellants submit, moreover, that Parliament has chosen different ways to deal with the concept of future debts in different insolvency contexts. For example, they point out, section 121 of the *Bankruptcy and Insolvency*

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Act[5] provides for the discounting of debts outstanding at the effective date of the bankruptcy, but falling due at a later date at the time when a dividend is paid. Subsection 121(3) of the *BIA* states:

> A creditor may prove a debt not payable at the date of the bankruptcy and may receive dividends equally with the other creditors, deducting only thereout a rebate of interest at the rate of five per cent per annum computed from the declaration of a dividend to the time when the debt would have become payable according to the terms on which it was contracted.

15 Accordingly, where Parliament has specifically chosen *not* to provide for a discount on the payment of a future debt, the argument goes — as is the case with section 71(1) of the *Winding-up Act* — the Courts should not impose such a provision on their own.

16 Finally, the appellants maintain that to attribute an interest factor into the face value of the Notes in this case would be inconsistent with their status as negotiable instruments under the *Bills of Exchange Act*[6]. This is so, they contend, because if the position of the Liquidator is accepted the amounts provable in the winding-up will depend not upon the value of the Notes as stated on their face or upon other information on the face of the Notes, but rather on terms set out in the confirmation slips, which do not form part of the Notes. In short, the amount provable would be something different than the amount of the negotiable instrument, thus destroying their effectiveness under the *Bills of Exchange Act*.

The Liquidator

17 To these arguments, the Liquidator responds that it is necessary to look at the substance and not the form of the transaction, and that in substance and reality the amount of the discount on the Notes is "interest". It meets all the criteria for interest, counsel submits, and to the extent that Canadian and American jurisprudence has considered the matter, the discount portion of commercial paper has been held to be tantamount to interest.

18 Therefore, the Liquidator concludes, that portion of the appellants' Notes which represents the difference between the face value of the Notes and what they actually advanced to Confederation Life (plus an attributed additional amount representing a "return" factor accrued or earned prior to the effective date of the winding-up), represents future interest and may not be proved in the winding-up because of the well-recognized "interest stops rule" in insolvency proceedings.

Law and Analysis

19 In spite of the skilful arguments advanced by Mr. Steiner and Mr. Doris on behalf of the appellants, I am in agreement with the Liquidator's position.

20 One of the governing principles of insolvency law — including proceedings in a winding-up — is that the assets of the insolvent debtor are to be distributed amongst classes of creditors rateably and equally, as those assets are found at the date of the insolvency. This principle has led to the development of the "interest stops rule", i.e., that no interest is payable on a debt from the date of the winding-up or bankruptcy. As Lord Justice James put it, colourfully, in *Savin, Re* (1872), 7 Ch. App. 760 (Eng. Ch. Div.), at p. 764:

> I believe, however, that if the question now arose for the first time I should agree with the rule [i.e. the "interest stops rule"], seeing that the theory in bankruptcy is to stop all things at the date of the bankruptcy, and to divide the wreck of the man's property as it stood at that time.

21 It is the decision of Lord Justice Selwyn in *Humber Ironworks & Shipbuilding Co., Warrant Finance Co.'s Case* (1869), 38 L.J. Ch. 712 (Eng. Ch. Div.) ("Re Humber Iron Works"), however, which is often cited as the starting point in the analysis. There — in a winding-up context — he said (at pp. 713-714):

> ... Now it has been admitted, very properly, that, as to interest due at the date of the winding-up, there can be no doubt ... because ... interest due at the date of the winding-up is just as much a debt as the principal. ... Justice, I think,

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> requires ... that all the money of an insolvent estate, being realized as speedily as possible, should be applied equally and rateably in payment of the debts as they existed at the date of the winding-up. I think, therefore, that nothing should be allowed for interest from that date. Consequently, in the present case, this debt of 25,000£, which had no interest due upon it at the date of the winding-up, should stand as a debt for that sum, and for no more. ... I think that as the tree falls, so it must lie. It must be ascertained what are the debts which existed at the date of the winding-up, and all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained.

22 This common law principle has been applied consistently in Canadian bankruptcy and winding-up proceedings. This is so notwithstanding the language of subsection 71(1) of the *Winding-Up Act* and section 121 of the *BIA*, which might be read to the contrary, in my view. The obligation to pay interest on a debt is a claim against the debtor, which exists at the date of the winding-up, but which does not become due or payable until some future date. It represents a future certain claim against the company (*Winding-Up Act*, s. 71(1)). It could be said to constitute a future debt or liability "to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of [an] obligation incurred before the day on which the bankrupt becomes bankrupt" (*BIA*, s. 121(1)). A discounted bill or note which matures after the date of winding-up is open to a similar analysis.

23 Yet the "interest stops" principle has always applied to the payment of post-insolvency interest, and the provisions of subsection 71(1) have never been interpreted to trump the common law insolvency "interest stops rule". That this remains the case is clarified, in my view, by the re-worded language of subsection 71(1) as it exists in the present *Winding-Up and Restructuring Act* [7]. Counsel submit that the effect of the old and the current versions of subsection 71(1) is in substance the same. The language of the current subsection makes it clear that the "interest stops rule" applies, in my opinion. Subsubsection 71(1) currently states:

> 71. (1) When the business of a company is being wound up under this Act, all debts and all other claims against the company in existence at the commencement of the winding-up, certain or contingent, matured or not, and liquidated or unliquidated, are admissible to proof against the company and, subject to subsection (2), *the amount of any claim admissible to proof is the unpaid debt or other liability of the company outstanding or accrued at the commencement of the winding-up* (emphasis added).

24 While the payment of post-insolvency interest and the payment of the face value of a discounted promissory note maturing after the date of liquidation may bear the analysis suggested in paragraph 22 above, the interpretation would lead to inconsistent treatment of interest in proofs of claim situations, if the discount portion of a note is truly interest, depending upon whether the payment is characterized as "interest" or as a "discount". I do not think the *Winding-Up Act* should be interpreted to give rise to such inconsistent treatment, particularly given the long-standing entrenchment of the "interest stops rule" in Canadian jurisprudence.

25 Thus, the substance of the issue to be determined by the court is whether the discounted portion of the Confederation Life Notes issued to Chase and UBS constitutes "interest" due or payable at a date subsequent to the effective date of the winding-up. If it is, then the "interest stops" principle must apply, because to hold otherwise would be to hold that a claim for interest which is camouflaged as a "discount" is to be treated differently than other claims for interest. I do not think it would be correct to do so.

26 Both the Ontario Court of Appeal and the Supreme Court of Canada have recognized that in reality and substance a discount on a bill of exchange is interest. American jurisprudence has adopted the same analysis.

27 *Singer v. Goldhar*, [1924] 2 D.L.R. 141 (Ont. C.A.), is one such case. It was a foreclosure action. The mortgage in question did not contain any provision respecting interest, but provided for the repayment of a sum as principal which was greater than the sum advanced. At trial, the action was dismissed on the basis that no monies were owing because instalment payments which equalled the total amount of the advance had been made. The difference between the amount advanced and the amount that was said to be the "principal" remained outstanding. This additional amount was held

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to constitute interest, and the monthly instalments to be a blend of principal and interest. Therefore, the provisions of the *Interest Act*[8] requiring that the interest rate be shown had been breached. The Court of Appeal upheld the trial judgment. In doing so, Masten J.A. stated (p. 144):

> Now the ordinary meaning of "*principal*" *is* the capital sum of money placed out at interest, in other words *the sum actually loaned or advanced* (See Wharton's Law Lexicon, 12th ed., p. 695). "*Interest*" when considered in relation to money *denotes the return* or consideration or compensation *for the use or retention by one party of a sum of money or other property belonging to another*. 21 Hals. P, 37, para 72.
>
> The definition in Wharton and other law lexicons is to the like effect. This definition applies as accurately to a lump sum agreed by way of compensation as to periodical payments at a rate per cent.
>
> I agree with the observation of my brother Orde made during the argument that the present transaction is, in respect to the question of interest, *analogous to the discount of a bill of exchange where a fixed sum is payable on a day certain though a smaller sum is advanced by the lender, the difference forming the compensation to the lender for the loan of the money advanced*.
>
> *Discount* in such a case *is defined* in Murray's New English Dictionary, vol. 3, pa. 428, *as "the interest charged by a banker or bill-discounter for advancing the value of a bill before it is due."* On the question whether or not the $1,200 is interest the principle is the same and the conclusion must be that the difference between the $3,500 advanced and the $4,700 to be repaid is interest. (italics and underlining added)

28 Support for the proposition that a "discount" is in essence "interest" is also found in the decision of the Supreme Court of Canada in *Ontario (Attorney General) v. Barfried Enterprises Ltd.*, [1963] S.C.R. 570 (S.C.C.). There, the Court was dealing with a bonus in a loan and with whether or not the bonus made the whole cost of the loan excessive and was therefore caught by the provisions of The *Unconscionable Transactions Relief Act* R.S.O. 1960, c. 410. The "whole cost of the loan" was broadly defined to include "interest, discount, subscription, premium, dues, bonus, commission, brokerage fees and charges". Judson J. noted, in reference to these (p. 575):

> The day-to-day accrual of interest seems to me to be an essential characteristic. All the other items mentioned in *The Unconscionable Transactions Relief Act* except discount lack this characteristic. They are not interest. (underlining added)

29 American insolvency jurisprudence is to the same effect. As one author has put it:

> Like Treasury bills, commercial paper is typically a discount security: the investor purchases notes at less than face value and receives the face value at maturity. The difference between the purchase price and the face value, called the discount, is the interest received on the investment. Occasionally, investors request that paper be issued as an interest-bearing note. The investor pays the face value and, at maturity, receives the face value and accrued interest. All commercial paper interest rates are quoted on a discount basis.
>
> See: Hahn, Thomas K., "Commercial Paper", Chapter 9, Instruments of Money Market (Federal Reserve Bank of Richmond), at p. 107.

30 Or, as Judge Lifland of the U.S. Bankruptcy Court for the Southern District of New York observed, in *Chateaugay Corp., Re*, [109 B.R. 51 (U.S. Bankr. S.D. N.Y. 1990)] [1990] Bankr. LEXIS 22, at p. 71:

> Unmatured interest is without question not an allowed claim under s. 502(b)(2) of the [U.S. Bankruptcy] Code. The dispute arises when we have the concept of OID [original interest discount] which in economic reality is interest, but not specifically denominated as such. It is therefore determined that semantics should not distort the rationale and purpose of the Code and that, in the fact situation before this Court, unamortized original issue discount on a note or debenture is indeed unmatured interest which is not an allowable claim under Code s. 502(b)(2).

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31 In my view, the fact that the U.S. Bankruptcy Code has codified the "interest stops rule" in providing that unmatured interest must be disallowed, whereas it is the common law principle which prevails in Canada, makes no difference in the circumstances of this case.

32 The appellants' argument that their claims are for the full face amount of the Notes, which just happen to mature at a future date after the winding-up, begs the question of what is the true nature of those claims. They say their claims include no element of interest, but in truth they do. It is relevant to keep in mind that the face value of the Notes was payable on the due date, and not before. Accordingly, their claims are for monies loaned to Confederation Life, plus an amount in excess of the monies advanced to reflect a consideration for the use of the monies advanced to the due date. Such a return, or consideration, is normally called "interest". Accordingly, the unearned portion of it, as at the date of the winding-up, is not recoverable in the liquidation.

33 Interest is an important part of what is owing by a debtor. In the case of a money-lender, such as Chase or UBS, it represents the money-lender's return, or profit, on the transaction. In the case of a supplier, that return or profit is built into the price of the product or service supplied, and interest on overdue payment serves simply to maintain the present value of the price on a continuing basis. As noted in *Re Humber Iron Works*, *supra* (at p. 713), the "interest due at the date of the winding-up is just as much a debt as the principal."

34 Mr. Steiner argued that Chase and UBS are just suppliers of money, and in that sense are in the same position as the supplier of goods or services who supplies on a delayed payment basis but is still entitled to recover the full amount of the price even when the debtor is wound up after delivery but before the payment due date arrives. I do not see it that way, however. The difference is that in the case of the supplier of goods or services on such terms, the product has already been delivered *with the return or profit already earned and built into the delivery price* at the date of the insolvency. In the case of a money supplier, however, while the product — the monies advanced — has been delivered at the date of the insolvency, the return or profit payable to the money lender for the use of the monies is not earned until the borrower has in fact used the monies to the date of maturity, when repayment is due.

35 Thus, in an insolvency, the money lender who makes advances on the basis of discounted commercial paper is only entitled to claim the amount of the advances plus any portion of the discount which may be said to have been notionally earned as at the effective date of the winding-up. The remaining portion of the discount is unrecoverable "interest" by virtue of the "interest stops rule" in insolvency proceedings.

36 With respect to the third argument of the appellants, based upon the *Bills of Exchange Act*, I am not persuaded that resort to bills of exchange law and principles is helpful in the circumstances of this case. The Notes are clearly "notes" within the meaning of the *Bills of Exchange Act*, but in my view nothing turns on that point. Assuming that Chase and UBS are holders in due course of the Notes, it is clear that Confederation Life is obligated to pay them the face amount of the Notes, free and clear of any equities between the parties. The question here, however, is whether Chase and UBS are entitled to prove their claim in the liquidation on the basis of those full face amounts, given that the amounts were advanced before the effective date of the winding-up but the face value of the Notes is not payable until after that date. The answer to that question depends upon the nature of the amount now being claimed, as I have explained, and the nature of that amount is "interest".

37 Thus, the issue to be determined here is not concerned with the principles of bills of exchange law, but rather with principles of insolvency law.

Disposition

38 The appeals of Chase and UBS from the partial disallowance of the claims by the Liquidator are therefore dismissed.

39 If the parties cannot agree with respect to costs, I may be spoken to in that regard.

Appeals dismissed.

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Footnotes

1 In these Reasons, for the sake of convenience, I shall refer to Confederation Life Insurance Company as "Confederation Life" and to The Chase Manhattan Bank and UBS AG as "Chase" and "UBS", respectively.

2 These amounts are in Canadian dollars. The Notes themselves were issued in amounts of $1 million or $5 million U.S.

3 R.S.C. 1985, chapter W-11["Winding-Up Act"]

4 The appeals were argued on the basis that it is the *Winding-Up Act*, as it existed on the date of the winding-up order and before its amendment and re-naming as the *Winding-Up and Restructuring Act* by S.C. 1996 c.6, s. 153, that applies. The proceedings in the Confederation Life insolvency have generally proceeded on this basis. On the view I take of the issues, the outcome of these appeals would be the same whichever version is applied.

5 R.S.C. 1985, c. B-3, as amended (the "BIA").

6 R.S.C. 1985, chapter B-4, sections 2, 55(1)(a) and (b), 59(1) and (2), 73(a) and (b), 176(1), 185(a), and 186(1).

7 *Supra*, footnote No. 4.

8 R.S.C. 1906, c. 120

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2010 SCC 60
Supreme Court of Canada

Ted Leroy Trucking [Century Services] Ltd., Re

2010 CarswellBC 3419, 2010 CarswellBC 3420, 2010 SCC 60, [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, [2011] 2 W.W.R. 383, [2011] B.C.W.L.D. 533, [2011] B.C.W.L.D. 534, 12 B.C.L.R. (5th) 1, 196 A.C.W.S. (3d) 27, 2011 D.T.C. 5006 (Eng.), 2011 G.T.C. 2006 (Eng.), 296 B.C.A.C. 1, 326 D.L.R. (4th) 577, 409 N.R. 201, 503 W.A.C. 1, 72 C.B.R. (5th) 170, J.E. 2011-5

Century Services Inc. (Appellant) and Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada (Respondent)

Deschamps J., McLachlin C.J.C., Binnie, LeBel, Fish, Abella, Charron, Rothstein, Cromwell JJ.

Heard: May 11, 2010
Judgment: December 16, 2010
Docket: 33239

Proceedings: reversing *Ted Leroy Trucking Ltd., Re* (2009), 2009 CarswellBC 1195, 2009 G.T.C. 2020 (Eng.), 2009 BCCA 205, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.); reversing *Ted Leroy Trucking Ltd., Re* (2008), 2008 CarswellBC 2895, 2008 BCSC 1805, [2008] G.S.T.C. 221, 2009 G.T.C. 2011 (Eng.) (B.C. S.C. [In Chambers])

Counsel: Mary I.A. Buttery, Owen J. James, Matthew J.G. Curtis for Appellant
Gordon Bourgard, David Jacyk, Michael J. Lema for Respondent

Subject: Estates and Trusts; Goods and Services Tax (GST); Tax — Miscellaneous; Insolvency

APPEAL by creditor from judgment reported at 2009 CarswellBC 1195, 2009 BCCA 205, [2009] G.S.T.C. 79, 98 B.C.L.R. (4th) 242, [2009] 12 W.W.R. 684, 270 B.C.A.C. 167, 454 W.A.C. 167, 2009 G.T.C. 2020 (Eng.) (B.C. C.A.), allowing Crown's appeal from dismissal of application for immediate payment of tax debt.

***Deschamps J.*:**

1 For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

1. Facts and Decisions of the Courts Below

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2 Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

3 Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a deemed trust in favour of the Crown for amounts collected in respect of GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA.* However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA.* Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA.* The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

4 On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

5 On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA.* The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, [2009] G.S.T.C. 79, 270 B.C.A.C. 167 (B.C. C.A.)). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

7 First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)*, [2005] G.S.T.C. 1, 73 O.R. (3d) 737 (Ont. C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA.*

8 Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by the Monitor in trust be paid to the Receiver General.

2. Issues

9 This appeal raises three broad issues which are addressed in turn:

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(1) Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

(2) Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

(3) Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the Crown in respect of those funds?

3. Analysis

10 The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite ... any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

11 In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

3.1 Purpose and Scope of Insolvency Law

12 Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

13 Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute — it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

14 Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below,

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the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

15 As I will discuss at greater length below, the purpose of the *CCAA* — Canada's first reorganization statute — is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

16 Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659 (S.C.C.), at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

17 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 which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

18 Early commentary and jurisprudence also endorsed the *CCAA's* remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). 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 (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

19 The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA's* objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

20 Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings*

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and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations, Issue No. 15, October 3, 1991, at pp. 15:15-15:16).

21 In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 481).

22 While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

23 Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c. 30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, ss. 25 and 29; see also *Alternative granite & marbre inc., Re*, 2009 SCC 49, [2009] 3 S.C.R. 286, [2009] G.S.T.C. 154 (S.C.C.); *Quebec (Deputy Minister of Revenue) c. Rainville* (1979), [1980] 1 S.C.R. 35 (S.C.C.); *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)).

24 With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, [2003] G.S.T.C. 193, 30 Alta. L.R. (4th) 192 (Alta. Q.B.), at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

3.2 GST Deemed Trust Under the CCAA

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26 The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

27 The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts follow it (see, e.g., *Komunik Corp., Re*, 2009 QCCS 6332 (C.S. Que.), leave to appeal granted, 2010 QCCA 183 (C.A. Que.)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

28 The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as am. by S.C. 1997, c. 12, s. 126).

29 Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bank. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims.

30 Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at § 2).

31 With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

32 Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

33 In *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the

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time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. Minister of National Revenue*, 2002 SCC 49, [2002] G.S.T.C. 23, [2002] 2 S.C.R. 720 (S.C.C.), this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

34 The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA.* The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

> **222.** (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed ....

35 The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an unsecured creditor in respect of GST only under the *BIA.* This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA.*

36 The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

37 Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

38 An analogous provision exists in the *BIA*, which, subject to the same specific exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

> **18.3** (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

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Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

39 Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions *(CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

> **18.4** (3) Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of
>
> (a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,
>
> (b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution ....

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

40 The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

41 A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219, [2003] G.S.T.C. 21 (Alta. Q.B.); *Gauntlet*

42 The Ontario Court of Appeal in *Ottawa Senators* rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

> The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

43 Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.), and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47-49).

44 Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

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45 I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA.* Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA.* Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

46 The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA.* Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

47 Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is 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 where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

48 Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA.* The anomaly of this result is made manifest by the fact that it would deprive companies of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

49 Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA.* However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA.*

50 It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna

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in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA.* However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

51 Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3) was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA.*

52 I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

53 A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA.* Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA.*

54 I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

55 In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA's* override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

56 My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation.

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Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

3.3 Discretionary Power of a Court Supervising a CCAA Reorganization

57 Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List])), at para. 10, *per* Farley J.).

58 *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

59 Judicial discretion must of course be exercised in furtherance of the *CCAA's* purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> 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.
>
> (*Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57, *per* Doherty J.A., dissenting)

60 Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134 (B.C. C.A. [In Chambers]), at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9 (Alta. Q.B.), at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J. [Commercial List]), at para. 3; *Air Canada, Re* [2003 CarswellOnt 4967 (Ont. S.C.J. [Commercial List])], 2003 CanLII 49366, at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92 and 217-26). In addition, 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 (see, e.g., *Canadian Red Cross Society / Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

61 When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA.* Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

62 Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary

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for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Gen. Div. [Commercial List]); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96 (B.C. C.A.), aff'g (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see Metcalfe & Mansfield). As well, the appointment of a Monitor to oversee the reorganization was originally a measure taken pursuant to the *CCAA's* supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

63 Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

64 The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (B.C. C.A.), at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.), paras. 31-33, *per* Blair J.A.).

65 I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

66 Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

67 The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

68 In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

69 The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)).

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70 The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA.* The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

71 It is well-established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA's* purposes, the ability to make it is within the discretion of a *CCAA* court.

72 The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

73 In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA.* Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA.*

74 It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

75 The question remains whether the order advanced the underlying purpose of the *CCAA.* The Court of Appeal held that it did not because the reorganization efforts had come to an end and the *CCAA* was accordingly spent. I disagree.

76 There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA*, the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA.* In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA.* The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA's* objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA.* That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA.* Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA.*

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77 The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

78 Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108 (Ont. C.A.), at paras. 62-63).

79 The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA.* Accordingly, creditors' incentives to prefer one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claims in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

80 Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA.* The court must do so in a manner that does not subvert the scheme of distribution under the *BIA.* Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA.* This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA.*

81 I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

3.4 Express Trust

82 The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

83 Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29 especially fn. 42).

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84 Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order of April 29, 2008, sufficient to support an express trust.

85 At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

86 The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

87 Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008, denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

4. Conclusion

88 I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

89 For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

***Fish J. (concurring)*:**

I

90 I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

91 More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

92 I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

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93 In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

94 Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

95 Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA* and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

96 In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* — or explicitly preserving — its effective operation.

97 This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

98 The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*") where s. 227(4) *creates* a deemed trust:

> **227 (4) Trust for moneys deducted** — Every person who deducts or withholds an amount under this Act <u>is deemed</u>, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, <u>to hold the amount separate and apart</u> from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, <u>in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act</u>. [Here and below, the emphasis is of course my own.]

99 In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

> **(4.1) Extension of trust** — <u>Notwithstanding</u> any other provision of this Act, <u>the *Bankruptcy and Insolvency Act*</u> (except sections 81.1 and 81.2 of that Act), <u>any other enactment of Canada</u>, any enactment of a province or any other law, <u>where</u> at any time <u>an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty</u> in the manner and at the time provided under this Act, <u>property of the person</u> ... equal in value to the amount so deemed to be held in trust <u>is deemed</u>
>
> > (a) <u>to be held</u>, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, <u>in trust for Her Majesty</u> whether or not the property is subject to such a security interest, ...
> >
> > ...
>
> ... and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

100 The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

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> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

101 The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

> **67** (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
>
> (3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

102 Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA* deemed trust under *both* the *CCAA* and the *BIA* regimes.

103 The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).

104 As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) the *CCAA* and in s. 67(3) the *BIA.* In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.

105 The same is not true with regard to the deemed trust created under the *ETA.* Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust — or expressly provide for its continued operation — in either the *BIA* or the *CCAA.* The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

106 The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:

> **222. (1) [Deemed] Trust for amounts collected** — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
>
> ...
>
> **(3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property

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held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, ...

...

... and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

107 Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.

108 In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA.* Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.

109 With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.), at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA.* Section 222 of the *ETA* does not break the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA.*

110 Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit — rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA.*

111 Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA.* Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.

112 Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA.* Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.

III

113 For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

***Abella J. (dissenting)*:**

114 The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*EIA*"), and specifically s. 222(3), gives priority during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.

115 Section 11 [1] of the *CCAA* stated:

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

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

> **222 (3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
>
> > (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
> >
> > (b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest
>
> and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

116 Century Services argued that the *CCAA's* general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

> **18.3** (1) ... [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

117 As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

118 By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following comments of MacPherson J.A. in *Ottawa Senators*:

> The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act* .... The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

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119 MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA.* Section 18.3(1) was not amended.

120 The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent with those in the *BIA.* In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71, at pp. 37-38). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

121 Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA.* Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision. I see this lack of response as relevant in this case, as it was in *R. v. Tele-Mobile Co.*, 2008 SCC 12, [2008] 1 S.C.R. 305 (S.C.C.), where this Court stated:

> While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be reimbursed for the reasonable costs of complying with evidence-gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

122 All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA.*

123 Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

> I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators*, it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA.* [para. 37]

124 Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails;

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and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogani*).

125 The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre-André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

126 The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be construed as affecting an earlier, special provision" (Côté, at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.)).

127 The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

> [T]he overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, ... at p. 239 ...:
>
>> The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat, *Interprétation des lois* (4th ed. 2009), at para. 1335.)

128 I accept the Crown's argument that the "later in time" principle is conclusive in this case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant).* But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA.* Section 18.3(1) of the *CCAA*, is thereby rendered inoperative for purposes of s. 222(3).

129 It is true that when the *CCAA* was amended in 2005, [2] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005, c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(f) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Canada (Attorney General) v. Canada (Public Service Staff Relations Board)*, [1977] 2 F.C. 663 (Fed. C.A.), dealing with the predecessor provision to s. 44(f)). It directs that new enactments not be construed as "new law" unless they differ in substance from the repealed provision:

> **44.** Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,
>
> ...

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> (f) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an enactment as "an Act or regulation or *any portion of an Act or regulation*".

130 Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

> **37.**(1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

131 The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to reorder the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

> On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*] makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive reworking of the CCAA.
>
> (*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

132 Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

133 This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA.*

134 While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act.* That includes the *ETA.* The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA.* Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

135 Given this conclusion, it is unnecessary to consider whether there was an express trust.

136 I would dismiss the appeal.

Appeal allowed.

Pourvoi accueilli.

Appendix

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at December 13, 2007)**

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

...

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

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (i);

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

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

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

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

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

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

...

(6) Burden of proof on application — The court shall not make an order under subsection (3) or (4) unless

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

(b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

11.4 (1) Her Majesty affected — An order made under section 11 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

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(iii) six months following the court sanction of a compromise or arrangement,

(iv) the default by the company on any term of a compromise or arrangement, or

(v) the performance of a compromise or arrangement in respect of the company; and\

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) When order ceases to be in effect — An order referred to in subsection (1) ceases to be in effect if

(a) the company defaults on payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

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(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) Deemed trusts — Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

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(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) Status of Crown claims — In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

...

(3) Operation of similar legislation — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

...

20. [Act to be applied conjointly with other Acts] — The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at September 18, 2009)**

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

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...

11.02 (1) Stays, etc. — initial application — A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

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

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

(2) Stays, etc. — other than initial application — A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

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

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

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

(3) Burden of proof on application — The court shall not make the order unless

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

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

...

11.09 (1) Stay — Her Majesty — An order made under section 11.02 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or an arrangement,

(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

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(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may apply.

(2) When order ceases to be in effect — The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(a) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

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(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) Deemed trusts — Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that

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subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

***Excise Tax Act*, R.S.C. 1985, c. E-15 (as at December 13, 2007)**

222. (1) [Deemed] Trust for amounts collected — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) Amounts collected before bankruptcy — Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act)*, to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

...

(3) Extension of trust — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

***Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (as at December 13, 2007)**

67. (1) Property of bankrupt — The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person,

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(b.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and

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(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) Deemed trusts — Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) Exceptions — Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) Status of Crown claims — In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

...

(3) Exceptions — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

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(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Footnotes

1 Section 11 was amended, effective September 18, 2009, and now states:

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

2 The amendments did not come into force until September 18, 2009.

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2002 SCC 84, 2002 CSC 84
Supreme Court of Canada

Gosselin c. Québec (Procureur général)

2002 CarswellQue 2706, 2002 CarswellQue 2707, 2002 SCC 84, 2002 CSC 84,
[2002] 4 S.C.R. 429, [2002] S.C.J. No. 85, 100 C.R.R. (2d) 1, 119 A.C.W.S. (3d) 43, 221
D.L.R. (4th) 257, 298 N.R. 1, 44 C.H.R.R. D/363, J.E. 2003-126, REJB 2002-36302

Louise Gosselin, Appellant v. The Attorney General of Quebec, Respondent and The Attorney General for Ontario, the Attorney General for New Brunswick, the Attorney General of British Columbia, the Attorney General for Alberta, Rights and Democracy (also known as International Centre for Human Rights and Democratic Development), Commission des droits de la personne et des droits de la jeunesse, National Association of Women and the Law (NAWL), Charter Committee on Poverty Issues (CCPI) and Canadian Association of Statutory Human Rights Agencies (CASHRA), Interveners

Bastarache J., LeBel J., McLachlin C.J.C.

Judgment: December 19, 2002
Heard: October 29, 2001
Docket: 27418

Proceedings: affirming (1999), 1999 CarswellQue 1203, [1999] R.J.Q. 1033 (C.A. Que.); affirming (1992), [1992] R.J.Q. 1647 (C.S. Que.)

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Gabriel Bourgeois, Q.C., for Intervener, Attorney General for New Brunswick
Sarah Macdonald, for Intervener, Attorney General for British Columbia
Maragret Unsworth, for Intervener, Attorney General for Alberta
David Matas, for Intervener, Rights and Democracy (also known as International Centre for Human Rights and Democratic Development)
Hélène Tessier, for Intervener, Commission des driots de la personne et des droits de la jeunesse
Gwen Brodsky, *Rachel Cox*, for Intervener, National Association of Women and the Law (NAWL)
Vincent Calderhead, *Martha Jackman*, for Intervener, Charter Committee on Poverty Issues (CCPI)
Chantal Masse, *Fred Headon*, for Intervener, Canadian Association of Statutory Human Rights Agencies (CASHRA)

Subject: Constitutional; Public; Human Rights

APPEAL by welfare recipient from judgment reported at 1999 CarswellQue 1203, [1999] J.Q. No. 1365, [1999] R.J.Q. 1033 (Que. C.A.), dismissing recipient's appeal from judgment reported at [1992] R.J.Q. 1647 (Que. S.C.), dismissing recipient's class action seeking the invalidity of s. 29(a) of the Regulation respecting social aid which provided that welfare recipients under 30 years of age would receiver lesser benefits.

POURVOI d'une bénéficiaire de l'aide sociale à l'encontre de l'arrêt publié à 1999 CarswellQue 1203, [1999] J.Q. No. 1365, [1999] R.J.Q. 1033 (C.A. Qué.), qui a rejeté son pourvoi à l'encontre du jugement publié à [1992] R.J.Q. 1647 (C.S.

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Qué.), qui avait rejeté son recours collectif visant à faire déclarer invalide l'art. 29a) du Règlement sur l'aide sociale qui accordait des prestations moindres aux bénéficiaires ayant moins de 30 ans.

***McLachlin C.J.C.*:**

I. Introduction

1 Louise Gosselin was born in 1959. She has led a difficult life, complicated by a struggle with psychological problems and drug and alcohol addictions. From time to time she has tried to work, attempting jobs such as cook, waitress, salesperson, and nurse's assistant, among many. But work would wear her down or cause her stress, and she would quit. For most of her adult life, Ms. Gosselin has received social assistance.

2 In 1984, the Quebec government altered its existing social assistance scheme in an effort to encourage young people to get job training and join the labour force. Under the scheme, which has since been repealed, the base amount payable to welfare recipients under 30 was lower than the base amount payable to those 30 and over. The new feature was that, to receive an amount comparable to that received by older people, recipients under 30 had to participate in a designated work activity or education program.

3 Ms. Gosselin contends that the lower base amount payable to people under 30 violates: (1) s. 15(1) of the *Canadian Charter of Rights and Freedoms* ("*Canadian Charter*"), which guarantees equal treatment without discrimination based on grounds including age; (2) s. 7 of the *Canadian Charter*, which prevents the government from depriving individuals of liberty and security except in accordance with the principles of fundamental justice; and (3) s. 45 of the Quebec *Charter of Human Rights and Freedoms, R.S.Q.*, c. C-12 ("*Quebec Charter*"). She further argues that neither of the alleged *Canadian Charter* violations can be demonstrably justified under s. 1.

4 On this basis, Ms. Gosselin asks this Court to order the Quebec government to pay the difference between the lower and the higher base amounts to all the people who: (1) lived in Quebec and were between the ages of 18 and 30 at any time from 1985 to 1989; (2) received the lower base amount payable to those under 30; and (3) did not participate in the government programs, for whatever reason. On her submissions, this would mean ordering the government to pay almost $389 million in benefits *plus* the interest accrued since 1985. Ms. Gosselin claims this remedy on behalf of over 75,000 unnamed class members, none of whom came forward in support of her claim.

5 In my view, the evidence fails to support Ms. Gosselin's claim on any of the asserted grounds. Accordingly, I would dismiss the appeal.

II. Facts and Decisions

6 In 1984, in the face of alarming and growing unemployment among young adults, the Quebec legislature made substantial amendments to the *Social Aid Act*, R.S.Q., c. A-16, creating a new scheme — the scheme at issue in this litigation. Section 29(*a*) of the *Regulation respecting social aid*, R.R.Q., c. A-17, r. 1, made under the *Act* continued to cap the base amount of welfare payable to those under 30 at roughly one third of the base amount payable to those 30 and over. However, the 1984 scheme for the first time made it possible for people under 30 to increase their welfare payments, over and above the basic entitlement, to the same (or nearly the same) level as those in the 30-and-over group.

7 The new scheme was based on the philosophy that the most effective way to encourage and enable young people to join the work force was to make increased benefits conditional on participation in one of three programs: On-the-job Training, Community Work, or Remedial Education. Participating in either On-the-job Training or Community Work boosted the welfare payment to a person under 30 up to the base amount for those 30 and over; participating in Remedial Education brought an under-30 within $100 of the 30-and-over base amount. The 30-and-over base amount still represented only 55 percent of the poverty level for a single person. For example, in 1987, non-participating under-30s were entitled to $170 per month, compared to $466 per month for welfare recipients 30 and over. According to Statistics Canada, the poverty level for a single person living in a large metropolitan area was $914 per month in 1987.

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Long-term dependence on welfare was neither socially desirable nor, realistically speaking, economically feasible. The Quebec scheme was designed to encourage under-30s to get training or basic education, helping them to find permanent employment and avoid developing a habit of relying on social assistance during these formative years.

8 The government initially made available 30,000 places in the three training programs. The record indicates that the percentage of eligible under-30s who actually participated in the programs averaged around one-third, but it does not explain this participation rate. Although Ms. Gosselin filed a class action on behalf of over 75,000 individuals, she provided no direct evidence of any other young person's experience with the government programs. She alone provided first-hand evidence and testimony as a class member in this case, and she in fact participated in each of the Community Work, Remedial Education and On-the-job Training Programs at various times. She ended up dropping out of virtually every program she started, apparently because of her own personal problems and personality traits. The testimony from one social worker, particularly as his clinic was attached to a psychiatric hospital and therefore received a disproportionate number of welfare recipients who also had serious psychological problems, does not give us a better or more accurate picture of the situation of the other class members, or of the relationship between Ms. Gosselin's personal difficulties and the structure of the welfare program.

9 Ms. Gosselin challenged the 1984 social assistance scheme on behalf of all welfare recipients under 30 subject to the differential regime from 1985 to 1989 (when, for reasons unrelated to this litigation, it was replaced by legislation that does not make age-based distinctions). As indicated above, she argued that Quebec's social assistance scheme violates s. 7 and s. 15(1) of the *Canadian Charter*, and s. 45 of the *Quebec Charter*. She asks the Court to declare s. 29(*a*) of the *Regulation* — which provided a lesser base welfare entitlement to people under 30 — to have been invalid from 1987 (when it lost the protection of the notwithstanding clause) to 1989, and to order the government of Quebec to reimburse all affected welfare recipients for the difference between what they actually received and what they would have received had they been 30 years of age or over, for a total of roughly $389 million, plus interest.

10 The trial judge, Reeves J., held that the claim was not supported by the evidence and that the distinction made by Quebec's social assistance regime was not discriminatory under s. 15(1) of the *Canadian Charter* because it was based on genuine considerations that corresponded to relevant characteristics of the under-30 age group, including the importance of providing under-30s with incentives to get training and work experience in the face of widespread youth unemployment: 1992 R.J.Q. 1647. He dismissed Ms. Gosselin's s. 7 claim, holding that s. 7's protection of security of the person does not extend to economic security and does not create a constitutional right to be free from poverty. He also rejected the claim under s. 45 of the *Quebec Charter* on the ground that s. 45 does not create an entitlement to a particular level of state assistance.

11 All three judges of the Quebec Court of Appeal agreed that s. 7 of the *Canadian Charter* was not engaged in this case: [1999] R.J.Q. 1033. Mailhot J.A. found this case indistinguishable from *Law v. Canada (Minister of Employment & Immigration)*, [1999] 1 S.C.R. 497 (S.C.C.), and dismissed the s. 15(1) claim accordingly. Baudouin J.A. found that Quebec's social assistance scheme breached s. 15(1), but he found the breach justified in a free and democratic society under s. 1 of the *Canadian Charter*. Robert J.A. would have found that the social assistance scheme breached s. 15(1) of the *Canadian Charter* and was not saved by s. 1, but he would have dismissed the claim for damages as inappropriate. On s. 45 of the *Quebec Charter*, only Robert J.A. found a breach, for which he held damages unavailable.

III. Issues

12 This case raises the important question of how to determine when the differential provision of government benefits crosses the line that divides appropriate tailoring in light of different groups' circumstances, and discrimination. To what extent does the *Canadian Charter* restrict a government's discretion to extend different kinds of help, and different levels of financial assistance, to different groups of welfare recipients? How much evidence is required to compel a government to retroactively reimburse tens of thousands of people for alleged shortfalls in their welfare payments, arising from a conditional benefits scheme? These issues have implications for the range of options available to governments throughout

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Canada in tailoring welfare programs to address the particular needs and circumstances of individuals requiring social assistance.

13 The specific legal issues are found in the stated constitutional questions:

> 1. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* on the ground that it established a discriminatory distinction based on age with respect to individuals, capable of working, aged 18 to 30 years?
>
> 2. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> 3. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 7 of the *Canadian Charter of Rights and Freedoms* on the ground that it deprived those to whom it applied of their right to security of the person contrary to the principles of fundamental justice?
>
> 4. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?

14 A further issue is whether s. 29(*a*) of the Regulation violates s. 45 of the *Quebec Charter*, and if so, whether a remedy is available.

15 A preliminary issue arises in connection with s. 33 of the *Canadian Charter* — the "notwithstanding clause". By virtue of *An Act respecting the Constitution Act, 1982*, R.S.Q., c. L-4.2, the Quebec legislature withdrew all Quebec laws from the *Canadian Charter* regime for five years from their inception. This means that the Act is immune from *Canadian Charter* scrutiny from June 23, 1982 to June 23, 1987, and the programs part of the scheme is immune from April 4, 1984 to April 4, 1989 (see *An Act to amend the Social Aid Act*, S.Q. 1984, c. 5, s. 4). It could be argued, therefore, that the scheme is protected from *Canadian Charter* scrutiny on s. 7 or s. 15(1) grounds for the whole period *except* for the four months from April 4, 1989 to August 1, 1989. This raises the further question of whether evidence on the legislation's impact *outside* the four-month period subject to *Canadian Charter* scrutiny can be used to generate conclusions about compliance with the *Canadian Charter within* the four-month period. In view of my conclusion that the program is constitutional in any event, I need not resolve these issues.

IV. Analysis

A. Does the Social Assistance Scheme Violate Section 15(1) of the Canadian Charter?

(1) The Section 15 Test

16 Section 15(1) of the *Canadian Charter* provides that "[e]very individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability."

17 To establish a violation of s. 15(1), the claimant must establish on a civil standard of proof that: (1) the law imposes differential treatment between the claimant and others, in purpose or effect; (2) one or more enumerated or analogous grounds are the basis for the differential treatment; and (3) the law in question has a purpose or effect that is discriminatory in the sense that it denies human dignity or treats people as less worthy on one of the enumerated or analogous grounds. In this case, the first two elements are clear, and the analysis focuses on whether the scheme was discriminatory.

18 My colleague Bastarache J. and I agree that *Law* remains the governing standard. We agree that the s. 15(1) test involves a contextual inquiry to determine whether a challenged distinction, viewed from the perspective of a reasonable

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person in the claimant's circumstances, violates that person's dignity and fails to respect her as a full and equal member of society. We agree that a distinction made on an enumerated or analogous ground violates essential human dignity to the extent that it reflects or promotes the view that the individuals affected are less deserving of concern, respect, and consideration than others: *Law* , *supra*, at para. 42; *Andrews v. Law Society (British Columbia)*, [1989] 1 S.C.R. 143 (S.C.C.), at p. 171, *per* McIntyre J. We agree that a claimant bears the burden under s. 15(1) of showing on a civil standard of proof that a challenged distinction is discriminatory, in the sense that it harms her dignity and fails to respect her as a full and equal member of society. We agree that, if a claimant meets this burden, the burden shifts to the government to justify the distinction under s. 1.

19 Where we disagree is on whether the claimant in this particular case has met her burden of proof. We both examine the contextual factors enunciated in *Law* , but we reach different conclusions with respect to the adequacy of the factual record, the nature of the inferences we can draw from that record, and the deference owed to the findings of the trial judge. Whatever sympathy Ms. Gosselin's economic circumstances might provoke, I simply cannot find that she has met her burden of proof in showing that the Quebec government discriminated against her based on her age. In my respectful view, she has not demonstrated that the government treated her as less worthy than older welfare recipients, simply because it conditioned increased payments on her participation in programs designed specifically to integrate her into the work force and to promote her long-term self-sufficiency.

20 We must approach the question of whether the scheme was discriminatory in light of the purpose of the s. 15 equality guarantee. That purpose is to ensure that governments respect the innate and equal dignity of every individual without discrimination on the basis of the listed or analogous grounds: *Law* , *supra*, at para. 51. The aspect of human dignity targeted by s. 15(1) is the right of each person to participate fully in society and to be treated as an equal member, regardless of irrelevant personal characteristics, or characteristics attributed to the individual based on his or her membership in a particular group without regard to the individual's actual circumstances. As Iacobucci J. put it in *Law* (at para. 51):

> [T]he purpose of s. 15(1) is to prevent the violation of essential human dignity and freedom through the imposition of disadvantage, stereotyping, or political or social prejudice, and to promote a society in which all person enjoy equal recognition at law as human beings or as members of Canadian society, equally capable and equally deserving of concern, respect and consideration.

21 Discrimination occurs when people are marginalized or treated as less worthy on the basis of irrelevant personal characteristics, without regard to their actual circumstances. The enumerated and analogous grounds of s. 15 serve as "legislative markers of suspect grounds associated with stereotypical, discriminatory decision making"; differential treatment based on these grounds invites judicial scrutiny: *Corbiere v. Canada (Minister of Indian & Northern Affairs)*, [1999] 2 S.C.R. 203 (S.C.C.), at para. 7, *per* McLachlin and Bastarache JJ. However, not every adverse distinction made on the basis of an enumerated or analogous ground constitutes discrimination: see *Corbiere* . Some group-based distinctions may be appropriate or indeed promote substantive equality, as envisaged in s. 15(2): see *Ardoch Algonquin First Nation & Allies v. Ontario*, [2000] 1 S.C.R. 950, 2000 SCC 37 (S.C.C.),

22 Section 15(1) seeks to ensure that all are treated as equally worthy of full participation in Canadian society, regardless of irrelevant personal characteristics or membership in groups defined by the enumerated and analogous grounds: see D. Greschner, "The Purpose of Canadian Equality Rights" (2000), 6 *Review of Constitutional Studies* 291. The focus is not on whether or not the claimant is subject to a formal distinction, but on whether the claimant has in *substance* been treated as less worthy than others, whether or not a formal distinction exists: *Andrews* , *supra*, at pp. 164-69, *per* McIntyre J.; *Law* , *supra*, at para. 25; *British Columbia (Public Service Employee Relations Commission) v. B.C.G.E.U.*, [1999] 3 S.C.R. 3 (S.C.C.).

23 Section 15's purpose of protecting equal membership and full participation in Canadian society runs like a leitmotif through our s. 15 jurisprudence. *Corbiere* addressed the participation off-reserve Aboriginal band members in band governance. *Eaton* and *Eldridge* spoke of the harms of excluding disabled individuals from the larger society: *Eaton v.*

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Brant (County) Board of Education (1996), [1997] 1 S.C.R. 241 (S.C.C.); *Eldridge v. British Columbia (Attorney General)*, [1997] 3 S.C.R. 624 (S.C.C.). *Vriend* dealt with a legislature's exclusion of the ground of sexual orientation from a human rights statute protecting individuals from discrimination based on a range of other grounds: *Vriend v. Alberta*, [1998] 1 S.C.R. 493 (S.C.C.). *Granovsky* resonated with the language of belonging: "Exclusion and marginalization are generally not created by the individual with disabilities but are created by the economic and social environment and, unfortunately, by the state itself": *Granovskyv. Canada (Minister of Employment and Immigration)*, [2000] 1 S.C.R. 703, 2000 SCC 28 (S.C.C.), at para. 30.

24 To determine whether a distinction made on an enumerated or analogous ground is discriminatory, we must examine its context. As Binnie J. stated in *Granovsky, supra*, at para. 59, citing U.S. Supreme Court Marshall J.'s partial dissent in *Cleburne (City) v. Cleburne Living Centre* (1985), 473 U.S. 432 (U.S. Tex.) (1985): "[a] sign that says 'men only' looks very different on a bathroom door than a courthouse door". In each case, we must ask whether the distinction, viewed in context, treats the subject as less worthy, less imbued with human dignity, on the basis of an enumerated or analogous ground.

25 The need for a contextual inquiry to establish whether a distinction conflicts with s.15(1)'s purpose is the central lesson of *Law* . The issue, as my colleagues and I all agree, is whether "a reasonable person in circumstances similar to those of the claimant would find that the legislation which imposes differential treatment has the effect of demeaning his or her dignity" having regard to the individual's or group's traits, history, and circumstances: *Law* , at para. 60, followed in *Ardoch Algonquin First Nation & Allies* , *supra*, at para. 55. As an aid to determining whether a distinction has a discriminatory purpose or effect under part (3) of this test, *Law* proposes an investigation of four contextual factors relating to the challenged distinction: (1) pre-existing disadvantage; (2) correspondence between the ground of distinction and the actual needs and circumstances of the affected group; (3) the ameliorative purpose or effect of the impugned measure for a more disadvantaged group; and (4) the nature and scope of the interests affected.

26 Both the purpose of the scheme and its effect must be considered in making this evaluation. I agree with Bastarache J. that the effects of the scheme are critical. However, under *Law* , the context of a given legislative scheme also includes its purpose. Simply put, it makes sense to consider what the legislator intended in determining whether the scheme denies human dignity. Intent, like the other contextual factors, is not determinative. Our case law has established that even a well-intentioned or facially neutral scheme can have the effect of discriminating: *B.C.G.E.U.* , *supra*. The scheme here is not facially neutral: we are dealing with an explicit distinction. The purpose of the distinction, in the context of the overall legislative scheme, is a factor that a reasonable person in the position of the complainant would take into account in determining whether the legislator was treating him or her as less worthy and less deserving of concern, respect and consideration than others.

27 I emphasize that a beneficent purpose will not shield an otherwise discriminatory distinction from judicial scrutiny under s. 15(1). Legislative purpose is relevant only insofar as it relates to whether or not a reasonable person in the claimant's position would feel that a challenged distinction harmed her dignity. As a matter of common sense, if a law is designed to promote the claimant's long-term autonomy and self-sufficiency, a reasonable person in the claimant's position would be less likely to view it as an assault on her inherent human dignity. This does not mean that one must uncritically accept the legislature's stated purpose at face value: a reasonable person in the claimant's position would not accept the exclusion of women from the workplace based merely on the legislature's assertion that this is for women's "own good". However, where the legislature is responding to certain concerns, and where those concerns appear to be well founded, it is legitimate to consider the legislature's purpose as part of the overall contextual evaluation of a challenged distinction from the claimant's perspective, as called for in *Law* . This is reflected in the questions Iacobucci J. asked in *Law* : "Do the impugned CPP provisions, *in purpose or effect*, violate essential human dignity and freedom through the imposition of disadvantage, stereotyping, or political or social prejudice?"; "Does the law, *in purpose or effect*, perpetuate the view that people under 45 are less capable or less worthy of recognition or value as human beings or as members of society?" (para. 99 (emphasis added)).

(2) Applying the Test

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28 The regulation at issue made a distinction on the basis of an enumerated ground, age. People under 30 were subject to a different welfare regime than people 30 and over. The question is whether this distinction in purpose or effect resulted in substantive inequality contrary to s. 15(1)'s purpose of ensuring that governments treat all individuals as equally worthy of concern, respect, and consideration. More precisely, the question is whether a reasonable person in Ms. Gosselin's position would, having regard to all the circumstances and the context of the legislation, conclude that the Regulation in purpose or effect treated welfare recipients under 30 as less worthy of respect than those 30 and over, marginalizing them on the basis of their youth.

29 To answer this question, we must consider the four factors set out in *Law* . None of these factors is a prerequisite for finding discrimination, and not all factors will apply in every case. The list of factors is neither absolute nor exhaustive. In addition, the factors may overlap, since they are all designed to illuminate the relevant contextual considerations surrounding a challenged distinction. Nonetheless, the four factors provide a useful guide to evaluating an allegation of discrimination, and I will examine each of them in turn.

(a) Pre-existing Disadvantage

30 A key marker of discrimination and denial of human dignity under s. 15(1) is whether the affected individual or group has suffered from "pre-existing disadvantage, vulnerability, stereotyping, or prejudice": *Law* , at para. 63. Historic patterns of discrimination against people in a group often indicate the presence of stereotypical or prejudicial views that have marginalized its members and prevented them from participating fully in society. This, in turn, raises the strong possibility that current differential treatment of the group may be motivated by or may perpetuate the same discriminatory views. The contextual factor of pre-existing disadvantage invites us to scrutinize group-based distinctions carefully to ensure that they are not based, either intentionally or unconsciously, on these kinds of unfounded generalizations and stereotypes.

31 Many of the enumerated grounds correspond to historically disadvantaged groups. For example, it is clear that members of particular racial or religious groups should not be excluded from receiving public benefits on account of their race or religion. However, unlike race, religion, or gender, age is not strongly associated with discrimination and arbitrary denial of privilege. This does not mean that examples of age discrimination do not exist. But age-based distinctions are a common and necessary way of ordering our society. They do not automatically evoke a context of pre-existing disadvantage suggesting discrimination and marginalization under this first contextual factor, in the way that other enumerated or analogous grounds might.

32 To expand on the earlier example, a sign on a courthouse door proclaiming "Men Only" evokes an entire history of discrimination against a historically disadvantaged class; a sign on a bar room door that reads "No Minors" fails to similarly offend. The fact that "[e]ach individual of any age has personally experienced all earlier ages and expects to experience the later ages" (P. W. Hogg, *Constitutional Law of Canada* (loose-leaf ed.), vol. 2, at p. 52-54) operates against the arbitrary marginalization of people in a particular age group. Again, this does *not* mean that age is a "lesser" ground for s. 15 purposes. However, pre-existing disadvantage and historic patterns of discrimination against a particular group do form part of the contextual evaluation of whether a distinction is discriminatory, as called for in *Law* . Concerns about age-based discrimination typically relate to discrimination against people of advanced age who are presumed to lack abilities that they may in fact possess. Young people do not have a similar history of being undervalued. This is by no means dispositive of the discrimination issue, but it may be relevant, as it was in *Law* .

33 Both as a general matter, and based on the evidence and our understanding of society, young adults as a class simply do not seem especially vulnerable or undervalued. There is no reason to believe that individuals between ages 18 and 30 in Quebec are or were particularly susceptible to negative preconceptions. No evidence was adduced to this effect, and I am unable to take judicial notice of such a counter-intuitive proposition. Indeed, the *opposite* conclusion seems more plausible, particularly as the programs participation component of the social assistance scheme was premised on a view of the greater long-term employability of under-30s, as compared to their older counterparts. Neither the nature

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of the distinction at issue nor the evidence suggests that the affected group of young adults constitutes a group that historically has suffered disadvantage, or that is at a particular risk of experiencing adverse differential treatment based on the attribution of presumed negative characteristics: see *Ardoch Algonquin First Nation & Allies* , *supra*, at para. 69.

34 With regard to this contextual factor, Ms. Gosselin is in the same position as Mrs. Law. In *Law* , Iacobucci J. stated (at para. 95):

> Relatively speaking, adults under the age of 45 have not been consistently and routinely subjected to the sorts of discrimination faced by some of Canada's discrete and insular minorities. For this reason, it will be more difficult as a practical matter for this Court to reason, from facts of which the Court may appropriately take judicial notice, that the legislative distinction at issue violates the human dignity of the appellant.

If anything, people under 30 appear to be advantaged over older people in finding employment. As Iacobucci J. also stated in *Law* , with respect to adults under 45 (at para. 101):

> It seems to me that the increasing difficulty with which one can find and maintain employment as one grows older is a matter of which a court may appropriately take judicial notice. Indeed, this Court has often recognized age as a factor in the context of labor force attachment and detachment. For example, writing for the majority in *McKinney*, [[1990] 3 S.C.R. 229], LaForest J. stated as follows, at p. 299:
>
>> Barring specific skills, it is generally known that persons over 45 have more difficulty finding work than others. They do not have the flexibility of the young, a disadvantage often accentuated by the fact that the latter are frequently more recently trained in the more modern skills.

Iacobucci J. went on to note that "[s]imilar thoughts were expressed in *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986 (S.C.C.), at pp. 998-99, *per* Iacobucci J., and at pp. 1008-9, *per* McLachlin J. [and] *Moge v. Moge*, [1992] 3 S.C.R. 813 (S.C.C.), at pp. 881-83, *per* McLachlin J."

35 Given the lack of pre-existing disadvantage experienced by young adults, Ms. Gosselin attempts to shift the focus from age to welfare, arguing that *all* welfare recipients suffer from stereotyping and vulnerability. However, this argument does not assist her claim. The ground of discrimination upon which she founds her claim is *age*. The question with respect to this contextual factor is therefore whether the targeted age-group, comprising young adults aged 18 to 30, has suffered from historic disadvantage as a result of stereotyping on the basis of age. Re-defining the group as welfare recipients aged 18 to 30 does not help us answer that question, in particular because the 30-and-over group that Ms. Gosselin asks us to use as a basis of comparison also consists entirely of welfare recipients.

36 I conclude that the appellant has not established that people aged 18 to 30 have suffered historical disadvantage on the basis of their age. There is nothing to suggest that people in this age group have historically been marginalized and treated as less worthy than older people.

(b) Relationship Between Grounds and the Claimant Group's Characteristics or Circumstances

37 The second contextual factor we must consider in determining whether the distinction is discriminatory in the sense of denying human dignity and equal worth is the relationship between the ground of distinction (age) and the actual characteristics and circumstances of the claimant's group: *Law* , at para. 70. A law that is closely tailored to the reality of the affected group is unlikely to discriminate within the meaning of s. 15(1). By contrast, a law that imposes restrictions or denies benefits on account of presumed or unjustly attributed characteristics is likely to deny essential human worth and to be discriminatory. Both purpose and effect are relevant here, insofar as they would affect the perception of a reasonable person in the claimant's position: see *Law* , at para 96.

38 I turn first to purpose in order to evaluate whether or not the rationale for the challenged distinction corresponded to the actual circumstances of under-30s subject to differential welfare scheme. The evidence indicates that the purpose of

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the challenged distinction, far from being stereotypical or arbitrary, corresponded to the actual needs and circumstances of individuals under 30. In the late 1960s and early 1970s, the unemployment rate among young Quebecers was relatively low, as jobs were readily available. However, circumstances changed dramatically in the course of the ensuing years. First, North America experienced a deep recession in the early 1980s, which hit Quebec hard and drove unemployment from a traditional rate hovering around 8 percent to a peak of 14.4 percent of the active population in 1982, and among the young from 6 percent (1966) to 23 percent. At the same time, the federal government tightened eligibility requirements for federal unemployment insurance benefits, and the number of young people entering the job market for the first time surged. These three events caused an unprecedented increase in the number of people capable of working who nevertheless ended up on the welfare rolls.

39 The situation of young adults was particularly dire. The unemployment rate among young adults was far higher than among the general population. People under 30, capable of working and without any dependants, made up a greater proportion of welfare recipients than ever before. Moreover, this group accounted for the largest — and steadily growing — proportion of *new entrants* into the welfare system: by 1983 fully two-thirds of new welfare recipients were under 30, and half were under the age of 23. In addition to coming onto the welfare rolls in ever greater numbers, younger individuals did so for increasingly lengthy periods of time. In 1975, 60 percent of welfare recipients under 30 not incapable of working left the welfare rolls within six months. By 1983, only 30 percent did so.

40 Behind these statistics lay a complex picture. The "new economy" emerging in the 1980s offered diminishing prospects for unskilled or under-educated workers. At the same time, a disturbing trend persisted of young Quebecers dropping out of school and trying to join the work force. The majority of unemployed youths in the early 1980s were school drop-outs. Unemployed youths were, on average, significantly less educated than the general population, and the unemployment rate among young people with fewer than eight years of education stood at 40 percent to 60 percent. Lack of skills and basic education were among the chief causes of youth unemployment.

41 The government's short-term purpose in the scheme at issue was to get recipients under 30 into work and training programs that would make up for the lower base amount they received while teaching them valuable skills. The differential regime of welfare payments was tailored to help the burgeoning ranks of unemployed youths obtain the skills and basic education they needed to get permanent jobs. The mechanism was straightforward. In order to increase their welfare benefits, people under 30 would be required to participate in On-the-job Training, Community Work or Remedial Education programs. Participating in the training and community service programs would bring welfare benefits up to the basic level payable to the 30-and-over group, and in the education program to about $100 less.

42 The government's longer-term purpose was to provide young welfare recipients with precisely the kind of remedial education and skills training they lacked and needed in order eventually to integrate into the work force and become self-sufficient. This policy reflects the practical wisdom of the old Chinese proverb: "Give a man a fish and you feed him for a day. Teach him how to fish and you feed him for a lifetime." This was not a denial of young people's dignity; it was an affirmation of their potential.

43 Simply handing over a bigger welfare cheque would have done nothing to help welfare recipients under 30 escape from unemployment and its potentially devastating social and psychological consequences above and beyond the short-term loss of income. Moreover, opposition to the incentive program entirely overlooks the cost to young people of being on welfare during the formative years of their working lives. For young people without significant educational qualifications, skills, or experience, entering into the labour market presents considerable difficulties. A young person who relies on welfare during this crucial initial period is denied those formative experiences which, for those who successfully undertake the transition into the productive work force, lay the foundation for economic self-sufficiency and autonomy, not to mention self-esteem. The longer a young person stays on welfare, the more difficult it becomes to integrate into the work force at a later time. In this way, reliance on welfare can contribute to a vicious circle of inability to find work, despair, and increasingly dismal prospects.

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44 Instead of turning a blind eye to these problems, the government sought to tackle them at their roots, designing social assistance measures that might help welfare recipients achieve long-term autonomy. Because federal rules in effect at the time prohibited making participation in the programs mandatory, the province's only real leverage in promoting these programs lay in making participation a prerequisite for increases in welfare. Even if one does not agree with the reasoning of the legislature or with its priorities, one cannot argue based on this record that the legislature's purpose lacked sufficient foundation in reality and common sense to fall within the bounds of permissible discretion in establishing and fine-tuning a complex social assistance scheme. Logic and common sense support the legislature's decision to structure its social assistance programs to give young people, who have a greater potential for long-term insertion into the work force than older people, the incentive to participate in programs specifically designed to provide them with training and experience. As indicated above, the government's purpose is a relevant contextual factor in the s. 15(1) analysis insofar as it relates to how a reasonable person in the claimant's circumstances would have perceived the incentive-based welfare regime. In this case, far from ignoring the actual circumstances of under-30s, the scheme at issue was designed to address their needs and abilities. A reasonable person in the claimant's circumstances would have taken this into account.

45 Turning to effect, Ms. Gosselin argues that the regime set up under the Regulation in fact failed to address the needs and circumstances of welfare recipients under 30 because the ability to "top up" the basic entitlement by participating in programs was more theoretical than real. She argues that, notwithstanding the legislature's intentions, the practical consequence of the Regulation was to abandon young welfare recipients, leaving them to survive on a grossly inadequate sum of money. In this way the program did not correspond to their actual needs, she argues, and amounted to discriminatory marginalization of the affected group.

46 The main difficulty with this argument is that the trial judge, after a lengthy trial and careful scrutiny of the record, found that Ms. Gosselin had failed to establish actual adverse effect. Reeves J. cautioned against generalizing from Ms. Gosselin's experience, and against over-reliance on opinion statements by experts in this regard, given the absence of any evidence to support the experts' claims about the material situation of individuals in the under-30 age group. He concluded: [translation] "It is therefore highly doubtful that the representative plaintiff, acting on behalf of some 75,000 individuals, has discharged her burden of proof concerning whether the law had adverse effects on them" (p. 1664).

47 I can find no basis upon which this Court can set aside this finding. There is no indication in the record that any welfare recipient under 30 wanting to participate in one of the programs was refused enrollment. Louise Gosselin, who in fact participated in each of the three programs, was the only witness to provide first-hand testimony about the programs at trial. There is no evidence that anyone who tried to access the programs was turned away, or that the programs were designed in such a way as to systematically exclude under-30s from participating. In fact, these programs were initially available *only* to people under 30 (and, in the case of the Remedial Education Program, to heads of single-parent households 30 and over); they were opened up to all welfare recipients in 1989. As the trial judge emphasized, the record contains no first-hand evidence supporting Ms. Gosselin's claim about the difficulties with the programs, and no indication that Ms. Gosselin can be considered representative of the under-30 class. It is, in my respectful opinion, utterly implausible to ask this Court to find the Quebec government guilty of discrimination under the *Canadian Charter* and order it to pay hundreds of millions of taxpayer dollars to tens of thousands of unidentified people, based on the testimony of a single affected individual. Nor does Ms. Gosselin present sufficient evidence that her own situation was a result of discrimination in violation of s. 15(1). The trial judge did not find evidence indicating a violation, and my review of the record does not reveal any error in this regard.

48 It is unnecessary to engage in the exercise of surmising how many program places would have been required had every eligible welfare recipient under 30 chosen to participate. In fact, contrary to her allegation, Ms. Gosselin's own experience clearly establishes that participation was a real possibility. For most of the relevant period, Ms. Gosselin's benefits were increased as a result of program participation. On those occasions when Ms. Gosselin dropped out of programs, the record indicates that this was due to personal problems, which included psychological and substance abuse components, rather than to flaws in the programs themselves. Ms. Gosselin's experience suggests that even individuals with serious problems were capable of supplementing their income under the impugned regime.

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49 Ms. Gosselin also objects to the fact that the Remedial Education Program yielded less of an increase in benefits than the other programs, leaving participants in that program with a lower basic entitlement than the older group. However, this seems to amount to little more than an incentive for young individuals to prefer some programs (On-the-job Training or Community Work) over another (Remedial Education). In addition, it is worth noting that the government provided books and other materials to Remedial Education participants free of charge. The decision to structure the programs in this particular fashion may be good or bad policy, but it does not establish a breach of the claimant's essential human dignity, or a lack of correlation between the provision and the affected group's actual circumstances.

50 My colleague Bastarache J. relies on the conclusion of Robert J.A., dissenting, that, based on the expert evidence, there were not enough places available in the programs to meet the needs of all welfare recipients under 30. This evidence was before the trial judge, who rejected it as insufficient and specifically cautioned against over-reliance on the experts' opinions. With respect, I am of the view that it is not open to this Court to revisit the trial judge's conclusion absent demonstrated error. Furthermore, my colleague appears to accept in the course of his s. 7 analysis that Ms. Gosselin's problems cannot be attributed solely to the age-based distinction she challenges under s. 15: He states, "[i]n this case, the threat to the appellant's right to security of the person [i.e., her poverty] was brought upon her by the vagaries of a weak economy, not by the legislature's decision not to accord her more financial assistance or to require her to participate in several programs in order for her to receive more assistance" (para. 217). And again: "[The appellant] has not demonstrated that the legislation, by excluding her, has reduced her security any more than it would have already been, given market conditions" (para. 222); "nor did the underinclusive nature of the Regulation substantially prevent or inhibit the appellant from protecting her own security" (para. 223).

51 My colleague Bastarache J. also relies on the claim that only a very small percentage of welfare recipients under 30 actually received the base amount allocated to those 30 and over, because the majority of participants tended to opt for the lower-paying Remedial Education Program (Robert J.A. cites a figure of 11.2 percent, apparently from an economist's 1988 report). The first point is, again, that the trial judge did not find Ms. Gosselin's statistical and expert evidence convincing, particularly given the absence of first-hand testimony from actual class members. But there are other problems. There is no evidence about why only about one-third of eligible welfare recipients participated in the programs. Nor is there evidence about the actual income of under-30s who did not participate; clearly "aid received" is not necessarily equivalent to "total income".

52 For these reasons, the appellant has not shown that the impugned Regulation effectively excluded her or others like her from the protection against extreme poverty afforded by the social security scheme. Rather, the effect was to cause young people to attend training and education programs as a condition of receiving the full "basic needs" level of social assistance. I do not believe that making payments conditional in this way violated the dignity or human worth of persons under 30 years of age. The condition was not imposed as a result of negative stereotypes. The condition did not effectively consign the appellant or others like her to extreme poverty. Finally, the condition did not force the appellant to do something that demeaned her dignity or human worth.

53 The long-term effects of the Regulation are also relevant in considering how a reasonable person in the claimant's position would have viewed the government program. The argument is that it imposed short-term pain. But the government thought that in the long run the program would benefit recipients under 30 by encouraging them to get training and find employment. We do not know whether it did so; the fact that the scheme was subsequently revamped may suggest the contrary. The point is simply this: Ms. Gosselin has not established, on the record before us, that the scheme did not correspond to the needs and situation of welfare recipients under 30 in the short or the long term, or that a reasonable person in her circumstances would have perceived that the government's efforts to equip her with training rather than simply giving her a monthly stipend denied her human dignity or treated her as less than a "full person" (Bastarache J., at para. 258).

54 It may well be that some under-30s fell through the cracks of the system and suffered poverty. However, absent concrete evidence, it is difficult to infer from this that the program failed to correspond to the actual needs of under-30s.

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I find no basis to interfere with the trial judge's conclusion that the record here simply does not support the contention of adverse effect on younger welfare recipients. This makes it difficult to conclude that the effect of the program did not correspond to the actual situation of welfare recipients under 30.

55 I add two comments. Perfect correspondence between a benefit program and the actual needs and circumstances of the claimant group is not required to find that a challenged provision does not violate the *Canadian Charter*. The situation of those who, for whatever reason, may have been incapable of participating in the programs attracts sympathy. Yet the inability of a given social program to meet the needs of each and every individual does not permit us to conclude that the program failed to correspond to the actual needs and circumstances of the affected group. As Iacobucci J. noted in *Law* , *supra*, at para. 105, we should not demand "that legislation must always correspond perfectly with social reality in order to comply with s. 15(1) of the *Charter*". Crafting a social assistance plan to meet the needs of young adults is a complex problem, for which there is no perfect solution. No matter what measures the government adopts, there will always be some individuals for whom a different set of measures might have been preferable. The fact that some people may fall through a program's cracks does not show that the law fails to consider the overall needs and circumstances of the group of individuals affected, or that distinctions contained in the law amount to discrimination in the substantives sense intended by s. 15(1).

56 Second, we cannot infer disparity between the purpose and effect of the scheme and the situation of those affected, from the mere failure of the government to prove that the assumptions upon which it proceeded were correct. Bastarache J. argues that the distinction between people under 30 and older people lacks a "rational basis" because it is "[b]ased on the unverifiable presumption that people under 30 had better chances of employment and lower needs" (para. 248). This seems to place on the legislator the duty to verify all its assumptions empirically, even where these assumptions are reasonably grounded in everyday experience and common sense. With respect, this standard is too high. Again, this is primarily a disagreement as to evidence, not as to fundamental approach. The legislator is entitled to proceed on informed general assumptions without running afoul of s. 15, *Law* , at para. 106, provided these assumptions are not based on arbitrary and demeaning stereotypes. The idea that younger people may have an easier time finding employment than older people is not such a stereotype. Indeed, it was relied on in *Law* to justify providing younger widows and widowers with a lesser survivor's benefit.

57 A final objection is that the selection of 30 years of age as a cut-off failed to correspond to the actual situation of young adults requiring social assistance. However, all age-based legislative distinctions have an element of this literal kind of "arbitrariness". That does not invalidate them. Provided that the age chosen is reasonably related to the legislative goal, the fact that some might prefer a different age — perhaps 29 for some, 31 for others — does not indicate a lack of sufficient correlation between the distinction and actual needs and circumstances. Here, moreover, there is no evidence that a different cut-off age would have been preferable to the one selected.

58 I conclude that the record in this case does not establish lack of correlation in purpose or effect between the ground of age and the needs and circumstances of welfare recipients under 30 in Quebec.

(c) The Ameliorative Purpose or Effects of the Impugned Law Upon a More Disadvantaged Person or Group in Society

59 A third factor to be considered in determining whether the group-based devaluation of human worth targeted by s. 15 is established, is whether the challenged distinction was designed to improve the situation of a more disadvantaged group. In *Law* , the Court took into account that the lower pensions for younger widows and widowers were linked to higher pensions for needier, less advantaged, widows and widowers: *Law* , at para. 103.

60 Here there is no link between creating an incentive scheme for young people involving lower benefits coupled with a program participation requirement, and providing more benefits for older or more disadvantaged people. From this perspective, this contextual factor is neutral. More broadly, the distinction in benefits can be argued to reflect the different situations of recipients under 30 and recipients 30 and over. It is true that younger people require as much to live as older people. However, we may take judicial notice of the increased difficulty older people may encounter in

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finding employment, as this Court did in *Law* . At the same time, the benefits of training and entry into the work force are greater for younger people than for older people: younger people have a longer career span ahead of them once they join the labour force, and, for them, dependence on welfare risks establishing a chronic pattern at an early age.

61 Viewed thus, the differential treatment of older and younger welfare recipients does not indicate that older recipients were more valued or respected than younger recipients. Older welfare recipients were, if not more disadvantaged (as in *Law*), "differently disadvantaged". Their different positions with respect to long-term employability as compared to younger people provided a reasonable basis for the legislature to tailor its programs to their different situations and needs. The provision of different initial amounts of monetary support to each of the two groups does not indicate that one group's dignity was prized above the other's. Those 30 and over and under-30s were not "similarly situated" in ways relevant to determining the appropriate level of social assistance in the form of unconditional welfare payments.

62 More generally, as discussed above, the Regulation was aimed at ameliorating the situation of welfare recipients under 30. A reasonable person in Ms. Gosselin's position would take this into account in determining whether the scheme treated under-30s as less worthy of respect and consideration than those 30 and over.

(d) Nature and Scope of the Interest Affected by the Impugned Law

63 This factor directs us to consider the impact of the impugned law — how "severe and localized the ... consequences [are] on the affected group": *Egan v. Canada*, [1995] 2 S.C.R. 513 (S.C.C.), at para. 63, quoted in *Law* , *supra*, at para. 74.

64 The trial judge, as noted, was unable to conclude that the evidence established actual adverse effects on welfare recipients under 30. The legislature thought it was helping under-30 welfare recipients; while we can surmise that the lower amount caused under-30s greater financial anxiety in the short term than a larger payment would have, we do not know how this actually played out in the context of the program participation scheme, or whether those 30 and over, who were only receiving 55 percent of the poverty level, experienced similar anxiety. The complainant argues that the lesser amount harmed under-30s and denied their essential human dignity by marginalizing them and preventing them from participating fully in society. But again, there is no evidence to support this claim. For those under 30 who were unable, for whatever reason, to increase their base entitlement, the lower base amount might have represented a significant adverse impact, depending on the availability of other resources, like family assistance. But even if we are prepared to accept that some young people must have been pushed well below the poverty line, we do not know how many, nor for how long. In this situation, it is difficult to gauge the nature and scope of the interests affected by the Regulation. We return once more to the central difficulty faced by the trial judge: despite Ms. Gosselin's claim to speak on behalf of 75,000 young people, she simply did not give the court sufficient evidence to support her allegation that the lower base amount was discriminatory, either against her or against the class as a whole.

65 Assessing the severity of the consequences also requires us to consider the positive impact of the legislation on welfare recipients under 30. The evidence shows that the regime set up under the *Social Aid Act* sought to promote the self-sufficiency and autonomy of young welfare recipients through their integration into the productive work force, and to combat the pernicious side effects of unemployment and welfare dependency. The participation incentive worked towards the realization of goals that go to the heart of the equality guarantee: self-determination, personal autonomy, self-respect, feelings of self-worth, and empowerment. These are the stuff and substance of essential human dignity: see *Law* , *supra*, at para. 53. I respectfully disagree with the suggestion that the incentive provisions somehow indicated disdain for young people or a belief that they could be made productive only through coercion. On the contrary, the program's structure reflected faith in the usefulness of education and the importance of encouraging young people to develop their skills and employability, rather than being consigned to dependence and unemployment. In my view, the interest promoted by the differential treatment at issue in this case is intimately and inextricably linked to the essential human dignity that animates the equality guarantee set out at s. 15(1) of the *Canadian Charter*.

66 We must decide this case on the evidence before us, not on hypotheticals, or on what we think the evidence ought to show. My assessment of the evidence leads me to conclude that, notwithstanding its possible short-term negative impact

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on the economic circumstances of some welfare recipients under 30 as compared to those 30 and over, the thrust of the program was to improve the situation of people in this group, and to enhance their dignity and capacity for long-term self-reliance. The nature and scope of the interests affected point not to discrimination but to concern for the situation of welfare recipients under 30. Absent more persuasive evidence to the contrary, I cannot conclude that a reasonable person in the claimant's position would have experienced this scheme as discriminatory, based on the contextual factors and the concern for dignity emphasized in *Law* .

(e) Summary of Contextual Factors Analysis

67 The question is whether a reasonable welfare recipient under age 30 who takes into account the contextual factors relevant to the claim would conclude that the lower base amount provided to people under 30 treated her, in purpose or effect, as less worthy and less deserving of respect, consideration and opportunity than people 30 and over. On the evidence before us, the answer to this question must be no.

68 Looking at the four contextual factors set out in *Law* , I cannot conclude that the denial of human dignity fundamental to a finding of discrimination is established. This is not a case where the complainant group suffered from pre-existing disadvantage and stigmatization. Lack of correspondence between the program and the actual circumstances of recipients under 30 is not established, in either purpose or effect. The "ameliorative purpose" factor is neutral with respect to discrimination. Finally, the findings of the trial judge and the evidence do not support the view that the overall impact on the affected individuals undermined their human dignity and their right to be recognized as fully participating members of society, notwithstanding their membership in the class affected by the distinction.

69 A reasonable welfare recipient under 30 might have concluded that the program was harsh, perhaps even misguided. (As noted, it eventually was repealed.) But she would not reasonably have concluded that it treated younger people as less worthy or less deserving of respect in a way that had the purpose or effect of marginalizing or denigrating younger people in our society. If anything, she would have concluded that the program treated young people as more able than older people to benefit from training and education, more able to get and retain a job, and more able to adapt to their situations and become fully participating and contributing members of society.

70 Far from relying on false stereotypes, the program was calibrated to address the particular needs and circumstances of young adults requiring social assistance, considered from both short-term and long-term perspectives. I do not suggest that stereotypical thinking must always be present for a finding that s. 15 is breached. However, its absence is a factor to be considered. The age-based distinction was made for an ameliorative, non-discriminatory purpose, and its social and economic thrust and impact were directed to enhancing the position of young people in society by placing them in a better position to find employment and live fuller, more independent lives. Nor, on the findings of the trial judge, is it established that the program's effect was to undermine the worth of its members in comparison with older people.

71 The most compelling way to put the claimant's case is this. We are asked to infer from the apparent lack of widespread participation in programs that some recipients under 30 must at some time have been reduced to utter poverty. From this we are further asked to infer that at least some of these people's human dignity and ability to participate as fully equally members of society were compromised.

72 The inferences that this argument asks us to draw are problematic. The trial judge, as discussed, was unable to find evidence of actual adverse impact on under-30s as a group. Moreover, the argument rests on a standard of perfection in social programs. As this Court noted in *Law* , that is not the standard to be applied. Some people will always fall through the cracks of social programs. That does not establish denial of human dignity and breach of s. 15. What is required is demonstration that the program as a whole and in the context of *Law* 's four factors in purpose or effect denied human dignity to the affected class, penalizing or marginalizing them simply for being who they were. In this case, that has not been shown.

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73 In many respects, the case before us is strikingly similar to *Law* . The provision there drew an age-based distinction in a survivor's entitlement to pension benefits, allocating no benefit to survivors who were under 35 years of age at the time of the contributor's death, in the absence of specific circumstances provided for in the legislation. The provision here draws an age-based distinction in an unemployed individual's entitlement to welfare benefits, allocating a reduced monetary benefit coupled with a program participation incentive to unemployed individuals who are under 30 years of age at the time of receipt, in the absence of specific circumstances provided for in the Regulation. The appellant in *Law* argued that the distinction, however well intentioned, was based on a faulty assumption that younger people can more easily obtain employment than older people. The appellant here argues that the distinction, however well intentioned, is based on a faulty assumption that younger people can more easily obtain employment than older people. The appellant in *Law* emphasized short-term differences, while the respondent emphasized long-term needs. The appellant here emphasizes short-term differences, while the respondent emphasizes long-term needs. The Court held in *Law* that while the law contained a facial age-based distinction that treated younger people adversely, "the differential treatment does not reflect or promote the notion that they are less capable or less deserving of concern, respect, and consideration, when the dual perspectives of long-term security and the greater opportunity of youth are considered" (para. 102). Similarly here, the aim of the legislation in averting long-term dependency on welfare and promoting insertion into the labour force, coupled with the provision of job training and remedial education programs, leads to the conclusion that the differential treatment does not reflect or promote the notion that young people are less capable or less deserving of concern, respect, and consideration. The Court found in *Law* that the legislation's failure to correspond perfectly to the circumstances of each and every individual member of the affected group did not "affect the ultimate conclusion that the legislation is consonant with the human dignity and freedom of the appellant" (para. 106). Likewise here, the legislation's arguable failure to correspond perfectly to Ms. Gosselin's personal circumstances, the only circumstances described in the record, does not affect the ultimate conclusion that the legislation is consonant with her human dignity and freedom, and with the human dignity and freedom of under-30s generally.

74 I conclude that the impugned law did not violate the essential human dignity of welfare recipients under 30. We must base our decision on the record before us, not on personal beliefs or hypotheticals. On the facts before us, the law did not discriminate against Ms. Gosselin, either individually or as a member of the group of 18- to 30-year-olds in Quebec. The differential welfare scheme did not breach s. 15(1) of the *Canadian Charter*.

B. Does the Social Assistance Scheme Violate Section 7 of the Canadian Charter?

75 Section 7 states that "[e]veryone has the right to life, liberty and security of the person" and "the right not to be deprived" of these "except in accordance with the principles of fundamental justice". The appellant argues that the s. 7 right to security of the person includes the right to receive a particular level of social assistance from the state adequate to meet basic needs. She argues that the state deprived her of this right by providing inadequate welfare benefits, in a way that violated the principles of fundamental justice. There are three elements to this claim: (1) that the legislation affects an interest protected by the right to life, liberty and security of the person within the meaning of s. 7; (2) that providing inadequate benefits constitutes a "deprivation" by the state; and (3) that, if deprivation of a right protected by s. 7 is established, this was not in accordance with the principles of fundamental justice. The factual record is insufficient to support this claim. Nevertheless, I will examine these three elements.

76 The first inquiry is whether the right here contended for — the right to a level of social assistance sufficient to meet basic needs — falls within s. 7. This requires us to consider the content of the right to life, liberty and security of person, and the nature of the interests protected by s. 7.

77 As emphasized by my colleague Bastarache J., the dominant strand of jurisprudence on s. 7 sees its purpose as guarding against certain kinds of deprivation of life, liberty and security of the person, namely, those "that occur as a result of an individual's interaction with the justice system and its administration": *New Brunswick (Minister of Health & Community Services) v. G. (J.)*, [1999] 3 S.C.R. 46 (S.C.C.), at para. 65. "[T]he justice system and its administration" refers to "the state's conduct in the course of enforcing and securing compliance with the law", (*G. (J.)*, at para. 65).

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This view limits the potential scope of "life, liberty and security of person" by asking whom or what s. 7 protects against. Under this narrow interpretation, s. 7 does not protect against all measures that might in some way impinge on life, liberty or security, but only against those that can be attributed to state action implicating the administration of justice: see *Reference re ss. 193 & 195.1(1)(c) of the Criminal Code (Canada)*, [1990] 1 S.C.R. 1123 (S.C.C.) (the "*Prostitution Reference*"), at pp. 1173-74, *per* Lamer J. (as he then was), writing for himself; *B. (R.) v. Children's Aid Society of Metropolitan Toronto* (1994), [1995] 1 S.C.R. 315 (S.C.C.), at paras. 21-23, *per* Lamer C.J., again writing for himself alone; and *G. (J.), supra*, for the majority. This approach was affirmed in *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, 2000 SCC 44 (S.C.C.), *per* Bastarache J. for the majority.

78 This Court has indicated in its s. 7 decisions that the administration of justice does not refer exclusively to processes operating in the criminal law, as Lamer C.J. observed in *G. (J.), supra*. Rather, our decisions recognize that the administration of justice can be implicated in a variety of circumstances: see *Blencoe* , *supra* (human rights process); *B. (R.)* , *supra*, (parental rights in relation to state-imposed medical treatment); *G. (J.), supra*, (parental rights in the custody process); *Winnipeg Child & Family Services (Northwest Area) v. G. (D.F.)*, [1997] 3 S.C.R. 925 (S.C.C.), (liberty to refuse state-imposed addiction treatment). Bastarache J. argues that s. 7 applies only in an adjudicative context. With respect, I believe that this conclusion may be premature. An adjudicative context might be sufficient, but we have not yet determined that one is *necessary* in order for s. 7 to be implicated.

79 In my view, it is both unnecessary and undesirable to attempt to state an exhaustive definition of the administration of justice at this stage, delimiting all circumstances in which the administration of justice might conceivably be implicated. The meaning of the administration of justice, and more broadly the meaning of s. 7, should be allowed to develop incrementally, as heretofore unforeseen issues arise for consideration. The issue here is not whether the administration of justice is implicated — plainly it is not — but whether the Court ought to apply s. 7 despite this fact.

80 Can s. 7 apply to protect rights or interests wholly unconnected to the administration of justice? The question remains unanswered. In *R. v. Morgentaler*, [1988] 1 S.C.R. 30 (S.C.C.), at p. 56, Dickson C.J., for himself and Lamer J. entertained (without deciding on) the possibility that the right to security of the person extends "to protect either interests central to personal autonomy, such as a right to privacy". Similarly, in *Irwin Toy Ltd. c. Québec (Procureur général)*, [1989] 1 S.C.R. 927 (S.C.C.), at p. 1003, Dickson C.J., for the majority, left open the question of whether s. 7 could operate to protect "economic rights fundamental to human ... survival". Some cases, while on their facts involving the administration of justice, have described the rights protected by s. 7 without explicitly linking them to the administration of justice: *B.(R.)*, supra; *G. (D.F.)*, *supra*.

81 Even if s. 7 could be read to encompass economic rights, a further hurdle emerges. Section 7 speaks of the right *not to be deprived* of life, liberty and security of the person, except in accordance with the principles of fundamental justice. Nothing in the jurisprudence thus far suggests that s. 7 places a positive obligation on the state to ensure that each person enjoys life, liberty or security of the person. Rather, s. 7 has been interpreted as restricting the state's ability to *deprive* people of these. Such a deprivation does not exist in the case at bar.

82 One day s. 7 may be interpreted to include positive obligations. To evoke Lord Sankey's celebrated phrase in *Edwards v. Canada (Attorney General)* (1929), [1930] A.C. 124 (Canada P.C.), the *Canadian Charter* must be viewed as "living tree capable of growth and expansion within its natural limits": see *Reference re Provincial Electoral Boundaries*, [1991] 2 S.C.R. 158 (S.C.C.), at p. 180, *per* McLachlin J. It would be a mistake to regard s. 7 as frozen, or its content as having been exhaustively defined in previous cases. In this connection, LeBel J.'s words in *Blencoe v. British Columbia (Human Rights Commission)*, *supra*, at para. 188 are apposite:

> We must remember though that s. 7 expresses some of the basic values of the *Charter*. It is certainly true that we must avoid collapsing the contents of the *Charter* and perhaps of Canadian law into a flexible and complex provision like s. 7. But its importance is such for the definition of substantive and procedural guarantees in Canadian law that it would be dangerous to freeze the development of this part of the law. The full impact of s. 7 will remain difficult

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> to foresee and assess for a long while yet. Our Court should be alive to the need to safeguard a degree of flexibility in the interpretation and evolution of s. 7 of the *Charter*.

The question therefore is not whether s. 7 has ever been — or will ever be — recognized as creating positive rights. Rather, the question is whether the present circumstances warrant a novel application of s. 7 as the basis for a positive state obligation to guarantee adequate living standards.

83 I conclude that they do not. With due respect for the views of my colleague Arbour J., I do not believe that there is sufficient evidence in this case to support the proposed interpretation of s. 7. I leave open the possibility that a positive obligation to sustain life, liberty, or security of person may be made out in special circumstances. However, this is not such a case. The impugned program contained compensatory "workfare" provisions and the evidence of actual hardship is wanting. The frail platform provided by the facts of this case cannot support the weight of a positive state obligation of citizen support.

84 In view of my conclusions under s. 15(1) and s. 7 of the *Canadian Charter*, the issue of justification under s. 1 does not arise. Nor does the issue of *Canadian Charter* remedies arise.

C. Does the Social Assistance Scheme Violate Section 45 of the Quebec Charter?

85 Section 45 of the *Quebec Charter* provides that every person in need has a right to "measures of financial assistance and to social measures provided for by law, susceptible of ensuring such person an acceptable standard of living".

86 Ms. Gosselin argues that s. 45 creates a right to an acceptable standard of living and that Quebec's social assistance scheme breached that right. On this issue, she substantially echoes the position of Robert J.A., dissenting, in the Quebec Court of Appeal. She further argues that a remedy for this alleged breach ought to be available under s. 49 of the *Quebec Charter*, a proposition that Robert J.A. rejected.

87 There can be no doubt that s. 45 purports to create a right. However, determining the scope and content of that right presents something of a challenge, as s. 45 is ambiguous, admitting of two possible interpretations. According to the first interpretation, by providing a right to "measures provided for by law, susceptible of ensuring ... an adequate standard of living", s. 45 requires courts to review social assistance measures adopted by the legislature to determine whether or not they succeed in ensuring an adequate standard of living. This is the approach urged upon us by the appellant.

88 A second interpretation reads s. 45 as creating a far more limited right. On this view, s. 45 requires the government to provide social assistance measures, but it places the adequacy of the particular measures adopted beyond the reach of judicial review. The phrase "susceptible of ensuring ... an adequate standard of living" serves to identify the measures that are the subject matter of the entitlement, i.e. to specify the *kind* of measures the state is obliged to provide, but it cannot ground a review of their adequacy. In my view, several considerations militate in favour of this second interpretation, as I indicate below.

89 Attention to the other provisions of Chapter IV of the *Quebec Charter*, entitled "Economic and Social Rights", helps to put s. 45 in context, and sheds considerable light on the interpretive issue. Some of the provisions in Chapter IV deal with rights as between individuals, and do not directly implicate the state at all. For example, s. 39 provides that "[e]very child has the right to the protection, security and attention that his parents or the persons acting in their stead are capable of providing", However, most of Chapter IV's provisions do implicate the state, including s. 45. Of these provisions implicating the state, all but two deal with "positive rights". That is, the rights described correspond to obligations for the state to do, or to provide, something. These include s. 40 (right to free public education); s. 41 (right to religious or moral education); and s. 44 (right to information).

90 Most of the provisions creating positive rights contain limiting language sharply curtailing the scope of the right. For example, the right to free public education provided at s. 40 is stated in the following terms: "[e]very person has a right, *to the extent and according to the standards provided for by law*, to free public education" (emphasis added). It

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would be misleading to characterize that right as creating a free-standing entitlement to free public education, in light of this limitation. Rather, the language of the provision suggests that the particulars of the regime enacted by the legislature in order to provide free education are beyond judicial review of their sufficiency.

91 This same structure applies to other key provisions in Chapter IV. For example:

> **41.** Parents or the persons acting in their stead have a right to require that, in the public educational establishments, their children receive a religious or moral education in conformity with their convictions, within the framework of the curricula provided for by law.
>
> **42.** Parents or the persons acting in their stead have a right to choose private educational establishments for their children, provided such establishments comply with the standards prescribed or approved by virtue of the law.
>
> **44.** Every person has a right to information to the extent provided by law.
>
> **46.** Every person who works has a right, in accordance with the law, to fair and reasonable conditions of employment which have proper regard for his health, safety and physical well-being.

92 In all these cases, the rights provided are limited in such a way as to put the specific legislative measures or framework adopted by the legislature beyond the reach of judicial review. These provisions require the state to take steps to make the Chapter IV rights effective, but they do not allow for the judicial assessment of the adequacy of those steps. Indeed, the *only* provision creating a positive right that does not display this feature is s. 48, which states that "[e]very aged person and every handicapped person has a right to protection against any form of exploitation." However, this provision seems distinguishable in that, unlike the other rights discussed above, the right contemplated does not *a priori* require the adoption of a special regime for its fulfilment.

93 Was s. 45 intended to make the adequacy of a social assistance regime's specific provisions subject to judicial review, unlike the neighbouring provisions canvassed above? Had the legislature intended such an exceptional result, it seems to me that it would have given effect to this intention unequivocally, using precise language. There are examples of legal documents purporting to do just that. For example, Article 11 of the *International Covenant on Economic, Social and Cultural Rights*, 993 U.N.T.S. 3, recognizes "the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions". Article 22 of the *Universal Declaration of Human Rights*, G.A. Res. 217A (III), U.N. Doc. A/810, at 71 (1948), provides that "[e]veryone, as a member of society, has the right to social security" and is "entitled to realization ... of the economic, social and cultural rights indispensable for his dignity and the free development of his personality". Article 25(1) provides that:

> Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.

In contrast to these provisions, which unambiguously and directly define the rights to which individuals are entitled (even though they may not be actionable), s. 45 of the *Quebec Charter* is highly equivocal. Indeed, s. 45 features *two layers* of equivocation. Rather than speaking of a right to an adequate standard of living, s. 45 refers to a right to *measures*. Moreover, the right is not to measures that ensure an adequate standard of living, but to measures that are *susceptible of ensuring* an adequate standard of living. In my view, the choice of the term "susceptible" underscores the idea that the measures adopted must be oriented toward the goal of ensuring an adequate standard of living, but are not required to achieve success. In other words, s. 45 requires only that the government be able to point to measures of the appropriate *kind*, without having to defend the wisdom of its enactments. This interpretation is also consistent with the respective institutional competence of courts and legislatures when it comes to enacting and fine-tuning basic social policy.

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94 For these reasons, I am unable to accept the view that s. 45 invites courts to review the adequacy of Quebec's social assistance regime. The *Social Aid Act* provides the *kind* of "measures provided for by law" that satisfy s. 45. I conclude that there was no breach of s. 45 of the *Quebec Charter* in this case.

95 Notwithstanding my conclusion that there is no breach of s. 45, I wish to make a brief comment on the issue of remedies. I agree with much that my colleague Bastarache J. says on the question of remedies. In particular, I agree that a breach of s. 45 cannot give rise to a declaration of invalidity, since such a remedy is available only under s. 52 of the *Quebec Charter*, which applies exclusively to s. 1 to s. 38. I further agree that s. 49 finds no application to a case such as this. However, I must respectfully disagree with Bastarache J. that it follows from the foregoing considerations that determining whether s. 45 has been breached is superfluous.

96 While it is true that courts lack the power to strike down laws that are inconsistent with the social and economic rights provided in Chapter IV of the *Quebec Charter*, it does not follow from this that courts are excused from considering claims based upon these rights. Individuals claiming their rights have been violated under the *Charter* are entitled to have those claims adjudicated, in appropriate cases. The *Quebec Charter* is a legal document, purporting to create social and economic *rights*. These may be symbolic, in that they cannot ground the invalidation of other laws or an action in damages. But there *is* a remedy for breaches of the social and economic rights set out in Chapter IV of the *Quebec Charter*: where these rights are violated, a court of competent jurisdiction can declare that this is so.

V. Conclusion

97 I would dismiss the appeal. I conclude that Quebec's social assistance scheme, as it stood from 1987 to 1989, did not violate s. 7 or s. 15(1) of the *Canadian Charter*, or s. 45 of the *Quebec Charter*. Accordingly, I would answer the constitutional questions as follows:

> 1. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q. c. A-16, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* on the ground that it established a discriminatory distinction based on age with respect to individuals, capable of working, aged 18 to 30 years?
>
> A: No.
>
> 2. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> A: In view of the answer to Question 1, it is not necessary to answer this question.
>
> 3. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q. c. A-16, infringe s. 7 of the *Canadian Charter of Rights and Freedoms* on the ground that it deprived those to whom it applied of their right to security of the person contrary to the principles of fundamental justice?
>
> A: No.
>
> 4. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> A: In view of the answer to Question 3, it is not necessary to answer this question.

***L'Heureux-Dubé J.*:**

I. Introduction

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98 This appeal raises the question of the constitutionality of s. 29(*a*) of the *Regulation Respecting social aid*, R.R.Q., c. A-16, r. 1 (since repealed). In my opinion, s. 29(*a*) does violate ss. 15 and 7 of the Canadian Charter of Rights and Freedoms ("the *Charter*") without justification, as well as s. 45 of the Quebec *Charter of Human Rights and Freedoms*, R.S.Q., c. C-12. Accordingly, I would allow the appeal.

99 In reaching these conclusions, I agree with my colleagues Bastarache and LeBel JJ., in the result, as to the violation of s. 15, and with my colleague Arbour J.'s reasons as to the violation of s. 7 of the *Charter*. As to s. 45 of the Quebec *Charter*, I am basically in agreement with the dissenting opinion of Robert J.A. (now Chief Justice) of the Quebec Court of Appeal ([1999] R.J.Q. 1033), and therefore disagree with the opinion of LeBel J. on this issue.

100 Since I have some reservations and comments on each of the above analyses I set out the following remarks.

II. Analysis

A. Section 15

101 The present facts provide this Court with an opportunity to revisit the fundamental objectives of, and reaffirm its commitment to, the *Charter*'s equality guarantee.

102 The purpose of a s.15 inquiry is to determine whether the claimant has received substantive equality or equal benefit before and under the law. Equality is denied when the claimant suffers the pernicious effects of a distinction drawn on the basis of an irrelevant characteristic. Such a distinction may be drawn on an enumerated or analogous ground and appear on the face of the law. Alternatively, the distinction may be facially neutral and the negative effects may uniquely be visited upon individuals who possess a personal characteristic that corresponds to the enumerated or analogous grounds. In either case, discrimination is the result.

103 The *Charter*'s structure dictates that even a finding that the claimant has been denied substantive equality is not the final step of the inquiry; it is possible for the infringement of s. 15 to be justified under s. 1. It is important to remember that the s. 15 inquiry precedes, and must always be kept distinct from, the s. 1 analysis. The evaluation of a s. 15 claim must always remain focussed on the particular claimant and his or her experience of the law.

104 The above comments should be uncontroversial, grounded as they are in this Court's equality jurisprudence. Yet it appears necessary to recall what the purposes of s. 15 are, and what they are not. Presumptively excluding from s. 15's protection groups which clearly fall within an enumerated category does not serve the purposes of the equality guarantee. Abstract discussion about the nature of particular grounds does not serve the purposes of s. 15. Blurring the division between the rights provisions and s. 1 of the *Charter*, by incorporating the perspective of the legislature in a s. 15 analysis, is at odds with this Court's approach to equality and surely does not serve the purposes of s. 15.

105 A majority of this Court has held that the objective of s. 15 is to affirm the dignity of individuals and groups by protecting them from unfair governmental action, which differentiates on the basis of characteristics that can be changed, if at all, only at great personal cost: *Corbiere v. Canada (Minister of Indian & Northern Affairs)*, [1999] 2 S.C.R. 203 (S.C.C.), at para. 13. The characteristics which fall within the scope of s. 15's protective ambit have been expressly enumerated by the legislature, or found to be analogous grounds by the judiciary: *Andrews v. Law Society (British Columbia)*, [1989] 1 S.C.R. 143 (S.C.C.); *Law v. Canada (Minister of Employment & Immigration)*, [1999] 1 S.C.R. 497 (S.C.C.).

106 This Court has previously been divided over the question of whether certain characteristics should be recognized as analogous grounds. See, e.g., *Miron v. Trudel*, [1995] 2 S.C.R. 418 (S.C.C.), on the question of whether marital status constitutes an analogous ground. In the present case, we are in the unusual circumstance of disagreeing about whether to respect s. 15's express wording. Those who would "typically" exclude youth from protection under the ground of age ignore both the plain language of the *Charter*, and the method that this Court has adopted for s. 15 inquiries.

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107 Under the *Law* test, the presence of a distinction made on the basis of an analogous ground is essentially a threshold question that leads to the heart of the inquiry, the question of whether the distinction infringes human dignity and contradicts the purposes of s. 15. It would appear that some are reluctant to accept that an explicit legislative distinction drawn on the basis of an enumerated ground satisfies the threshold requirement that permits courts to proceed to a detailed contextual analysis under the third stage of the *Law* inquiry.

108 Age is an enumerated ground. This Court has concluded that once recognized, an analogous ground remains a permanent marker of suspect distinction in all contexts: *Corbiere* , *supra*. It would seem to follow that grounds explicitly enumerated in s. 15 were similarly permanent markers. Admittedly, the Constitution ousts the protection afforded by this ground in specific contexts. See *Constitution Act, 1867*, ss. 23, 29 and 99, and the discussion in P. W. Hogg, *Constitutional Law of Canada* (loose-leaf ed.), vol. 2, at p. 52-47. However, the *Charter* could have contained a general provision which excluded those below a certain age threshold from protection *against discrimination, as p*rovincial human rights codes have done. *See, e.g., Ontario Human Rights Code, R.S.O. 1990, c. H.19, s. 10(1)* "age". The *Charter* contains no such provision.

109 Any attempt to read the limited range of provincial human rights codes' age protections into s. 15 must fail. Provincial human rights codes in the employment context expressly exclude those 65 and over from protection on the grounds of age: Ontario *Human Rights Code*, ss.5(1) and 10(1) "age". This Court has declined to follow this example in its s. 15 jurisprudence. It has held that those the age of 65 and over fall within the scope of s. 15's protection, although government action that discriminates on this basis may be saved under s. 1: *McKinney v. University of Guelph*, [1990] 3 S.C.R. 229 (S.C.C.); *Harrison v. University of British Columbia*, [1990] 3 S.C.R. 451 (S.C.C.); *Stoffman v. Vancouver General Hospital*, [1990] 3 S.C.R. 483 (S.C.C.); and *Tétreault-Gadoury v. Canada (Employment & Immigration Commission)*, [1991] 2 S.C.R. 22 (S.C.C.). This Court's jurisprudence on age discrimination has respected the express wording of s. 15, even in the face of contrary tendencies in quasi-constitutional statutes. I see no principled reason to depart from this history of fidelity to the *Charter*'s text and aspirations.

110 Moreover, any attempt to presumptively exclude youth from s. 15 protection, for the reason that age is a unique ground, misplaces the focus of a s. 15 inquiry. The proper focus of analysis is on the effects of discrimination, and not on the categorizing of grounds. In *Egan v. Canada*, [1995] 2 S.C.R. 513 (S.C.C.), at paras. 48 and 53, I wrote:

> We must remember that the grounds in s. 15, enumerated and analogous, are instruments for finding discrimination. They are a means to an end. By focussing almost entirely on the nature, content and context of the disputed ground, however, we have begun to approach it as an end, in and of itself. ...
>
> We will never address the problem of discrimination completely, or ferret it out in all its forms, if we continue to focus on abstract categories and generalizations rather than on specific effects. [Emphasis deleted.]

111 I recently restated this position in *Dunmore v. Ontario (Attorney General)*, [2001] 3 S.C.R. 1016, 2001 SCC 94 (S.C.C.), at para. 166. I remain convinced that a discrimination claim should be evaluated primarily in terms of an impugned distinction's effects, as they would have been experienced by a reasonable person in the claimant's position. The point of departure should *not* lie in abstract generalizations about the nature of grounds.

112 Since courts engaged in a s. 15 analysis should focus on the effects of an impugned distinction, they should also refrain from relying on the viewpoint of the legislature. At the s. 15 stage, courts should not be concerned with whether the legislature was well-intentioned. This Court has long recognized that an intention to discriminate is not a necessary condition for a finding of discrimination: *O'Malley v. Simpsons-Sears Ltd.*, [1985] 2 S.C.R. 536 (S.C.C.); *Canadian National Railway v. Canada (Human Rights Commission)*, [1987] 1 S.C.R. 1114 (S.C.C.); *Brooks v. Canada Safeway Ltd.*, [1989] 1 S.C.R. 1219 (S.C.C.); and *Andrews* , *supra*, at pp. 173-74. By necessary implication, the fact that a legislature intends to *assist* the group or individual adversely affected by the impugned distinction also does not preclude a court from finding discrimination. Nor is it determinative, where a distinction produces prejudicial effects, that a

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legislature intends to provide an incentive for the affected individuals to alter their conduct or to change themselves in ways that the legislature believes would ultimately be beneficial for them: *Lavoie v. Canada*, 2002 SCC 23 (S.C.C.) , at paras. 5, *per* McLachlin C.J. and L'Heureux-Dubé J., dissenting, and 51, *per* Bastarache J.

113 Of course, benign legislative intent may aid in saving a discriminatory distinction at s. 1, but that is a separate inquiry. In the earliest moments of its *Charter* jurisprudence, this Court insisted that the analysis of the right at issue should be kept separate from the inquiry into an impugned distinction's justification: *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.); *Andrews* , *supra*, at p.182. As we enter the third decade of the *Charter*'s existence, I see no reason to depart from this fundamental division. Moreover, I am unable to imagine how a departure could result in anything but a weakening of the equality guarantee.

(1) The Law Test

114 This Court has repeatedly affirmed the importance of protecting individuals and groups from the negative effects of discrimination, as these are defined from the perspective of the reasonable person in the claimant's position. The *Law* test is one such affirmation. I turn now to the question of how that test should be interpreted to ensure that human dignity remains the fundamental reference point for any evaluation of a s. 15 claim.

115 It is undisputed that s. 29(a) draws a distinction on an enumerated ground. All that remains under the *Law* test is to determine whether the impugned provision denies human dignity in purpose or effect. I begin by setting out two broad principles which should animate any application of *Law* : (1) discrimination need not involve stereotypes, and (2) the reasonable claimant is the perspective from which to evaluate a s. 15 claim.

(a) Discrimination Without Stereotypes

116 In addressing the question of stereotypes, it is worth quoting in full the unanimous Court in *Law* 's consolidation of various interpretive approaches to s. 15:

> It may be said that the purpose of s. 15(1) is to prevent the violation of essential human dignity and freedom through the imposition of disadvantage, stereotyping, or political or social prejudice, and to promote a society in which all persons enjoy equal recognition at law as human beings or as members of Canadian society, equally capable and equally deserving of concern, respect and consideration. Legislation which effects differential treatment between individuals or groups will violate this fundamental purpose where those who are subject to differential treatment fall within one or more enumerated or analogous grounds, and <u>where the differential treatment reflects the stereotypical application of presumed group or personal characteristic, or otherwise has the effect of perpetuating or promoting the view that the individual is less capable, or less worthy of recognition or value as a human being or as a member of Canadian society</u>. [Emphasis added.]

This passage presents the application of stereotypical characteristics, and the "effect of perpetuating or promoting the view that the individual is less capable, or less worthy of recognition" as *alternative* bases for finding discrimination. The presence of a stereotype is therefore not a necessary condition for a finding of discrimination and support for this proposition can be found throughout this Court's equality jurisprudence.

117 In *Andrews* , McIntyre J. rejected the Court of Appeal's attempt to "define discrimination under s. 15(1) as an unjustifiable or unreasonable distinction" (p. 181), and reasoned that such a definition would undermine the division between s. 15 and s. 1 (p. 182). A distinction that is stereotypical is necessarily unjustifiable or unreasonable. Consequently, the presence of a stereotype is not determinative of a finding of a discrimination.

118 One may object that McIntyre J.'s assertion only demonstrates that the presence of a stereotype is not sufficient grounds for a finding of discrimination. However, both *Andrews* itself and this Court's subsequent jurisprudence on adverse effect discrimination make clear that the presence of stereotypes is also not a necessary condition for a finding of discrimination.

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119 The distinction drawn in *Andrews* was discriminatory because it was irrelevant and singled out a group that was understood to fall within the ambit of s. 15's concern. McIntyre J. held ((at p. 183):

> A rule which bars an entire class of persons from certain forms of employment, solely on the grounds of a lack of citizenship status and without consideration of educational and professional qualifications or the other attributes or merits of individuals in the group, would, in my view, infringe s. 15 equality rights.

McIntyre J. reached his conclusion without considering the question of stereotypes, and this Court's jurisprudence demonstrates that stereotypes need not be present for a finding of adverse effect discrimination.

120 A distinction that results in adverse effect discrimination need not, of course, include an intention to discriminate. In this Court's definitive statement on indirect discrimination, McLachlin J. (as she then was) held that adverse effects are "unwitting, accidental" (*British Columbia (Public Service Employee Relations Commission) v. B.C.G.E.U.*, [1999] 3 S.C.R. 3 (S.C.C.), at para. 49). A neutral distinction, or one that "unwittingly" yields negative effects, is by definition not premised on a negative stereotype. Such distinctions yield, without justification, disproportionately negative impacts on groups recognized as being within the scope of an equality provision's protection. In *B.C.G.E.U.* , McLachlin J. held (at para. 33):

> The standard itself is discriminatory precisely because it treats some individuals differently from others, on the basis of a prohibited ground: see generally *Toronto-Dominion Bank, supra*, at paras. 140-41, *per* Roberston J.A. As this Court held in *Law v. Canada (Minster of Employment and Immigration)*, [1999] 1 S.C.R. 497, at para. 66, if a rule has a substantively discriminatory effect on a prohibited ground, it should be characterized as such regardless of whether the claimant is a member of a majority or minority group.

In *B.C.G.E.U.* , the facially neutral standard was discriminatory because it had the effect of disproportionately excluding women. As in *Andrews* , *supra*, an analysis of stereotypes was simply not necessary for the disposition of the case. Prejudicial effects giving rise to a s. 15 claim may result when a legislature simply fails to turn its mind to the particular needs and abilities of individuals or groups so as to provide equal benefit under the law to all members of society: *B.C.G.E.U.* , at para. 33; *Eldridge v. British Columbia (Attorney General)*, [1997] 3 S.C.R. 624 (S.C.C.).

(b) Dignity Through the Eyes of the Reasonable Claimant

121 If a stereotype is not a necessary or sufficient condition for a finding of discrimination, there must be other relevant indicators. *Law* listed four contextual factors to which a claimant can refer to demonstrate that a distinction has the effect of demeaning his or her dignity. Before considering these, it would be helpful to revisit *Law* 's understanding of human dignity. I reproduce in full a particularly illuminating passage (at para. 53):

> Human dignity means that an individual or group feels self-respect and self-worth. It is concerned with physical and psychological integrity and empowerment. Human dignity is harmed by unfair treatment premised upon personal traits or circumstances which do not relate to individual needs, capacities or merits. It is enhanced by laws which are sensitive to the needs, capacities, and merits of different individuals, taking into account the context underlying their differences. Human dignity is harmed when individuals and groups are marginalized, ignored, or devalued, and is enhanced when laws recognize the full place of all individuals and groups within Canadian society. Human dignity within the meaning of the equality guarantee does not relate to the status or position of an individual in society *per se*, but rather concerns the manner in which a person legitimately feels when confronted with a particular law. Does the law treat him or her unfairly, taking into account all of the circumstances regarding the individuals affected and excluded by the law?

122 This passage serves as a reminder that discrimination can arise in circumstances other than in the presence of stereotypes, and removes an ambiguity in the previously cited discussion of equality (see above, at para. 116). On one reading, the phrase "or otherwise has the effect of perpetuating or promoting the view that the individual is less

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capable, or less worthy of recognition", taken together with the phrase "stereotypical application of presumed group or personal characteristic" (see above, at para. 116), may be understood to suggest that discrimination only arises where there has been a message sent to the community at large that is demeaning to the claimant. By contrast, the present passage unequivocally reveals that dignity can be infringed even if the "message" is conveyed only to the claimant.

123 The passage makes clear that if individual interests including physical and psychological integrity are infringed, a harm to dignity results. Such infringements undermine the individual's self-respect and self-worth. They communicate to the individual that he or she is not a full member of Canadian society. Moreover, this passage proposes a reasonableness standard when it discusses what the claimant "legitimately feels when confronted with a particular law". In these descriptions of human dignity, one can hear echoes of my position in the 1995 trilogy. In *Egan* , *supra*, I held (at para. 56) that the examination of whether a distinction is discriminatory

> should be undertaken from a subjective-objective perspective: i.e. from the point of view of the reasonable person, dispassionate and fully apprised of the circumstances, possessed of similar attributes to, and under similar circumstances as, the group of which the rights claimant is a member.

This Court has recently expressed its continuing support for this "reasonable claimant" standard in *Ardoch Algonquin First Nation & Allies v. Ontario*, [2000] 1 S.C.R. 950, 2000 SCC 37 (S.C.C.), at para. 55. See also *Corbiere* , *supra*, at para. 65; *Granovsky v. Canada (Minister of Employment & Immigration)*, [2000] 1 S.C.R. 703, 2000 SCC 28 (S.C.C.), , at para. 81; *Winko v. Forensic Psychiatric Institute*, [1999] 2 S.C.R. 625 (S.C.C.), at para. 75.

124 These preliminary remarks about *Law* serve as reminders that stereotypes are not needed to find a distinction to be discriminatory, and that the reasonable claimant is the perspective from, and the standard by which to evaluate a discrimination claim. With these remarks in mind, it is now time to turn to a consideration of the *Law* factors.

(c) Putting Effects First in Law

125 The four factors in *Law* are: (1) pre-existing disadvantage, (2) relationship between grounds and the claimant's characteristics or circumstances, (3) ameliorative purposes or effects, and (4) the nature of the interest affected.

126 Although this Court made clear in *Law* that it is not necessary that all four factors be present for there to be a finding that a claimant's human dignity has been infringed, and indeed that the presence or absence of no factor is determinative, subsequent applications of the *Law* test have typically attempted to either refute or establish every factor. See e.g., *Corbiere* , *supra*, and *Ardoch Algonquin First Nation & Allies* , *supra*.

127 In addition, although the Court in *Law* held that "the most compelling factor favouring a conclusion that differential treatment imposed by legislation is truly discriminatory will be, where it exists, pre-existing disadvantage, vulnerability, stereotyping, or prejudice experienced by the individual or group" (para. 63), it insisted that "although a distinction drawn on such a basis is an important *indicium* of discrimination, it is not determinative" (para. 65). Therefore, although pre-existing disadvantage is the factor the presence of which will most likely weigh in favour of a finding that human dignity is infringed, its absence does not inexorably lead to the conclusion that dignity has not been infringed.

128 Courts applying *Law* must keep these reservations in mind. Since not all the factors must be shown to exist, and since pre-existing disadvantage is a compelling, but not necessary condition, it is conceivable that the sole presence of another factor may be sufficient to establish an infringement of dignity. Moreover, given that the effects of an impugned distinction should be the focal point of a discrimination analysis, and that stereotypes are not necessary for a finding of discrimination, the severe impairment of an extremely important interest may be sufficient to ground a claim of discrimination. I foresaw this possibility in *Egan* , *supra*, when I wrote (at para. 65):

> The more fundamental the interest affected or the more serious the consequences of the distinction, the more likely that the impugned distinction will have a discriminatory impact even with respect to groups that occupy a position of advantage in society.

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It may be that particularly severe negative effects, as assessed under the fourth contextual factor in the third step of the *Law* test, may alone qualify a distinction as discriminatory. It is at least conceivable that negative effects severe enough would signal to a reasonable person possessing *any* personal characteristics, with membership in any classificatory group, that he or she is being less valued as a member of society. Therefore, even if we accept for the moment that youth are generally an advantaged group, if a distinction were to severely harm the fundamental interests of youth and only youth, that distinction would be found to be discriminatory.

129 These are the facts that are before this Court.

130 As a result of s. 29(*a*), adults under 30 were uniquely exposed by the legislative scheme to the threat of living beneath what the government itself considered to be a subsistence level of income. Of those eligible to participate in the programs, 88.8 percent were unable to increase their benefits to the level payable to those over 30 and over. Ms. Gosselin was exposed to the risk of severe poverty as a sole consequence of being under 30 years of age. Ms. Gosselin's psychological and physical integrity were breached. There is little question that living with the constant threat of poverty is psychologically harmful. There is no dispute that Ms. Gosselin lived at times below the government's own standard of bare subsistence. In 1987, the monthly cost of proper nourishment was $152. The guaranteed monthly payment to young adults was $170. I cannot imagine how it can be maintained that Ms. Gosselin's physical integrity was not breached.

131 The sole remaining question is whether a reasonable person in Ms. Gosselin's position, apprised of all the circumstances, would perceive that her dignity had been threatened. The reasonable claimant would have been informed of the legislature's intention to help young people enter the marketplace. She would have been informed that those 30 and over have more difficulty changing careers, and that those under 30 run serious social and personal risks if they do not enter the job market in a timely manner. She would have been told that the long-term goal of the legislative scheme was to affirm her dignity.

132 The reasonable claimant would also likely have been a member of the 88.8 percent who were eligible for the programs and whose income did not rise to the levels available to all adults 30 years of age and over. Even if she wished to participate in training programs, she would have found that there were intervals between the completion of one program and the starting of another, during which the amount of her social assistance benefit would have plunged. The reasonable claimant would have made daily life choices in the face of an imminent and severe threat of poverty. The reasonable claimant would likely have suffered malnourishment. She might have turned to prostitution and crime to make ends meet. The reasonable claimant would have perceived that as a result of her deep poverty, she had been excluded from full participation in Canadian society. She would have perceived that her right to dignity was infringed as a sole consequence of being under 30 years of age, a factor over which, at any given moment, she had no control. While individuals may be able to strive to overcome the detriment imposed by merit-based distinctions, Ms. Gosselin was powerless to alter the single personal characteristic that the government's scheme made determinative for her level of benefits.

133 The reasonable claimant would have suffered, as Ms. Gosselin manifestly did suffer, from discrimination as a result of the impugned legislative distinction. I see no other conclusion but that Ms. Gosselin would have reasonably felt that she was being less valued as a member of society than people 30 and over and that she was being treated as less deserving of respect.

(d) Law's Other Factors

134 Since I have concluded that finding an individual or group to have suffered a severe harm to a fundamental interest, as a result of a legislative distinction drawn on either an enumerated or analogous ground, is sufficient for a court to conclude that the distinction was discriminatory, it is unnecessary to discuss the remaining *Law* factors. I will, however, do so briefly.

135 In respect of the second factor, there should be a strong presumption that a legislative scheme which causes individuals to suffer severe threats to their physical and psychological integrity as a result of their possessing a

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characteristic which cannot be changed does not adequately take into account the needs, capacity or circumstances of the individual or group in question. In the present circumstances, the impugned legislation sought to alleviate young adults' experience of poverty by providing them with training. However, the reason that young adults experienced poverty was not a lack of training, but rather a lack of available employment. In any case, a legislative scheme that exposes the members of an enumerated or analogous category, and only those members, to severe poverty *prima facie* does not take into consideration the needs of that category's members.

136 In respect of the third factor, I would like to address an apparent confusion. *Law* states at para. 72:

> An ameliorative purpose or effect which accords with the purpose of s. 15(1) of the *Charter* will likely not violate the human dignity of more advantaged individuals where the exclusion of these more advantaged individuals largely corresponds to the greater need or the different circumstances experienced by the disadvantaged group being targeted by the legislation.

This passage makes clear that the ameliorative purpose must be for the benefit of a group less advantaged than the one targeted by the impugned distinction. The relevant ameliorative purpose under the third factor is *not* defined with reference to the group that suffers the disadvantage imposed by the impugned distinction.

137 I stipulated above that youth do not suffer pre-existing disadvantage for the purpose of showing that in circumstances such as the present, a severe negative effect under the fourth factor would be sufficient to establish an infringement of dignity. I did not concede the point, nor do I believe that it should be conceded. The motivation behind the present legislative scheme was precisely to help a young adult population that was in disadvantaged circumstances. If 23 percent of young adults were unemployed by comparison with 14 percent of the general active population, and if an unprecedented number of young people were entering the job market at a time when federal social assistance programs were faltering, I fail to see how young adults did not suffer from a pre-existing disadvantage.

138 It may be argued that in the long view of history, young people have not suffered disadvantage, and therefore, for the purposes of an equality analysis, a court need not consider young people to suffer from pre-existing disadvantage. This is, however, inconsistent with a basic premise of discrimination law. In *Brooks* , *supra*, this Court held that a disadvantage need not be shared by all members of a group for there to be a finding of discrimination, if it can be shown that *only* members of that group suffered the disadvantage. This Court held that a distinction drawn on the basis of pregnancy could be found to discriminate against women, since although not all women would become pregnant, only women could. The same conclusion was reached in *Egan* , *supra*, where it did not matter whether the particular claimants would have made net gains by being included in the governmental pension regime at issue. What mattered was that where there was a disadvantage, it fell solely on the basis of sexual orientation.

139 A unique constellation of circumstances caused a crisis of unemployment, at the historical moment in question, which threatened human dignity in ways that were particularly grievous for young adults. Only youth would suffer from the long-term harms to self-esteem that attend not participating in the workforce at a young age. The reasoning in *Brooks* , *supra*, applied to the present circumstances should lead to the conclusion that while not *all* members of the class "young adults throughout time" suffered the particular threats to self esteem that attend youth unemployment, *only* members of that class, or only "young adults at the relevant time", did. Application of the reasoning in *Brooks* should lead to the conclusion that young adults suffered from a pre-existing disadvantage.

140 The breach of s. 15 was not justified under s. 1 and I concur entirely with my colleague Bastarache J.'s s. 1 analysis on this point.

B. Section 7

141 I concur in my colleague Arbour J.'s thorough analysis of s. 7 of the *Charter* and for the reasons she expresses, I agree that s. 29(*a*) of the *Regulation* does violate s. 7 of the *Charter*. I would, however, like to offer a clarification. It is true that the legislature is in the best position to make the allocative choices necessary to implement a policy of

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social assistance. For a wide variety of reasons, courts are not in the best position to make such choices, and this is why this Court has historically shown judicial deference to governments in these matters. See, e.g., *Mahe v. Alberta*, [1990] 1 S.C.R. 342 (S.C.C.); *Reference re s. 79(3), (4) & (7) of the Public Schools Act (Manitoba)*, [1993] 1 S.C.R. 839 (S.C.C.); and *Eldridge* , *supra*.

142 However, although governments should in general make policy implementation choices, other actors may aid in determining whether social programs are necessary. In the present case, the government stated what it considered to be a minimal level of assistance but a claimant can also establish with adequate evidence what a minimal level of assistance would be. An analogy with the jurisprudence on minority language rights instruction may be helpful. In such cases, plaintiffs are able to establish whether "numbers warrant" the provision of minority language instruction even though legislatures and executives are generally given deference with respect to the operational choices that result in facilities being provided. See e.g., *Mahe* , *supra*. The same logic should apply in cases such as the present one.

143 As regards s. 1, I do not share my colleague Arbour J.'s contextual analysis in all its refinements (paras. 349 to 358), and prefer the approach to legislative context offered by Gonthier J. in *Sauvé v. Canada (Chief Electoral Officer)*, 2002 SCC 68 (S.C.C.) . The latter wrote (at para. 98):

> The role of this Court, when faced with competing social or political philosophies and justifications dependent on them, is therefore to define the parameters within which the acceptable reconciliation of competing values lies. [Emphasis in original.]

Nonetheless, substantially for the reasons Arbour J. expressed as well as those of Robert J.A.'s dissent in the Quebec Court of Appeal, I agree that the present violation of s. 7 was not justified.

C. Section 7 and Section 15

144 In another context, s. 15 concerns informed my analysis of s. 7. This was appropriate because the provisions of the *Charter* are to be understood as mutually reinforcing (see, e.g., *R. v. L. (T.P.)*, [1987] 2 S.C.R. 309 (S.C.C.), at p. 326; *R. v. Tran*, [1994] 2 S.C.R. 951 (S.C.C.), at p. 976). In addition, the equality provision is of foundational importance in the *Charter*. As McIntyre J. wrote in *Andrews* , *supra*, at p. 185:

> The section 15(1) guarantee is the broadest of all guarantees. It applies to and supports all other rights guaranteed by the *Charter*.

Consequently, in *New Brunswick (Minister of Health & Community Services) v. G. (J.)*, [1999] 3 S.C.R. 46 (S.C.C.), I brought the lens of the equality guarantee to the appellant's s. 7 claim to state-funded counsel in hearings where the Minister of Health and Community Services sought an extension of a custody order. I found that the claim could only be adequately addressed in light of the appellant's status as a single mother. I wrote (at para. 113):

> This case raises issues of gender equality because women, and especially single mothers, are disproportionately and particularly affected by child protection proceedings. ...

145 Conversely, in the present and similar fact situations, judicial interpretations of s. 15 can be informed by s. 7. To explain why, I revisit my reasons in *Egan v. Canada*. I wrote (at para. 63):

> [T]he nature, quantum and context of an economic prejudice or denial of such a benefit are important factors in determining whether the distinction from which the differing economic consequences flow is one which is discriminatory. If all other things are equal, the more severe and localized the economic consequences on the affected group, the more likely that the distinction responsible for these consequences is discriminatory within the meaning of s. 15 of the *Charter*.

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If, as in the present case, a harm is visited uniquely upon members of an analogous or enumerated group and is severe enough to give rise to a s. 7 claim, then there will be *prima facie* grounds for a s. 15 claim. This conclusion must follow from the above s. 15 analysis, which places individuals' *experience* of discrimination at the centre of judicial attention.

D. Section 45 of the Quebec Charter

146 I subscribe entirely to the exhaustive analysis of s. 45 of the Quebec *Charter* undertaken by Robert J.A. in his dissenting opinion in the Quebec Court of Appeal. For the reasons he expresses, I conclude as he does as to a violation of s.45 of the Quebec *Charter* in the present case.

147 As Robert J.A. states (at p. 1092): [translation] "Section 45 of the Quebec Charter thus bears a very close resemblance to article 11 of the *International Covenant on Economic, Social and Cultural Rights*", which, as the Court of Appeal notes, para. 10 of the *Report on the Fifth Session* of the United Nations Committee on Economic, Social and Cultural Rights further specifies as containing: "a minimum core obligation to ensure the satisfaction of, at the very least, minimum essential levels [of subsistence needs and the provision of basic services]" (*ibid.* at para. 337).

148 I am also in agreement that the Quebec *Charter* [translation] "was intended to establish a domestic law regime that reflects Canada's international commitments" (p. 1099) and that (at p. 1101)

> [TRANSLATION] the quasi-constitutional right guaranteed by section 45 to social and economic measures susceptible of ensuring an acceptable standard of living includes, at the very least, the right of every person in need to receive what Canadian society objectively considers sufficient means to provide the basic necessities of life.

III. Conclusion

149 In the result, I agree with the result reached by each of my colleagues Bastarache, Arbour and Lebel JJ. and would allow the appeal with costs throughout.

***Bastarache J.*:**

I. Introduction

150 This case involves the constitutional review of a provision that existed in the regulations under Quebec's *Social Aid Act*, R.S.Q., c. A-16, between 1984 and 1989. That provision fixed the maximum benefits to be received by single adults under the age of 30 at a level approximately one third that of those 30 years of age and over.

151 The appellant has offered this Court a number of constitutional issues to consider. She claims, on behalf of herself and all single recipients of welfare in the province of Quebec who were under the age of 30 at some point between 1985 and 1989, that the benefits provision violates the right not to be deprived of security of the person under s. 7 of the *Canadian Charter of Rights and Freedoms* ("*Canadian Charter*" or "*Charter*"), the right to equal treatment before and under the law, protected by s. 15 of the *Canadian Charter*, as well as the right to be provided with a decent level of support, guaranteed by s. 45 of the Quebec *Charter of Human Rights and Freedoms*, R.S.Q., c. C-12 ("*Quebec Charter*").

152 In making her claim, the appellant is seeking a declaration from this Court that the provision was constitutionally invalid pursuant to s. 52 of the *Constitution Act, 1982* and s. 45 of the Quebec *Charter*, as well as damages in the amount of $388,563,316 for benefits denied to the members of the appellant's group, pursuant to s. 24(1) of the *Canadian Charter* and the joint operation of ss. 45 and 49 of the Quebec *Charter*, from March 1985 to July 31, 1989.

153 In the end, I conclude that s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, violated the appellant's s. 15 right to equal benefit of the law, and that such discrimination was not justified under s. 1.

II. Legislative History

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154 At issue in this case is the differential treatment of social assistance recipients under 30 years of age. This differential treatment is prescribed by s. 29(*a*) of the *Regulation respecting social aid*. To properly determine whether s. 29(*a*) is discriminatory, it is necessary to look at the section in its historical context as well as the context of its governing legislation and regulations.

155 The *Social Aid Act* of 1984 grew out of reforms to Quebec social policy that dated back to the late 1960s. The first *Social Aid Act* in Quebec was brought into force in 1970. Prior to that time, Quebec social policy focussed, through a variety of legislative Acts, on the needs of those citizens who were unable to work. The guiding principle for this combination of Acts was that the more incapable one was of working, the greater one's benefits would be. Even at that time, however, some benefits were provided to able-bodied persons. Under this regime, distinctions were made and benefits were based on whether or not one lived with one's parents, and whether one was under 30 years of age. For instance, under the pre-1970 law, a person under 30 who lived with his or her parents would receive $30 a month, while a person who lived on his or her own would receive $55. For those 30 and over, the benefits also varied based on whether they lived in a rural or urban setting. A person 30 and over living alone in the city would be eligible for a $65 benefit, while one living with a parent would receive only $55.

156 The reforms of 1969-70 sought to change the foundational principles of Quebec social policy, moving from a regime based on degree of incapacity to one based on need. Despite this emphasis on need, the distinction between those under 30 and those 30 and over was maintained and incorporated into the new legislation. Whereas the benefits of those 30 and over varied depending on whether or not they lived with their parents (from $75 to $106), those under 30 received only the $75 amount. In other words, those under 30 were deemed to be living with their parents, regardless of their actual circumstances.

157 Over the course of the next decade, the benefits for those 30 or over grew at a much faster rate than those for single persons under 30. Apart from several slight adjustments, the under-30 benefits remained stable, while the reforms of 1974 increased the benefits for those 30 and over by 45 percent. Other amendments made in 1975 indexed benefits for those 30 and over to the rate of inflation. By the time the under-30 benefits were indexed, in 1979, they had fallen to 36 percent of those of a similarly situated person 30 and over. In 1969, they had represented 84 percent of the full amount.

158 In the early 1980s, the Quebec government, responding to a deep and long-lasting crisis in the North American economy, once again considered reforming its *Social Aid Act*. Between 1981 and 1983, unemployment in Quebec had skyrocketed from traditional levels of around 8 percent to approximately 14 percent. Among young people, the levels of unemployment were even more pronounced. Youth unemployment in 1982 was 23 percent. The difference between youth unemployment and the rate for the general population had never been higher. During this period, the government was also concerned by a change in the composition of social assistance recipients. Between 1975 and 1983, the number of people under 30 on social assistance rose six-fold, to 85 000. This resulted in the proportion of social assistance recipients under 30 rising from 3 to 12 percent. The government was also witnessing an increase in the percentage of able-bodied recipients; it went from 41 percent in 1974 to 75 percent in 1983. At the same time, the government was seeing an increase in the number of recipients with a relatively high level of education.

159 In response to this grim picture, the government chose to focus on providing young people with the skills and education required for them to get jobs. At the centre of this new approach were three new programs designed to provide people on social assistance with work experience and education. These programs were, quite practically, entitled Remedial Education, Community Work and On-the-job Training. Under s. 29(*a*) of the new Regulation, social assistance beneficiaries under 30 would continue to receive a lower level of support (as of 1987 they received $170 per month) than their older counterparts (who were receiving $466 per month), but could have their benefits raised by participating in one of these programs.

160 The Remedial Education Program was designed to help social assistance recipients return to school to get their high school diploma. For admission to the program, one had to be a recipient of social assistance who had been out

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of school for more than nine months and who had been financially independent of his or her parents for at least six months. There is evidence that the illiterate were also excluded. While participating in a Remedial Education Program, the beneficiary would receive an increase of $196 per month in his or her social assistance benefits; the participant under 30 years of age was therefore left with $100 less than the base amount for the social assistance beneficiary 30 and over.

161 The On-the-job Training Program was designed to provide social assistance recipients with real job experience. A participant would be paired with a private or public organization and work for it on a full-time basis. During that time, he or she would receive specialized training. In order to qualify for this program, the potential participant must have been out of school for at least 12 months. Holders of CEGEP or university degrees were excluded from the program. This placement would last one year. During the time that they participated, social assistance beneficiaries would receive an increase of $296 in their benefits, $100 of which was paid by their employer. This increase would leave a person under 30 with the same amount of benefits per month as the base amount for a person 30 and over.

162 In the Community Work Program, social assistance beneficiaries were paired with community organizations and governmental agencies in order to complete simple tasks. The goal of this program was to provide more rudimentary work-related skills, such as learning to show up on time, to dress properly for work, to file documents and to answer the telephone. Priority for admission to the program was given to those who had been on social assistance for at least one year. As in the case of the On-the-job Training Program, participants received a $296 increase in their benefits, $100 of which was paid by the community organization or government agency.

163 While all three of these programs were ostensibly designed for social assistance recipients under 30, at least one of the programs was in fact open to some persons 30 and over, who received the same increase in their benefits when they participated. Thus, a recipient under 30 would never receive the same amount as some similarly situated persons 30 and over, since the older person would receive the same extra benefit over and above the base benefit.

III. Factual Background

164 It was under this legislative and regulatory framework that the claimant and class representative in this case, Ms. Gosselin, received assistance between 1984 and her 30th birthday, in 1989. Louise Gosselin was born on July 9, 1959. Her life has not been an easy one. Much of her formative years was spent moving back and forth between her mother's home and various centres d'accueil and foster homes. Health problems, both physical and psychological, also constituted a burden. Despite her desire to finish school, her attempts always seemed to come up short.

165 On the job market, Ms. Gosselin's success was not any more marked. At various times she worked as a nurse's assistant and a waitress but, owing to physical or mental exhaustion, these jobs never lasted for long. Suicides were attempted, alcohol was abused, jobs were hard to come by, and depression ensued. Thus, from the time she was 18 Ms. Gosselin was, for the most part, reliant on social assistance - as was her mother, with whom she often lived.

166 In March of 1985, at the age of 25, Ms. Gosselin contacted her local CLSC (local community service centre) to find out how she might go about finding friends her own age. It was at that time that she was first informed of a program known as "Community Work". In May 1985, she applied and was accepted into the program, working for an organization called "Réveil des assistés sociaux". Through this program she became involved in various committees in which she learned about social assistance law and about the types of programs that were available to assist her. Her participation in the program helped her to meet people and to have more social interactions. However, the program only lasted one year. After she had completed it, she fell back onto the reduced amount and was forced to move back in with her mother. No one suggested another program to her.

167 Living with her mother at the age of 27 was not a comfortable situation; Ms. Gosselin hoped desperately that her luck would turn around. In October of 1986, she was forced, following a change in the building's by-laws, to move out of her mother's one-bedroom apartment. She lived in a variety of rooming houses, and maisons d'accueil, where she

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faced various types of harassment. At one point, she was able to get a job cleaning homes, but was unable to continue after she was overcome with the fear of being fired. She reluctantly moved back in with her mother.

168 In November of 1986, she was granted a medical certificate due to her mental state; this allowed her to collect the full benefit under the regulations. She moved out of her mother's apartment in December of that year. A few months later, by happenstance, her father's neighbour offered to arrange a placement for her at Revenu travail-Quebec as part of the On-the-job Training program. She worked there for three months, before switching placements to work at a pet store, where she had wanted to work because of her love of animals. Unfortunately, allergies quickly became a problem and she had to leave after only a couple of weeks.

169 At this point, she fell back onto the reduced benefit and was hospitalized at a psychiatric hospital for two months. Released from the hospital in January 1988, she was once again considered able-bodied and allocated the reduced benefit. She moved through several rooming homes, paying $170 per month for rent while receiving only $188 per month in benefits. In March of 1988, she got her own apartment, paying a rent of $235 per month. To pay for it, she cleaned homes, earning extra money. In order to make ends meet, she ate most of her meals at her mother's house, but sometimes had to resort to soup kitchens. In May of 1988, she hurt her back and was granted a medical certificate.

170 In September of 1988, she enrolled in the Remedial Education Program and went back to school. While this raised her benefits to $100 less than the base amount, she was terrified that she would not succeed and would be forced back onto the reduced rate. After paying her rent and phone, she was left with only $150 per month, which she had to stretch scrupulously in order to buy food and bus tickets. Finally, in July of 1989, she turned 30 and was allocated the full social assistance benefit. When that benefit was added to the money she received for participating in the Remedial Education Program, her total monthly benefits rose to $739 per month.

IV. Relevant Statutory Provisions

171 *Social Aid Act*, R.S.Q., c. A-16, as amended by *An Act to amend the Social Aid Act*, S.Q. 1984, c. 5 (repealed by *An Act respecting income security*, S.Q. 1988, c. 51, s. 92.)

> **5.** ...
>
> Ordinary needs are food, clothing household and personal requirements and any other costs relating to the habitation of a house or lodging.
>
> All other needs are special needs
>
> **6.** Social Aid shall meet the ordinary and special needs of any family or individual lacking means of subsistance.
>
> **11.** The Minister may propose a recovery plan to a family or individual who is receiving or who applies for social aid.
>
> The recovery plan may include, in particular, the participation of an individual or a member of a family in a program of work activities or a training program established by the Minister in view of developing the recipient's qualifications for an employment.
>
> The criteria of eligibility to a program established under the second paragraph may take the recipient's age into account.
>
> **11.1** The Government, by regulation, shall designate to which work activities programs or training programs sections 11.2 to 11.4 apply.
>
> **11.2** In the case of an individual or a family having no dependent child, needs relating to a recipient's participation in a designated program are special needs to the extent determined by regulation for each program.

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In all other cases, needs described in the first paragraph are special needs to the extent determined by the Minister for each recipient, but not in excess of the amount determined by regulation.

31. In addition to the other regulatory powers assigned to it by this act, the Gouvernement [*sic*], subject to the provisions of this act, may make regulations respecting:

. . . . .

(*e*) the extent to which the ordinary needs of a family or individual may be met through social aid and the methods whereby such needs must be proven and appraised; in determining what the aid shall be, account may be taken of the age or capacity for work of an individual or of the members of a family having no dependent children, having had no children who are deceased, or the fact that a family or individual is living with a relative or a child;

Regulation respecting social aid, R.R.Q. 1981, c. A-16, r. 1. (This is the text of the pertinent sections of the Regulation as it appeared on *April 17, 1985*)

23. The ordinary needs of a household shall be determined in terms of its members, each month, according to the following scale:

Adults	Dependent children	Ordinary needs
1	0	357 $
1	1	488
1	2 and over	526
2	0	568
2	1	615
2	2 and over	651.

However, the ordinary needs can be accorded only insofar as the costs a household incurs for lodging on a monthly basis within the meaning of section 27 are equal to or greater than 85 $ for a family and 65 $ for a single person. The ordinary needs are reduced by the amount by which these costs fall short of these amounts.

29. Aid for ordinary needs shall not exceed:

(*a*) 121 $ per month, in the case of an individual capable of working and less than 30 years of age;

(*b*) twice the monthly amount prescribed in subparagraph a for a family without dependent children, where both consorts are able-bodied and under 30 years of age.

In the case of a family without children receiving uninterrupted aid following an application made before 1 July 1984, subparagraph *b* of the first paragraph does not apply if the said family had a child who died before 1 July 1984.

For the month in which the application was made, the amounts prescribed in the first paragraph represent the ordinary needs of the household. The latter are apportioned in the manner indicated in section 10.

35.0.1 Sections 11.2 to 11.4 of the Act shall apply to the following programs established by the Minister under section 11 of the Act:

(*a*) On-the-job Training Program;

(*b*) Community Work Program.

Section 11.2 of the Act shall also apply to the Remedial Education Program.

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35.0.2 In order to develop employability, an amount of 150 $ is granted to the single person or to the adult of a family without dependent children for a complete month during which he participates in a program subject to section 35.0.1.

In the case of a participant in the Remedial Education Program whose work load established by the school is less than 60 hours per month, an amount of 150 $ is deducted on the basis of the number of hours of work in relation to 60.

35.0.5 The amount provided in section 35.0.2 or determined by the Minister under section 35.0.3, except for child care expenses, is reduced on the basis of unauthorized hours of absence under programs subject to section 35.0.1 for the said month with respect to the required hours of participation.

In the case of the Remedial Education Program, the deduction is established according to unauthorized hours of absence from classes under this program with respect to the monthly number of class hours.

35.0.6 No reduction is made when the unauthorized hours of absence do not exceed 5 percent of the hours of participation established for a participant during the month.

35.0.7 The aid shall also meet the cost required by a person attending a vocational training course that makes this person eligible for an allowance under the National Vocational Training Program Act (S.C., 1980-81-82-83, c. 109).

This cost is equal to the amount of the allowance paid, as reduced under subparagraph *f* of section 40.

For recipients covered by s. 29, the cost is equal to the same amount less the difference between ordinary needs under section 23 and the amount prescribed in s. 29.

However, it shall not exceed:

i. for a family, 40 $ plus 5 $ per dependent child, plus 50 $ in the case of a family including only one adult;

ii. for a single person, 25 $;

The maximum provided in the fourth paragraph shall not apply to the month in which courses begin if aid for ordinary needs has been granted for at least 3 consecutive months without this paragraph having been applied during the six preceding months.

Section 35.0.2 was amended, *effective August 7, 1985*, by O.C. 1542-85, 24 July 1985, G.O.Q. 1985.II.3690, s. 1 as follows:

35.0.2 To assist in developing aptitudes for work, an amount is granted as a special need to the single person or to a spouse in a family without dependent children, for a complete month of participation in a program subject to section 35.0.1.

This amount is equal to the amount obtained when 100 $ is subtracted from the difference between the amount paid subject to the first paragraph of section 23, taking into account section 31, to a single person under 30 years of age and the maximum amount paid under s. 29, taking into account section 31, to a single person under 30 years of age.

In the case of a participant in the Remedial Education Program whose course schedule is under 60 hours per month, the amount is reduced to a prorata of the number of actual course hours with respect to 60.

The Regulation was amended, *effective April 30, 1986*, by *Regulation respecting social aid (Amendment)*, O.C. 555-86, 23 April 1986, G.O.Q. 1986.II.605, ss. 1, 3:

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23. The ordinary needs of a household shall be determined in terms of its members, each month, according to the following scale:

Adults	Dependent children	Ordinary needs
1	0	448 $
1	1	609
1	2 and more	659
2	0	712
2	1	769
2	2 and more	815

However, the ordinary needs of a household living with a parent or a child are reduced by 85 $.

In all other cases, the ordinary needs are reduced by the amount by which the costs incurred by the household for lodging on a monthly basis within the meaning of section 27 are less than 85 $ for a family or less than 65 $ for a single person.

29. Aid for ordinary needs shall not exceed:

(*a*) 163 $ per month, in the case of an individual capable of working and less than 30 years of age;

(*b*) twice the monthly amount prescribed in subparagraph *a* for a family without dependent children, where both consorts are able-bodied and under 30 years of age.

The amounts provided for in the first paragraph are increased by 8 $ per adult except:

(*a*) when the household lives with a parent or child;

(*b*) when a single person lives with a foster family;

(*c*) when the household lives in housing administered by a municipal housing bureau constituted under the Act respecting the Société d'habitation du Quebec (R.S.Q., c. S-8).

In the case of a family without children receiving uninterrupted aid following an application made before 1 July 1984, subparagraph *b* of the first paragraph does not apply if the said family had a child who died before 1 July 1984.

For the month in which the application was made, the amounts prescribed in the first paragraph represent the ordinary needs of the household. The latter are apportioned in the manner indicated in section 10.

Charter of Human Rights and Freedoms, R.S.Q., c. C-12

10. Every person has a right to full and equal recognition and exercise of his human rights and freedoms, without distinction, exclusion or preference based on race, colour, sex, pregnancy, sexual orientation, civil status, age except as provided by law, religion, political convictions, language, ethnic or national origin, social condition, a handicap or the use of any means to palliate a handicap.

Discrimination exists where such a distinction, exclusion or preference has the effect of nullifying or impairing such right.

45. Every person in need has a right, for himself and his family, to measures of financial assistance and to social measures provided for by law, susceptible of ensuring such person an acceptable standard of living.

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49. Any unlawful interference with any right or freedom recognized by this Charter entitles the victim to obtain the cessation of such interference and compensation for the moral or material prejudice resulting therefrom.

In case of unlawful and intentional interference, the tribunal may, in addition, condemn the person guilty of it to punitive damages.

52. No provision of any Act, even subsequent to the Charter, may derogate from sections 1 to 38, except so far as provided by those sections, unless such Act expressly states that it applies despite the Charter.

53. If any doubt arises in the interpretation of a provision of the Act, it shall be resolved in keeping with the intent of the Charter.

Canadian Charter of Rights and Freedoms

1. The *Canadian Charter of Rights and Freedoms* guarantees the rights and freedoms set out in it subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society.

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

15. (1) Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.

24. (1) Anyone whose rights or freedoms, as guaranteed by this Charter, have been infringed or denied may apply to a court of competent jurisdiction to obtain such remedy as the court considers appropriate and just in the circumstances.

33. (1) Parliament or the legislature of a province may expressly declare in an Act of Parliament or of the legislature, as the case may be, that the Act or a provision thereof shall operate notwithstanding a provision included in section 2 or sections 7 to 15 of this Charter.

. . . . .

(3) A declaration made under subsection (1) shall cease to have effect five years after it comes into force or on such earlier date as may be specified in the declaration.

Constitution Act, 1982

52. (1) The Constitution of Canada is the supreme law of Canada, and any law that is inconsistent with the provisions of the Constitution is, to the extent of the inconsistency, of no force or effect.

Act respecting the Constitution Act, 1982, R.S.Q., c. L-4.2

1. Each of the Acts adopted before 17 April 1982 is replaced by the text of each of them as they existed at that date, after being amended by the addition, at the end and as a separate section, of the following:

This Act shall operate notwithstanding the provisions of sections 2 and 7 to 15 of the Constitution Act, 1982 (Schedule B of the Canada Act, chapter 11 in the 1982 volume of the Acts of the Parliament of the United Kingdom).

The text so amended of each of these Acts constitutes a separate Act.

No such Act is to be construed as new law except for the purposes of section 33 of the Constitution Act, 1982; for all other purposes, it has force of law as if it were a consolidation of the Act it replaces.

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Every provision of such an Act shall have effect from the date the provision it replaces took effect or is to take effect.

Such an Act must be cited in the same manner as the Act it replaces.

V. Judicial History

A. Quebec Superior Court, [1992] R.J.Q. 1647 (C.S. Que.)

172 In his reasons of May 27, 1992, Reeves J. ruled in favour of the defendant government, holding that the legislation in question did not infringe any of the rights claimed by the plaintiff.

173 With regard to the claim under s. 7 of the *Canadian Charter*, Reeves J. characterized life, liberty and security of the person as rights that do not include purely economic interests. He founded this conclusion on the fact that the right to property was specifically excluded from the *Canadian Charter* at the time of its drafting. Moreover, he noted that s. 7, along with ss. 8 to 14 of the *Canadian Charter*, fell under the heading "Legal Rights", thus requiring a link to the administration of justice. Finally, he held that the term "security of the person"did not apply to the benefit of social assistance because such a right would require the state to take positive actions. Reeves J. held that s. 7 protects only negative rights, such as the right to be free of any state intrusion upon the security of one's person.

174 In analysing the discriminatory nature of the legislation under s. 15, Reeves J. emphasized the fact that not all differences in treatment will result in discrimination. He held that the essence of equality is a respect for differences, and that substantive equality did not necessarily signify uniformity of treatment - different people must sometimes be treated differently. He therefore concluded that the Act was not discriminatory because young adults generally have a better chance of integrating into the job market and need to be encouraged to do so. Moreover, he found that since participation in the employment programs would result, under the law, in an income for young adults equal to that of those 30 or over, equality could be achieved, and thus there was no discrimination.

175 On the s. 45 of the *Quebec Charter* issue, Reeves J. held that the term "provided for by law" limited the obligation that this section places on the government. As a result of this wording, he held that the government was free to limit the obligations that it undertook in providing financial and social assistance. More importantly, Reeves J. held that since s. 52 stipulates that "No provision of any Act, even subsequent to the *Charter*, may derogate from sections 1 to 38", it does not apply to s. 45. He therefore concluded that s. 45 could not confer the right to damages and serves only as a general statement of policy by the Quebec legislature.

B. Quebec Court of Appeal, [1999] R.J.Q. 1033 (C.A. Que.)

176 The claimant appealed the case to the Quebec Court of Appeal. In its decision of April 23, 1999, the Court of Appeal dismissed the appeal, Robert J.A. dissenting. The court ruled in three separate judgments, each judge deciding differently with regards to the application of s. 15 of the *Canadian Charter*.

177 The three justices, Robert, Baudouin and Mailhot JJ.A., agreed that s. 7 was not violated. Their primary reason for reaching this conclusion was that s. 7 of the *Canadian Charter* was designed to protect legal rights. Here, they found that there was not a sufficient link between the appellant's claim and the justice system. They also rejected the appellant's argument that the government's institution of a social assistance program had somehow created a right to social assistance protected by the right to security of the person. In taking this position, Robert and Baudouin JJ.A., who both wrote on the issue, held that s. 7 of the *Canadian Charter* only applied to negative rights and not to the positive social rights being claimed by the appellant.

178 The three justices offered separate analysis of the s. 15 claim. Mailhot J.A. held that under the test set out by this Court in *Law v. Canada (Minister of Employment & Immigration)*, [1999] 1 S.C.R. 497 (S.C.C.), the legislation did not constitute an infringement of s. 15. She held that, as in *Law* , the distinction that this legislation made on the basis of age, when viewed in the context of the legislation as a whole, is not an affront to human dignity.

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179 Robert J.A. held that the legislation constituted a violation of s. 15 that was not demonstrably justified under s. 1. Having established that s. 29(*a*) of the Regulations created a distinction on the basis of the enumerated characteristic of age, Robert J.A. turned to the question of whether the legislation was substantively discriminatory under the terms of s. 15 of the *Canadian Charter*. In so doing, he examined the effects of the legislation and placed considerable weight on the evidence that 73 percent of all social assistance recipients under the age of 30 received only the reduced benefit. He found that there was enough evidence to show that the effect of the legislation was to deny to those under 30 an advantage of the law enjoyed by those 30 and over.

180 He was also particularly concerned by the fact that there were not enough places available in the programs in order for every young person on social assistance to have participated. Moreover, he found that, even when an individual did take part in one of the educational programs, there were periods, such as when they were on waiting lists, during which they only received the smaller amount. This weighed in favour of a finding of discrimination. He also noted that because the Remedial Education Program provided increased benefits amounting to $100 less than the base amount, only 11 percent of the young people in the group actually received the base amount allocated to all those 30 and over. He concluded that the legislation was discriminatory and harmful to the dignity of the appellant and members of her group; there was therefore a violation of s. 15 of the *Canadian Charter*.

181 While they agreed on the application of s. 15, Robert and Baudouin JJ.A. differed in their s. 1 analysis. Robert J.A. held that the provision was not demonstrably justifiable in a free and democratic society, while Baudouin J. found that the government had met its burden and upheld the law under s. 1.

182 In defining the objective of the legislation, Robert J.A. held that the differentiation served two objectives, [translation] "(1) to avoid making the program too attractive, and (2) to encourage incitement to work and reintegration into the workplace" (p. 1073). Given the economic situation of the early 1980s, Robert J.A. found that these objectives, particularly that of encouraging integration into the workplace, were pressing and substantial.

183 Under the heading of minimal impairment, Robert J.A. found that the regime of conditional aid for young people did not limit the right as little as possible. For the most part, he based this finding on the fact that the option of participation in the employment programs was limited by the number of places made available, the lack of information offered to beneficiaries about these programs, and the various criteria which guaranteed that not all those who wished to participate would have that opportunity. The fact that the Remedial Education Program did not result in a complete supplementation of the lower level of assistance was another factor that led him to conclude that the regime was not minimally impairing.

184 For the legislation to have been upheld at this stage of the *R. v. Oakes*, [1989] 1 S.C.R. 143 (S.C.C.), test, Robert J.A. held that the government would have had to have shown that the criteria for admission to the educational programs were flexible enough to allow anyone under the age of 30 to be admitted and that the government was acting in a reasonable manner in determining the conditions under which a young beneficiary would be able to receive an increase in assistance. In his view, it is reasonable to expect that the government should offer such flexibility given that young adults would otherwise receive assistance that was one third that received by those 30 or over, well below a subsistence level. Robert J.A. therefore concluded that the distinction in benefits created by s. 29(*a*) of the Regulation could not be justified under s. 1 of the *Canadian Charter*.

185 Baudouin J.A. disagreed with Robert J.A.'s approach to the minimal impairment issue. He approached the analysis with considerable reticence, given the fact that, in his view, [translation] "it is easy for the courts, several years after the alleged infringement, in an entirely different context and without the political, economic and social constraints of governments, to criticize their decisions and set themselves up as legislators" (p.1045).

186 While he agreed that the educational programs put into place were not a success, he found that the failure of these programs could not be linked to the conditions that were placed on participation. In this case, he placed some

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responsibility on the members of the group for having chosen not to participate in the programs. Moreover, he disagreed with the importance that Robert J.A. gave to the fact that there were not enough spaces available for all those under 30 to have participated, holding that it would be absurd for the government to have been forced to open 75 000 places when not even the 30 000 available places were filled.

187 Thus, Baudoin J.A. concluded that the government had met its burden of showing that its programs were minimally impairing and that its deleterious effects were reasonably proportional to the salutary effects. In doing so, he emphasized that just because a program is not a success should not be enough for a court to conclude that the means were not proportional to the objective sought.

188 Because he was the only justice to find that there had been a *Canadian Charter* infringement that was not upheld by s. 1, Robert J.A. was the only one to deal with the issue of remedy. He held that the most appropriate remedy would be to declare both ss. 29(*a*) and 23 of the Regulation invalid, since it was clear that the governement would not have adopted that regulation without s. 29(*a*). However, due to the consequences of such a declaration, he held that it should be suspended for a period.

189 Robert J.A. then rejected the appellant's claim for compensation for herself and the members of her class. In order for damages to be ordered following a s. 52 declaration of unconstitutionality, he held that there had to be some correlation between the remedy ordered under s. 52 and s. 24(1): *Schachter v. Canada*, [1992] 2 S.C.R. 679 (S.C.C.); *Guimond c. Québec (Procureur général)*, [1996] 3 S.C.R. 347 (S.C.C.).

190 On the issue of s. 45 of the *Quebec Charter*'s application to this case, two separate sets of reasons were delivered by the Court of Appeal. Baudoin J.A., Mailhot J.A. concurring, held that s. 45 had not been infringed. In interpreting the wording of the section, Baudouin J.A. held that the legislature would not, through s. 45, have adopted an obligation as massive as that of providing social assistance, while setting out strict limitations for the other economic rights. He therefore held that s. 45, like the other sections in the economic rights chapter of the *Quebec Charter*, only provided Quebec residents with a right to be provided access to whatever social assistance might exist, without discrimination.

191 Upon examination of the context, as well as the language used in the adjoining sections, Robert J.A. held that s. 45 did in fact create a positive right to social assistance, and that it had been infringed. Whereas the other sections of the economic rights chapter of the *Quebec Charter* were drafted with explicit limitations, such as "*to the extent* provided by law" in s. 44, in the case of s. 45 there is a specifically different phrasing that is not used in any other section. Robert J.A. held that these differences must mean something; he found that s. 45 did not contain an internal limitation.

192 Robert J.A. went on to hold that s. 45 had been infringed. Nevertheless, he found that no award for damages could be awarded under s. 49 because, in order to make such an order, there must be wrongful conduct by a party. He held that the fact that a provision is found to be unconstitutional does not amount to a finding of wrongful conduct on the part of the government.

193 The claimant appealed the Quebec Court of Appeal's decision to this Court.

VI. Issues

194 The following four constitutional questions were stated by the Chief Justice on November 1, 2000:

> 1. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* on the ground that it established a discriminatory distinction based on age with respect to individuals, capable of working, aged 18 to 30 years?
>
> 2. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?

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3. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 7 of the *Canadian Charter of Rights and Freedoms* on the ground that it deprived those to whom it applied of their right to security of the person contrary to the principles of fundamental justice?

4. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*.

195 The appellant also makes a claim under s. 45 of the *Quebec Charter*.

VII. Analysis

A. Procedural Issues

196 The history of this case spans three decades. On July 29, 1986, the appellant filed a motion to authorize a class action suit pursuant to art. 1002 of the Quebec *Code of Civil Procedure*, R.S.Q., c. C-25. On December 11, 1986, Reeves J. of the Quebec Superior Court certified the group. He described the group as follows:

[TRANSLATION]

Individuals capable of working, aged 18 to 30 years, who are currently receiving benefits under s. 29(*a*) of the *Regulation Respecting Social Aid* adopted under the *Social Aid Act* (R.S.Q., c. A-16, s. 31) and/or who received social aid benefits under s. 29(*a*) of the *Regulation Respecting Social Aid* adopted under the *Social Aid Act* (R.S.Q., c. A-16, s. 31) during any period since April 17, 1985, and/or who become or will be recipients of social aid benefits under s. 29(*a*) of the *Regulation Respecting Social Aid* adopted under the *Social Aid Act* (R.S.Q., c. A-16, s. 31) from this day until the date of judgment in the present matter.

The final date to exclude one's self from the class was February 8, 1987.

197 While the legislation in question existed in its disputed form between 1984 and 1989, the operation of Quebec's *Act Respecting the Constitution Act*, means that the *Social Aid Act* operated notwithstanding the *Canadian Charter* until June 23, 1987. The *Social Aid Act* was amended to make all benefits conditional on July 31, 1989. Thus, it is only between those dates that the *Canadian Charter* applied to the present case. On the other hand, the *Quebec Charter* applied for the entire period. Despite the divergence in applicable dates, I would agree with the holding of Reeves J. that the events that transpired over the entire period may be examined in order to determine the constitutionality of the legislation.

198 As a result of this case being brought by means of a class action, the respondent raised two preliminary procedural issues before this Court. First, the government argues that a class action is an inappropriate method for bringing a direct action of invalidity. It contends that, pursuant to the holding of Gonthier J. in *Guimond* , *supra*, an action for damages cannot be coupled with a declaratory action for invalidity and that Reeves J. should not have authorized the bringing of the class action because the facts alleged did not justify the conclusions sought. However, as Gonthier J. held in *Guimond* , the rule against coupling an action for a s. 24(1) remedy with a direct action under s. 52 is only a general rule. It was certainly within the discretion of Reeves J. to allow the class to be certified. Admittedly, obtaining a s. 24(1) order for damages pursuant to a declaration of invalidity is an unlikely outcome for any *Canadian Charter* complainant. However, rather than creating a bar to litigants who might be seeking one or the other type of remedy, this analysis is best dealt with when determining the appropriate remedy.

199 The second preliminary issue argued by the respondent is that the Superior Court was not a competent court to hear the constitutional arguments since the complainants could have, at any time after June 23, 1987, made an application to be heard by the Social Affairs Commission. In support of this, the respondent relies on the holding of this Court that an administrative body that is expressly empowered by legislative mandate to interpret or apply any law necessary to reach its findings has the power to apply the *Canadian Charter*: *Douglas/Kwantlen Faculty Assn. v. Douglas College*, [1990]

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3 S.C.R. 570 (S.C.C.); *Cuddy Chicks Ltd. v. Ontario (Labour Relations Board)*, [1991] 2 S.C.R. 5 (S.C.C.); *Tétreault-Gadoury v. Canada (Employment & Immigration Commission)*, [1991] 2 S.C.R. 22 (S.C.C.).

200 While the above cases stand for the proposition that an administrative body could have jurisdiction to determine constitutional questions, they did not determine that such bodies have *exclusive* jurisdiction over such matters. In the later case of *Weber v. Ontario Hydro*, [1995] 2 S.C.R. 929 (S.C.C.), McLachlin J. (as she then was) held that when an administrative body has been granted the authority to make orders under an Act or collective agreement, such body may constitute a court of competent jurisdiction for the purposes of s. 24(1) of the *Canadian Charter*. McLachlin J. noted that mandatory arbitration clauses in labour statutes may deprive the courts of concurrent jurisdiction. That case did not, however, deal with the question of whether a declaration of invalidity, such as the one being sought here, can be made by an administrative body. Indeed, La Forest J. held in *Cuddy Chicks, supra*, that such a body can only declare an impugned provision invalid for the purposes of the matter before it (p. 17).

201 In the context of this case, it would be inappropriate to decide what is the scope of the Social Affairs Commission's power to make orders pursuant to s. 24(1). Little, if any evidence has been advanced regarding the powers of the Commission, and the matter was not argued in any depth before this Court. Given that the Superior Court was the only forum that the appellant could choose in order to obtain a general declaration of invalidity, and that prior to 1990 it was considered to be the only appropriate forum for a determination of any of the constitutional questions raised, I do not believe that it would be advisable to halt the process at this late date for procedural reasons.

B. Canadian Charter of Rights and Freedoms

202 The appellant advances arguments relating to both s. 7 and s. 15 of the *Charter*. When multiple *Charter* rights are advanced, there is always some question as to the proper manner in which to proceed. While it is generally sufficient to find that one of the rights is infringed and simply state that the other "need not be dealt with", this approach is sometimes unhelpful. Each case must be dealt with separately. In the recent case of *Dunmore v. Ontario (Attorney General)*, 2001 SCC 94 (S.C.C.) , for instance, the complainant put forth claims based on both his s. 2(*d*) associational rights and his s. 15 equality rights. I held for the majority that the burdens imposed by ss. 2(*d*) and 15(1) differed in the sense that the latter focuses on the effects of underinclusion on human dignity, while the former is concerned with the ability to exercise the fundamental freedom of association (para. 28). In that case, at its core, the appellant's claim was concerned with his capacity to organize. I therefore began with a consideration of that right and, having found an unjustified *Charter* breach, did not have to proceed to a consideration of the s. 15(1) claim.

203 In this case, we are again faced with two *Charter* claims, based on rights that require different approaches. While s. 15 is concerned with the effect of over- or underinclusive legislation on the claimant's human dignity, s. 7 is concerned with the manner in which the state's actions interfere with a free-willed person's ability to enjoy his life, liberty and security interests. Any infringement of those rights by the state must be imposed in accordance with the principles of fundamental justice. Though both sets of rights are protected under the *Charter*, the two protect different interests. While it is important that the *Charter* be interpreted in a consistent fashion, the rights themselves must be interpreted in accordance with their individual terms. In a given situation, one right may be infringed while another is not. "*Charter* values" are an important concept that may help to inform a *Charter* right, but they cannot be invoked to modify the wording of the *Charter* itself.

204 In this case, the different nature of the two rights comes to the fore, and it is for this reason that, even though I have held that the legislation in dispute constitutes an unjustified infringement of s. 15, I have chosen to undertake an examination of s. 7 as well, in order to contrast the particular limits of the two rights.

1. Section 7

205 Section 7 of the *Charter* provides that "[e]veryone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice." The appellant in this

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case argues that the statutory framework that reduced benefits for those under 30 infringed her right to security of the person, since it had the effect of leaving her and the members of her class in a position of abject poverty that threatened both their physical and psychological integrity. In order to establish a s. 7 breach, the claimant must first show that she was deprived of her right to life, liberty or security of the person, and then must establish that the state caused such deprivation in a manner that was not in accordance with the principles of fundamental justice.

206 The protection provided for by s. 7's right to life, liberty and security of the person is reflective of our country's traditional and long-held concern that persons should, in general, be free from the constraints of the state and be treated with dignity and respect. In *R. v. Morgentaler*, [1988] 1 S.C.R. 30 (S.C.C.), Dickson C.J. held that security of the person is implicated in the case of "state interference with bodily integrity and serious state-imposed psychological stress" (p. 56).

207 In *New Brunswick (Minister of Health & Community Services) v. G. (J.)*, [1999] 3 S.C.R. 46 (S.C.C.), at para. 60, Lamer C.J. held that, for a restriction of the right to security of the person to be made out:

> the impugned state action must have a serious and profound effect on a person's psychological integrity. The effects of the state interference must be assessed objectively, with a view to their impact on the psychological integrity of a person of reasonable sensibility. This need not rise to the level of nervous shock or psychiatric illness, but must be greater than ordinary stress or anxiety.

208 In this case, the appellant has gone to great lengths to demonstrate that the negative effects of living on the reduced level of support were seriously harmful to the physical and psychological well-being of those affected. Certainly, those who, like the appellant, were living on a reduced benefit were not in a very "secure" position. The remaining question at this first stage of the s. 7 analysis is, however, whether this position of insecurity was brought about by the state.

209 The requirement that the violation of a person's rights under s. 7 must emanate from a particular state action can be found in the wording of the section itself. S. 7 does not grant a right to security of the person, full stop. Rather, the right is protected only insofar as the claimant is deprived of the right to security of the person by the state, in a manner that is contrary to the principles of fundamental justice. The nature of the required nexus between the right and a particular state action has evolved over time.

210 In *Reference re ss. 193 & 195.1(1)(c) of the Criminal Code (Canada)*, [1990] 1 S.C.R. 1123 (S.C.C.) ("*Prostitution Reference*"), Lamer J., as he then was, held that s. 7 was not necessarily limited to purely criminal or penal matters (p. 1175). Nonetheless, he did maintain that, given the context of the surrounding rights and the heading "Legal Rights" under which s. 7 is found, it was proper to conclude that "the restrictions on liberty and security of the person that s. 7 is concerned with are those that occur as a result of an individual's interaction with the justice system, and its administration" (p. 1173).

211 In *G. (J.)* , *supra*, Lamer C.J. again addressed the issue of whether s. 7 rights could be extended beyond the criminal law context, this time, with respect to the right to state-funded counsel for a parent at a custody hearing. In finding that such a right was contemplated by s. 7, he held that the subject matter of s. 7 was "the state's conduct in the course of enforcing and securing compliance with the law, where the state's conduct deprives an individual of his or her right to life, liberty, or security of the person" (para. 65). In *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, 2000 SCC 44 (S.C.C.), I agreed with this statement of the law and concluded that s. 7 rights could be infringed in the context of an investigation under human rights legislation.

212 In *Winnipeg Child & Family Services (Central Area) v. W. (K.L.)*, [2000] 2 S.C.R. 519, 2000 SCC 48 (S.C.C.), the ambit of state action was expanded beyond the confines of a court room. In that case, a mother sought an injunction against the Child and Family Services agency's decision to apprehend her child without a warrant. While there was no judicial process at issue, she claimed that the action of the state in apprehending her child violated her s. 7 right to security of the person. L'Heureux-Dubé J. held that the claimant had been deprived of her right in accordance with the principles

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of fundamental justice, recognizing nevertheless that she had satisfied the first part of the s. 7 test. This can be explained by the fact that the seizure of the claimant's newborn child constituted a determinative government action.

213 Thus, in certain exceptional circumstances, this Court has found that s. 7 rights may include situations outside of the traditional criminal context - extending to other areas of judicial competence. In this case, however, there is no link between the harm to the appellant's security of the person and the judicial system or its administration. The appellant was not implicated in any judicial or administrative proceedings, or even in an investigation that would at some point lead to such a proceeding. At the very least, a s. 7 claim must arise as a result of a determinative state action that in and of itself deprives the claimant of the right to life, liberty or security of the person.

214 Some may find this threshold requirement to be overly formalistic. The appellant, for instance, argues that this Court has found that respect for human dignity underlies most if not all of the rights protected under the *Charter*. Undoubtedly, I agree that respect for the dignity of all human beings is an important, if not foundational, value in this or any society, and that the interpretation of the *Charter* may be aided by taking such values into account. However, this does not mean that the language of the *Charter* can be totally avoided by proceeding to a general examination of such values or that the court can through the process of judicial interpretation change the nature of the right. As held in *Blencoe* , *supra*, "[w]hile notions of dignity and reputation underlie many *Charter* rights, they are not stand-alone rights that trigger s. 7 in and of themselves" (para. 97). A purposive approach to *Charter* interpretation, while coloured by an overarching concern with human dignity, democracy and other such "*Charter* values", must first and foremost look to the purpose of the section in question. Without some link to the language of the *Charter*, the legitimacy of the entire process of *Charter* adjudication is brought into question.

215 In the *Charter*, s. 7 is grouped, along with ss. 8 to 14, under the heading "Legal Rights", in French, "*Garanties juridiques*". Given the wording of this heading, as well as the subject-matter of ss. 8 to 14, it is apparent that s. 7 has, as its primary goal, the protection of one's right to life, liberty and security of the person against the coercive power of the state (Hogg, *Constitutional Laws of Canada* (loose-leaf ed.), vol. 2, at p. 44-9; *Prostitution Reference, supra*, per Lamer J.). The judicial nature of the s. 7 rights is also evident from the fact that people may only be deprived of those rights in accordance with the principles of fundamental justice. As Lamer J. held in *Reference re s. 94(2) of the Motor Vehicle Act (British Columbia)*, [1985] 2 S.C.R. 486 (S.C.C.), such principles are to be found "in the basic tenets of our legal system. They do not lie in the realm of general public policy but in the inherent domain of the judiciary as guardian of the justice system" (p. 503). It is this strong relationship between the right and the role of the judiciary that leads me to the conclusion that some relationship to the judicial system or its administration must be engaged before s. 7 may be applied.

216 To suggest that this nexus is required is not to fossilize s. 7. This Court has already held, in *G. (J.)* , and *Suresh v. Canada (Minister of Citizenship & Immigration)*, 2002 SCC 1 (S.C.C.) , that this link to the judicial system does not mean that s. 7 is limited to purely criminal or penal matters. In *K.L.W., supra*, it was recognized that there need not be a link to a trial-like process. Individuals who find themselves subject to administrative processes may find that they have been deprived of their right to life, liberty or security of the person. The manner in which these various administrative processes will be reviewed has by no means been calcified. Nor has the interpretation of the "principles of fundamental justice" which apply to these processes. However, at the very least, in order for one to be deprived of a s. 7 right, some determinative state action, analogous to a judicial or administrative process, must be shown to exist. Only then may the process of interpreting the principles of fundamental justice or the analysis of government action be undertaken.

217 In this case, there has been no engagement with the judicial system or its administration, and thus, the protections of s. 7 are not available. As will be discussed below, I have concluded that s. 29(*a*) of the *Regulation respecting social aid*, by treating individuals differently on the basis of their age, constitutes an infringement of the appellant's equality rights. However, s. 7 does not have the same comparative characteristics as the s. 15 right. The appellant's situation must be viewed in more absolute terms. In this case, the threat to the appellant's right to security of the person was brought upon her by the vagaries of a weak economy, not by the legislature's decision not to accord her more financial assistance or to require her to participate in several programs in order for her to receive more assistance.

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218 The appellant and several of the interveners made forceful arguments regarding the distinction that is sometimes drawn between negative and positive rights, as well as that which is made between economic and civil rights, arguing that security of the person often requires the positive involvement of government in order for it to be realised. This is true. The right to be tried within a reasonable time, for instance, may require governments to spend more money in order to establish efficient judicial institutions. However, in order for s. 7 to be engaged, the threat to the person's right itself must emanate from the state.

219 In *G. (J.)* , *supra*, for instance, this Court held that the claimant had the right to be provided with legal aid to assist her during a child custody hearing. To the extent that that order required the government to spend money so as to ensure that the complainant was not deprived of her right to security of the person in a manner that was inconsistent with the principles of fundamental justice, such a right could be construed as "positive" and perhaps "economic". However, what was determinative in that case was that the claimant, pursuant to s. 7, was being directly deprived of her right to security of the person through the action of the state It was the fact that the state was attempting to obtain custody of the claimant's children that threatened her security. It is such initial state action, one that directly affects and deprives a claimant of his or her right to life, liberty or security of the person that is required by the language of s. 7.

220 The appellant also directed our attention to the dissenting statements of Dickson C. J. in *Reference re Public Service Employee Relations Act (Alberta)*, [1987] 1 S.C.R. 313 (S.C.C.), in which he noted that a conceptual approach in which freedoms are said to involve simply an absence of interference or constraint "may be too narrow since it fails to acknowledge situations where the absence of government intervention may in effect substantially impede the enjoyment of fundamental freedoms" (p. 361). The question of whether a fundamental freedom can be infringed through the lack of government action was canvassed most recently in the case of *Dunmore* , *supra*. In that case, I held that legislation that is underinclusive may, in unique circumstances, substantially impact the exercise of a constitutional freedom (para. 22). I explained that in order to meet the requirement that there be some form of government action as prescribed by s. 32, the legislation must have been specifically designed to safeguard the exercise of the fundamental freedom in question. The affected group was required to show that it was substantially incapable of exercising the freedom sought without the protection of the legislation, and that its exclusion from the legislation substantially reinforced the inherent difficulty to exercise the freedom in question. While the existence of the *Social Aid Act* might constitute sufficient government action to engage s. 32, none of the other factors enumerated in *Dunmore* are present in this case.

221 In *Dunmore* , I found that the Ontario *Labour Relations Act, 1995*, S.O. 1995, c. 1, Sched. A, instantiated the freedom to organize and that without its protection agricultural workers were substantially incapable of exercising their freedom to associate. The legislation reinforced the already precarious position of agricultural workers in the world of labour relations. In undertaking the underinclusiveness analysis, a complainant must demonstrate that he or she is being deprived of the right itself and not simply the statutory benefit that is being provided to other groups. Here, the *Social Aid Act* seeks to remedy the situation of those persons who find themselves without work or other assistance by providing them with financial support and job training so that they can integrate to the active workforce. As in *Delisle c. Canada (Sous-procureur général)*, [1999] 2 S.C.R. 989 (S.C.C.), and *Haig v. R.*, [1993] 2 S.C.R. 995 (S.C.C.), the exclusion of people under 30 from the full, unconditional benefit package does not render them substantially incapable of exercising their right to security of the person without government intervention. Leaving aside the possibilities that might exist on the open market, training programs are offered to assist in finding work and to provide additional benefits.

222 The appellant has failed to demonstrate that there exists an inherent difficulty for young people under 30 to protect their right to security of the person without government intervention. Nor has the existence of a higher base benefit for recipients 30 years of age and over been shown to reduce, on its own, or substantially, the potential of young people to exercise their right to security of the person. The fact that the remedial programs instituted by the reforms of 1984 might not have been designed in a manner that was overly favourable to the appellant does not help the appellant in meeting her burden. My concern here is with the ability of the appellant's group to access the right itself, not to benefit better from the statutory scheme. The appellant has failed to show a substantial incapability of protecting her right to security.

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She has not demonstrated that the legislation, by excluding her, has reduced her security any more than it would have already been, given market conditions.

223 For these reasons, I would hold that s. 29(*a*) of the *Regulation respecting social aid* does not infringe s. 7 of the *Canadian Charter*. The threat to the appellant's security of the person was not related to the administration of justice, nor was it caused by any state action, nor did the underinclusive nature of the Regulation substantially prevent or inhibit the appellant from protecting her own security. Such a result should not be unexpected. As I noted in *Dunmore* , *supra*, total exclusion of a group from a statutory scheme protecting a certain right may in some limited circumstances engage that right to such an extent that it is in essence the substantive right that has been infringed as opposed to the equality right protected under s. 15(1) of the *Charter*. However, the underinclusiveness of legislation will normally be the province of s. 15(1), and so it is to the equality analysis that we must now turn.

2. Section 15

224 Section 15(1) of the *Charter* protects every individual's right to the equal protection and benefit of the law, without discrimination based on, among other grounds, age. As this Court has enunciated on numerous occasions, a purposive approach to this right must take into consideration a concern for the individual human dignity of all those subject to the law. As noted in the s. 7 analysis, while a concern for and understanding of the basic values underlying the *Charter* are important in order to give proper consideration to a *Charter* claim, such principles cannot be allowed to override the language of the *Charter* itself.

225 Among the grounds of prohibited discrimination enumerated under s. 15(1), age is the one that tends to cause the most theoretical confusion. The source of such confusion in implementing the s. 15(1) guarantee of age equality is rooted in our understanding of substantive equality. In protecting substantive equality, this Court has recognized that like people should be treated alike and, reciprocally, different people must often be treated differently. Most of the grounds enumerated under s. 15(1) tend to be characteristics that our society has deemed to be "irrelevant" to one's abilities. The problem with age is that because we all, as human beings trapped in the continuum of time, experience the process of aging, it is sometimes difficult to assess discriminative behaviour. Health allowing, we all have the opportunity to be young and foolish as well as old and crotchety. As Professor Hogg, *supra*, argues, "[a] minority defined by age is much less likely to suffer from the hostility, intolerance and prejudice of the majority than is a minority defined by race or religion or any other characteristic that the majority has never possessed and will never possess" (p. 52-54).

226 Moreover, whereas distinctions based on most other enumerated or analogous grounds may often be said to be using the characteristic as an illegitimate proxy for merit, distinctions based on age as a proxy for merit or ability are often made and viewed as legitimate. This acceptance of distinctions based on age is due to the fact that at different ages people *are* capable of different things. Ten-year-olds, in general, do not make good drivers. The same might be said for the majority of centenarians. It is in recognition of these developmental differences that several laws draw distinctions on the basis of age.

227 However, despite this apparent recognition that age is of a different sort than the other grounds enumerated in s. 15(1), the fact of the matter is that it was included as a prohibited ground of discrimination in the *Canadian Charter*. Recall that in *Law* Iacobucci J. referred to the remark in *Andrews v. Law Society (British Columbia)* that it would be a rare case in which differential treatment based on one or more of the enumerated or analogous grounds would not be discriminatory: *Law* , *supra*, at para. 110. In contrast, some human rights laws do not include age as a ground of discrimination, or limit the ground to discrimination between the ages of 18 and 65: *Human Rights Code*, R.S.B.C. 1996, c. 210; *Quebec Charter*, s. 10. But the *Canadian Charter* does include age, without internal limitation. In *Corbiere v. Canada (Minister of Indian & Northern Affairs)*, [1999] 2 S.C.R. 203 (S.C.C.), McLachlin J. and I held that the grounds of discrimination enumerated in s. 15(1) "function as legislative markers of suspect grounds associated with stereotypical, discriminatory decision making" (para. 7). Legislation that draws a distinction based on such a ground is suspect because it often leads to discrimination and denial of substantive equality. This is the case whether the distinction is based on race, gender or age. While distinctions based on age may often be justified, they are nonetheless equally suspect. While

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age is a ground that is experienced by all people, it is not necessarily experienced in the same way by all people at all times. Large cohorts may use age to discriminate against smaller, more vulnerable cohorts. A change in economic, historical or political circumstances may mean that presumptions and stereotypes about a certain age group no longer hold true. Moreover, the fact remains that, while one's age is constantly changing, it is a personal characteristic that at any given moment one can do nothing to alter. Accordingly, age falls squarely within the concern of the equality provision that people not be penalized for characteristics they either cannot change or should not be asked to change.

228 The fact that the Regulation here makes a distinction based on a personal characteristic that is specifically enumerated under s. 15 should therefore raise serious concerns when considering whether such a distinction is in fact discriminatory. While not creating a presumption of discrimination, a distinction based on an enumerated ground reveals a strong suggestion that the provision in question is discriminatory for the purposes of s. 15. In recent years, this Court has stated that disrespect for human dignity lies at the heart of discrimination: *Egan v. Canada*, [1995] 2 S.C.R. 513 (S.C.C.), *per* L'Heureux-Dubé J.; *Miron v. Trudel*, [1995] 2 S.C.R. 418 (S.C.C.), *per* McLachlin J.; *Vriend v. Alberta*, [1998] 1 S.C.R. 493 (S.C.C.). However, it is worth repeating that the concept of "human dignity" has essentially been brought to the fore in an effort to capture the essence of what differential treatment based on one of the grounds in s. 15 captures.

229 The framework for undertaking a s. 15 analysis was put forth most recently by this Court in *Law* , *supra*. In that case, this Court affirmed that the s. 15 analysis is to take place through a three-stage process: Is there differential treatment between the claimant and others, in purpose or effect; is the differential treatment based on one or more of the grounds enumerated under s. 15(1) or a ground analogous to those contained therein; does the law in question have a purpose or effect that is discriminatory within the meaning of the equality guarantee? (*Law* , at para. 88). At each stage of this process, the claimant bears the civil burden of proof. This burden remains constant no matter how serious the claim or how many people are potentially involved.

230 It is evident, in this case, and the respondent does not appear to dispute this point, that s. 29(*a*) of the *Regulation respecting social aid* creates a distinction between single social assistance recipients under the age of 30 and those 30 and over. Single recipients under the age of 30 have their base benefits capped at a level one third of that of those 30 and over. While they may participate in certain programs in order to increase their benefits, those 30 and over do not have to do so. This results in the differential treatment of the two groups. Thus, the fundamental question that needs to be dealt with in any depth here is whether the distinction outlined in s. 29(*a*) is indicative that the government treats social assistance recipients under 30 in a way that is respectful of their dignity as members of our society. Evidence regarding the actual impact of the distinction will also be considered, although I conclude that the regulatory regime is discriminatory on its face.

231 In *Law* , *supra*, Iacobucci J. held that this third inquiry is to be assessed as by a reasonable person in the claimant's circumstances, having regard to several "contextual factors". The factors suggested in *Law* , while not exhaustive, are (1) pre-existing disadvantage, stereotyping, prejudice or vulnerability, (2) correspondence between the distinction drawn and the needs, capacity or circumstances of the claimant or others, (3) any ameliorative purpose or effects of the impugned law upon a more disadvantaged group or person, and (4) the nature and scope of the interest affected by the impugned law. Iacobucci J. noted that the presence or absence of any of these contextual factors is not determinative.

232 Interestingly, *Law* , also involved a claim that a legislative provision, by offering lower pension benefits to younger people, constituted age discrimination under s. 15. In that case, the claimant argued that provisions of the Canadian Pension Plan that gradually reduced the survivor's pension for able-bodied surviving spouses without dependant children by 1/120th of the full rate for each month that the claimant's age was less than 45 at the time of the contributor's death was discriminatory. The effect of the legislation was to make 35 years of age the threshold age for receiving survivor benefits for persons not having attained the retirement age of 65. Those over 45 at the time of their spouse's death would receive full benefits, those under 35 would receive no benefits until they were 65, and those between 35 and 45 would receive a graduated amount until they were 65. After examining the contextual factors enunciated above, Iacobucci J. held that this distinction, though based on the enumerated ground of age, was not substantively discriminatory.

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233 The fact that a certain legislative provision which limited the benefits to those under a certain age was found to be constitutional in one case does not necessarily lead to the same conclusion here. In order to determine in this case whether the legislation is respectful of the self-worth and dignity of the appellant, the legislation has to be examined in the context of both its overriding purpose and effects, as well as the situation of the appellant.

234 As this Court held in *Law* and *Egan* , *supra*, the s. 15 analysis must be undertaken from the perspective of the appellant. As this Court has previously agreed, the focus of the inquiry is both subjective and objective (*Law* , at para. 59):

> ... subjective in so far as the right to equal treatment is an individual right, asserted by a specific claimant with particular traits and circumstances; and objective in so far as it is possible to determine whether the individual claimant's equality rights have been infringed only by considering the larger context of the legislation in question, and society's past and present treatment of the claimant and of other persons or groups with similar characteristics or circumstances.

Thus, while it is not enough for the appellant to simply claim that her dignity was violated, a demonstration, following the subjective-objective method previously described, that there is a rational foundation for her experience of discrimination will be sufficient to ground the s. 15 claim (*Lavoie v. Canada*, 2002 SCC 23 (S.C.C.) , at para. 46). The factual basis upon which the court will come to a conclusion on this point is very different from the one that will be considered in the context of a s.1 justification. The appellant in this case must demonstrate that the legislation treated recipients of social assistance under the age of 30 in a manner that would lead a reasonable person, similarly situated, to feel that he or she was considered less worthy of "recognition ... as a member of Canadian society": *Law* , *supra*, at para. 88. There is no balancing of interests here. In order to demonstrate that her dignity is affected, the appellant may wish to deal with some of the factors enumerated in *Law* , such as the manner in which the legislation emphasises a pre-existing disadvantage or stereotype suffered by the appellant's group, the importance or nature of the right that is being withheld from the appellant's group, as well as the degree of care that the government took in crafting the legislation so as to take into account the actual needs and situation of the group's members.

(1) Pre-existing disadvantage or stereotype

235 The first contextual factor that was considered in *Law* was that of pre-existing disadvantage or prejudice. In *Law* , Iacobucci J. took notice of the fact that young widows are generally better situated to prepare for retirement than are older widows; there is no pre-existing disadvantage in their case. The respondent argues the same thing here, noting that young people are generally not considered to be routinely subjected to the sort of discrimination faced by some of Canada's discrete and insular minorities, and that they are not disadvantaged. While, in general, such a rule of thumb may hold true, it is precisely because of the generality of this type of consideration that distinctions based on enumerated or analogous grounds are suspect. The purpose of undertaking a contextual discrimination analysis is to try to determine whether the dignity of the claimant was actually threatened. In this case, we are not dealing with a general age distinction but with one applicable within a particular social group, welfare recipients. Within that group, the record makes clear that it was not, in fact, easier for persons under 30 to get jobs as opposed to their elders. The unemployment rate in 1982 had risen to 14 percent, with the rate among young people reaching 24 percent. As a percentage of the total population of people on social assistance, those under 30 years of age rose from 3 percent in 1975 to 12 percent in 1983. Thus, the stereotypical view upon which the distinction was based, that the young social welfare recipients suffer no special economic disadvantages, was not grounded in fact; it was based on old assumptions regarding the employability of young people. The creation of the assistance programs themselves demonstrates that the government itself was aware of this disadvantage.

236 The appellant argues that people on social assistance have always suffered disadvantage because they are victims of stereotypical assumptions regarding the reasons for being welfare recipients, and are therefore marginalised from society. In making such an argument, the appellant is not comparing social assistance recipients under 30 to those 30

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and over, but instead, comparing the relative position of young social assistance recipients to members of society as a whole. This raises the question of determinating what is the proper comparator.

237 In *Law* , no argument was made that widows, as a category, have been traditionally marginalised. It was recognized, however, that in determining whether a group has suffered previous disadvantage, the analysis need not necessarily adopt the comparator upon which the distinction is first made. The question to be examined here is not whether differential treatment has occurred, which has already been established, but whether the particular group affected has been traditionally marginalised, or has faced unfair stereotyping. In *Ardoch Algonquin First Nation & Allies v. Ontario*, [2000] 1 S.C.R. 950 (S.C.C.), Iacobucci J. noted that the claimant group (non-registered natives) had faced considerable discrimination, but refused to enter into a "race to the bottom" (para. 69) by deciding who is more disadvantaged. The same approach, should, in my view, be adopted here. There is no compelling evidence that younger welfare recipients, as compared to all welfare recipients, have been traditionally marginalised by reason of their age. But that does not end the inquiry.

238 The concern, when determining whether the differential treatment of a group is discriminatory, must, according to this Court in *Law* , be governed by an overarching concern for human dignity. The fact that people on social assistance are in a precarious, vulnerable position adds weight to the argument that differentiation that affects them negatively may pose a greater threat to their human dignity. The fact that their status as beneficiaries of social assistance was not argued as constituting a new analogous ground should not be a matter of concern at this stage of the analysis, since it has already been determined at the second stage of the *Law* test that the differentiation has been made on the basis of an enumerated ground. The issue, at this stage, is to determine whether, in the context of this case, a differentiation based an enumerated ground is threatening to the appelant's human dignity. If the vulnerability of the appellant's group as welfare recipients cannot be recognized at this stage, can we really be said to be undertaking a contextual analysis?

(2) Correspondence between grounds upon which claim is based and the actual needs, capacity or circumstances of the claimant:

239 It is at this stage of the analysis that the contrast between the competing characterisations of the legislation put forth by the appellant and the respondent is most apparent. The appellant claims that the government did not take into account the real circumstances of young adults in crafting its legislation. In arguing this point, she relies on the estimate that, in reality, only 11.2 percent of young adults were able to receive the full amount of assistance.

240 The respondent, on the other hand, argues that while, as in *Law* , this legislation treated younger adults differently because their prospects for supporting themselves in the future were greater than that of their elders, this regulation, unlike that in *Law* , was specifically designed to assist those under 30. In support of this contention, the respondent presents a considerable amount of evidence demonstrating that the institution of the educational programs constituted a response to an alarmingly high rate of unemployment among young people, and was therefore designed to give them the skills necessary to enter the job market so that they could be more autonomous.

241 The witnesses for the respondent explained that their intention in developing the new system was to help young people in their particular situation. However, the language of much of the regulatory scheme appears, on its face, to suggest that the educational programs, and the monetary incentives that accompanied them, were blind as to the age of participants. Sections 32, 35.0.1 and 35.0.2 of the Regulation give no indication that such programs were specifically designed for young people. This is confirmed by the fact that while the programs ostensibly targeted those under 30, some people 30 and over did participate in the programs. In his judgment, Robert J.A. gave considerable weight to the fact that there were not enough places available in the programs to meet the needs of all beneficiaries under 30. When the programs were started, 30 000 places were opened, even though 85 000 single people under 30 were on social assistance. As was mentioned earlier, the programs were also open to persons 30 and over. I do not consider evidence of the number of places opened to be a significant factor in determining legislative purpose.

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242 In my view, the treatment of legislative purpose at this stage of the s. 15(1) analysis must not undermine or replace that which will be undertaken when applying s. 1. Whether the distinction is made explicitly in the legislation, as compared with a facially neutral scheme, is immaterial when looking at legislative purpose. Indeed, this Court has adopted a unified approach to discrimination for claims under both the *Charter* and provincial human rights statutes, and affirmed that the *method* of discrimination is irrelevant. As McLachlin J. wrote for a unanimous Court in *British Columbia (Public Service Employee Relations Commission) v. B.C.G.E.U.*, [1999] 3 S.C.R. 3 (S.C.C.), at paras. 47 and 48:

> In the *Charter* context, the distinction between direct and adverse effect discrimination may have some analytical significance but, because the principal concern is the effect of the impugned law, it has little legal importance. As Iacobucci J. noted at para. 80 of *Law, supra*:
>
> > While it is well established that it is open to a s. 15(1) claimant to establish discrimination by demonstrating a discriminatory legislative purpose, proof of legislative intent is not required in order to found a s. 15(1) claim: *Andrews, supra*, at p. 174. What is required is that the claimant establish that either the purpose or the effect of the legislation infringes s. 15(1), such that the onus may be satisfied by showing only a discriminatory effect. (Emphasis in original.)
>
> Where s. 15(1) of the *Charter* is concerned, therefore, this Court has recognized that the negative effect on the individual complainant's dignity does not substantially vary depending on whether the discrimination is overt or covert. [Emphasis in original.]

243 Whether a positive legislative purpose may be relevant under the *Law* analysis at the s. 15 stage is another matter. As is clear in the passage from *Law* that I have just reproduced, a claimant may demonstrate an infringement of s. 15(1) by either the legislative purpose or the effect. In the context, it is clear that Iacobucci J. is talking only about a *detrimental* purpose or effect, since it is nonsensical to think that a claimant might establish that a beneficial or benign purpose or effect infringes s. 15(1). It may be argued that a positive legislative intention might make some difference in the subjective-objective assessment of a distinction's impact on a claimant's human dignity, but the "principal concern", as McLachlin J. put it, remains the effect. Furthermore, any argument based on the positive legislative intention must take into account the impugned distinction. As stated earlier, the assumption that long- term benefits of training are greater for younger persons has nothing to do with the present need of all persons for a minimum amount of support and their likely response to the availability of training programs through penalties or incentives.

244 Indeed, giving too much weight here to what the government says was its objective in designing the scheme would amount to accepting a s. 1 justification before it is required. Commentators have already raised concerns with the blurring between s. 15 and s. 1: see e.g. C. D. Bredt and A. M. Dodek, "The Increasing Irrelevance of Section 1 of the Charter" (2001), 14 *Sup. Ct. L. Rev.* (2d) 175, at p. 182; Hogg, *supra*, at p. 52-27. In my view, it is highly significant whether certain factors are considered under s. 15 or s. 1. As the Chief Justice recently wrote for the majority of this Court in *Sauvé v. Canada (Chief Electoral Officer)*, 2002 SCC 68 (S.C.C.) , at para. 10:

> The *Charter* distinguishes between two separate issues: whether a right has been infringed, and whether the limitation is justified. The complainant bears the burden of showing the infringement of a right (the first step), at which point the burden shifts to the government to justify the limit as a reasonable limit under s. 1 (the second step). These are distinct processes with different burdens.

The point is that under the *Oakes* analysis, the legislative objective is not accepted uncritically. At the s. 15 stage, it is not appropriate to accept at face value the legislature's characterization of the purpose of the legislation and then use that to negate the otherwise discriminatory effects.

245 In any case, as I have noted, the legislature's intention is much less important at this stage of the *Law* analysis than the real effects on the claimant. The fundamental question, then, in this case, is not how the legislature viewed the scheme, nor how members of the majority would have viewed it in relation to the claimant group. The approach set out

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for us by *Law* is to ask how any member of the majority, reasonably informed, would feel in the shoes of the claimant, experiencing the effects of the legislation. This approach is essential: if people whom the legislature views as different are not demonstrably different at all, the measure should not be acceptable. In other words, this Court's holding that substantive equality can mean treating different people differently applies only where there is a genuine difference.

246 Moreover, unlike the situation in *Law* , in which the legislation in question gradually decreased the benefits from the age of 45 to 35, the *Social Aid Act* created a bright line at 30, a line which appears to have had little, if any, relationship to the real situation of younger people. As the appellant has demonstrated, and the respondent conceded, the dietary and housing costs of people under 30 are no different from those 30 and over. The respondent argued that those under 30 were more likely to live with their parents than those 30 and over. While this appears to have been true, the government had no empirical data to support that view when it adopted the Regulation; it was also shown that those over 25 were much less likely to live with their parents than those under 25. Thus, the decision to draw a bright-line at the age of 30 appears to have little to do with the actual situation of the affected group.

247 No attempt appears to have been made by the government to actually identify those recipients who were living with their parents, either through the Regulation or through the screening and application process. In fact, no effort was made to establish what living conditions were and a presumption was adopted that all persons under 30 received assistance from their family. This was obviously untrue, as the appellant's personal experience has shown. It is worth mentioning here that this situation is very different from that in *Law* , where there was a rational basis for presuming that younger widows had fewer needs and superior means of meeting those needs than older widows. In contrast, the young in the present case have similar needs to their elders and their relative youth provides no advantage in meeting those needs.

248 While the government offered evidence to show that the programs it established targeted what it saw as the needs of those under 30, there does seem to have been a certain degree of reliance on the fact that, by happenstance, the distinction between those under 30 years of age and those 30 and over had traditionally existed in Quebec's social assistance laws. As the government economist Pierre Fortin noted in his report, speaking about the need to do something about the difficult situation facing young welfare recipients:

> [TRANSLATION]
>
> An opportunity was provided by the existence of the reduced scale for those capable of working who were under 30 years of age, which could be brought back up to the regular scale provided the recipient participated in one or other of the employability development measures

(P. Fortin, *Les mesures d'employabilité à l'aide sociale: origine, signification et portée* (1990)). The prior existence of the distinction between beneficiaries under 30 and those 30 and over was based upon older schemes which had sought to emphasise the "principle of parental responsibility" and which had been created within the context of much lower levels of youth unemployment. Thus, the relationship between the actual needs of welfare recipients under 30 and the provisions of the *Social Aid Act* and Regulation was not particularly strong. By relying on a distinction that had existed decades earlier and that did not take into account the actual circumstances faced by those under 30 in the 1980s, the legislation appears to have shown little respect for the value of those recipients as individual human beings. It created for them what it defined as substandard living conditions on the basis of their age. Where, as here, persons experience serious detriment and evidence shows that the presumptions guiding the legislature were factually unsupported, it is not necessary to demonstrate actual stereotyping, prejudice, or other discriminatory intention. Nor does a positive intention save the regulation. That is the lesson to be drawn from this Court's cases on indirect or effects discrimination: *B.C.G.E.U.* , *supra*; *Eldridge v. British Columbia (Attorney General)*, [1997] 3 S.C.R. 624 (S.C.C.); *Canadian National Railway v. Canada (Human Rights Commission)*, [1987] 1 S.C.R. 1114 (S.C.C.). I would therefore disagree with the Chief Justice's views as expressed at para. 38 of her reasons. She writes there that far from being stereotypical or arbitrary, the program was calibrated to address the particular needs and circumstances of young adults requiring social assistance. In my view it is more appropriate to characterize the government's action in this way: Based on the unverifiable presumption that people under 30 had better chances of employment and lower needs, the program delivered to those people two thirds less of

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what the government viewed as the basic survival amount, drawing its distinction on a characteristic over which those people had no control, their age.

249 Before turning to the next contextual factor, I wish to address the issue of evidence and the burden of proof necessary to demonstrate a *Canadian Charter* infringement. The Chief Justice is clearly influenced by what she perceives as the lack of evidence from other individuals besides Ms. Gosselin in support of the contentions of adverse effect. It appears to me that the Chief Justice is also influenced by the procedural fact that Ms. Gosselin's claim was authorized as a class action. It is clear that, in Quebec, to obtain authorization for a class action, the applicant must prove the existence of a group of persons harmed by facts deriving from a common origin: P.-C. Lafond, *Le recours collectif comme voie d'accès à la justice pour les consommateurs* (1996), at p. 400. Ms. Gosselin obtained authorization, and that authorization is not a live issue in this appeal, so it is established that she has proved the existence of such a group before the court. While even respecting the common law mechanism it is not necessary that common issues predominate or that the class members be identically situated *vis-à-vis* the opposing party (*Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534 (S.C.C.), at para. 39, *per* McLachlin C.J.), the legislature in Quebec deliberately departed from the conception of common interest by which all points at issue must be identical, questions of law as well as questions of fact. The legislative intention was for the class action to apply where the problem raised by a member of the group resembles without being identical to those raised by other members. See Lafond, *supra*, at pp. 405-6; *Code of Civil Procedure*, R.S.Q., c. C-25, art. 1003(*a*). The question of the extent of individual disadvantage suffered would become relevant much later, when calculating damages. At this stage, however, it would be a departure from past jurisprudence for this Court to refuse to find a *Canadian Charter* breach on the basis that the claimant had not proven disadvantage to enough others. As the Chief Justice wrote in *Sauvé* , *supra*, at para. 55: "Even one person whose *Charter* rights are unjustifiably limited is entitled to seek redress under the *Charter*."

(3) Ameliorative Purpose

250 The respondent argues that the purpose of this legislation was ameliorative in that it was meant to improve the situation of unemployed youths through academic and experiential benefits, as opposed to exclusively pecuniary assistance. Quite simply, this is not a useful factor in determining whether this legislation's differential treatment was discriminatory. In *Law* , *supra*, Iacobucci J. held that a piece of legislation might be less harmful to a group's dignity if its purpose or effect is to help a more disadvantaged person or group in society. In that case, the fact that the purpose of the legislation was to aid elderly widows meant that the impact on the dignity of those under the age of 35 was lessened. Such is not the case here. In this case, the legislature has differentiated between the appellant's group and other welfare recipients based on what it claims is an effort to ameliorate the situation of the very group in question. Groups that are the subject of an inferior differential treatment based on an enumerated or analogous ground are not treated with dignity just because the government claims that the detrimental provisions are "for their own good". If the purpose and effect of the distinction really are to help the group in question, the government should be able to show a tight correspondence between the grounds upon which the distinction is being made and the actual needs of the group. Here, no correspondence has been shown between the lower benefit and the actual needs of the group, even though it may have been established that the programs were themselves beneficial. The only logical inference for the differential treatment is that younger welfare recipients will not respond as positively to training opportunities and must be coerced by punitive measures while older welfare recipients are expected to respond positively to incentives.

(4) Nature of the Interest Affected

251 The more important the interest that is affected by differential treatment, the greater the chance that such differential treatment will threaten a group's self-worth and dignity. This determination will generally require both a qualitative assessment of the interest affected and a quantitative inquiry as to the extent to which it is denied to the claimant. This case deals with a social assistance program which, despite the admitted existence of a secondary objective of helping people integrate into the workforce, has as its stated purpose the provision of the basic necessities for those in need. Thus, when the government creates a distinction that in some cases will result in people receiving only one third of what it has deemed to be the bare minimum for the sustainment of life, the effect on the members of the group is severe.

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As Iacobucci J. held in *Law* , *supra*, citing L'Heureux-Dubé J. in *Egan* , *supra*: "the discriminatory calibre of differential treatment cannot be fully appreciated without evaluating not only the economic but also the constitutional and societal significance attributed to the interest or interests adversely affected by the legislation in question" (para. 74). Here, there is an obvious and important interest in having enough money to assure one's own survival.

252 In *Law* , the Court noted that the purpose and function of the impugned CPP provisions were not to remedy the immediate financial need experienced by widows and widowers, but rather to enable older widows and widowers to meet their basic needs in the long-term. In this case, while it is admitted that dealing with long-term dependancy is one of the legislation's objectives, the short-term remedying of immediate financial needs continues to play a dominant role in the objectives of the legislation. The difference in the nature and importance of the interest affected - provision for basic needs immediately as opposed to over the long term - is one of the crucial distinctions between the present case and *Law* . The effect of the distinction in the present case is that the claimant and others like her would have had their income far below not just the government's poverty line, but its basic survival amount. A genuine contextual approach will appreciate this distinction and will not find the result determined by the apparent similarities in that both cases address an age distinction for a government benefit.

253 In her submissions, the respondent argues that it was not the creation of a lower base level of support for young people that was responsible for the deplorable situation in which many of them found themselves during the early 1980s. Instead, she argues, what was being offered were skills to allow young persons to enter the workforce, thereby reinforcing their dignity and self-worth:

> [TRANSLATION] work is universally recognized as an essential component of human dignity.

254 This statement says nothing about the differential treatment of those offered opportunities to obtain training or work experience. Furthermore, what much of the government's reasoning neglects is that the global economic situation that created the need for a program to help young people was characterized by the fact that there were no jobs available. The reason that these young people were not in the labour force was not exclusively that their skills were too low, or that they were undereducated, but that there were no jobs to be had. This is not to question the wisdom of the government's programs, but to emphasize that the effect that the maintenance of this distinction had on the members of the group in question was real and severe given the economic context of the time. *Even if one were to accept, as I do not, that the government's positive intention was a significant factor in diminishing the impact of the impugned law on human dignity, or that there was no implicit stereotype that young persons would not have participated in training programs absent severe deprivation, any reading of the evidence indicates that it was highly improbable that a person under 30, with the best intentions, could at all times until he or she was 30 years old be registered in a program and therefore receive the full subsistence amount. Not all programs were open to each welfare recipient, and there would inevitably be waiting periods between the completion of one program and the start of another. During such periods, persons under 30 would clearly be exposed to deep poverty unlike persons 30 and over, in a way going directly to their human dignity and full participation as equally valued members of society*.

255 The situation of Ms. Gosselin herself is illustrative of the manner in which s. 29(*a*) operated and affected her basic human dignity. There is no necessity for her to bring evidence of actual deprivation of other named welfare recipients under the age of 30. From the inception of the legislative scheme in question, Ms. Gosselin spent some months participating in the programs, receiving full benefits, and some months between programs, receiving a reduced amount in benefits. During the times that she was participating in the programs, she benefited from the experience that the programs offered, as well as the increase in benefits that such participation provided her. But, being a person under 30 years of age, much of the time she was living in fear of being returned to the reduced level of support. At certain times, she was not immediately capable of entering into a program; then, as well as when a program ended, she was left to fall back on the lower benefit. When she was given the opportunity of participating in a program, she took advantage of it. But if her participation in a particular program did not work out, as when she discovered that she had an allergy to animals and could no longer work at the pet store, she was left to survive on the reduced amount until another placement was made

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available to her. The presumption that she could rely on her mother was not based on true fact. She was in reality forced to survive on less than the recognized minimum received by those 30 and over.

256 This threat to her living income, described by a government witness as "the stick" to accompany "the carrot", caused a great deal of stress to the appellant. This additional stress, which was not experienced by those recipients 30 and over, dominated the appellant's life. Even when she was able to live with her mother, the arrangement was not ideal. It was in fact a situation she expended a great deal of energy in avoiding. At certain times, living with her mother was not even an option, as when the rules in her mother's housing changed, preventing the appellant from sharing her mother's one-bedroom apartment. Undoubtedly, this is a situation that would be stressful for any person, but for the purposes of s. 15 what made the appellant's experience demeaning was the fact that she was placed in a position that the government itself admits is a precarious and unliveable one, while it provided that older recipients of social assistance would be permitted to participate in at least one of the same programs and to receive an equivalent increase in benefits. Older recipients did not suffer a massive decrease in their benefits for failure to participate in a self-improvement program. This distinction was made simply on the basis of age, not need, opportunity or personal circumstances.

257 I wish to reiterate that, as this Court's jurisprudence makes clear, the fourth contextual inquiry focuses on the particular interest denied or limited in respect of the claimant, not the societal interests engaged by the legislature's broader program or another particular benefit purportedly being provided to the claimant. In my view, the interests that the Chief Justice discusses under the fourth inquiry of the *Law* test at para. 65 belong properly under the s. 1 justification. The interest denied the appellant in this case was not "faith in the usefulness of education," but rather welfare payments at the government's own recognized subsistence level. Consideration of any "positive impact of the legislation" belongs in the proportionality analysis at s. 1.

258 In conclusion, the appellant has shown that in certain circumstances, and in her circumstances in particular, there were occasions when the effect of the *Regulation respecting social aid's* differentiation between those under 30 years of age and those 30 and over was such that beneficiaries under 30 could objectively be said to have experienced governmental treatment that failed to respect them as full persons. Given that this differential treatment was based on the enumerated ground of age, it was already suspect for the purposes of s. 15. The fact, among others, that no matter what she did, a beneficiary under 30 would never receive the same benefit as a beneficiary 30 or over participating in a similar program confirms, from the standpoint of the reasonable person, that such treatment would affect one's own feeling of self-worth. I would therefore find that the distinction made by s. 29(*a*) of the *Regulation Respecting Social Aid* is discriminatory.

259 It can be argued that the government could not design a perfect program, and that in a program such as this, some people are bound to fall through the cracks. Indeed, the Chief Justice accepts this argument, noting that a government need not achieve a perfect correspondence between a benefit program and the actual needs and circumstances of the claimant group. But in light of the importance of the interest affected, this should not provide a bar to a finding that Ms. Gosselin's dignity was adversely affected. The severe harm suffered by the appellant as a result of the age-based distinction far exceeds the margin of imperfection Iacobucci J. contemplated in *Law* , *supra*, at para. 105. The respondent's claim that such treatment was in the best interest of the appellant is better left to the s. 1 analysis where the government can argue that the adverse effects that the legislation had on the appellant's dignity were justifiable given the practical, economic and social reality of designing a complex social assistance program. Indeed, this sort of reasoning is typical of reasoning under the *Oakes* test, at minimal impairment or proportionality, to determine whether a breach, *once found*, is justifiable: *R. v. Videoflicks Ltd.*, [1986] 2 S.C.R. 713 (S.C.C.). It is not what we associate with s. 15 reasoning, and in this case serves to make sustaining a breach much more onerous. As I noted earlier, the burden of proof is significant, too. The Chief Justice appears to believe that the appellant has the onus, under s. 15(1), to demonstrate not only that *she* is harmed, but also that the government program allows more than an acceptable number of *other* individuals to fall through the cracks. Given the government's resources, it is much more appropriate to require it to adduce proof of the importance and purpose of the program and its minimal impairment of equality rights in discharging its burden under s. 1.

3. Section. 1

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260 Since it is found that the appellant's equality rights were infringed by the legislation, the burden falls on the government to prove that such a limit on her rights was a reasonable one that is demonstrably justifiable in a free and democratic society; see *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.), at pp. 136-37. In order to demonstrably justify such a limit, the government must show that the provision pursues an objective that is sufficiently important to justify limiting a *Charter* right, and that it does so in a manner that is (1) rationally connected to that objective, (2) impairs the right no more than is reasonably necessary to accomplish the objective, and (3) does not have a disproportionately severe effect on the persons to whom it applies; see *Oakes*, at pp. 138-39.

261 These criteria will be applied with varying levels of rigour depending on the context of the appeal; see *Thomson Newspapers Co. v. Canada (Attorney General)*, [1998] 1 S.C.R. 877 (S.C.C.). In this case, we are presented with a law that attempts to remedy the financial situation of the chronically unemployed by providing them with cash benefits and training in order to ensure their subsistence and help them integrate into the workforce. The development of the training programs was obviously a complex process that involved the balancing of various interests, the expenditure of large sums of public money, and a consideration of many variables. Social policy is by no means an exact science; a certain degree of deference should be accorded in reviewing this type of legislation. That being said, the government does not have *carte blanche* to limit rights in the area of social policy.

262 In *Thomson Newspapers*, I held that part of what may lead to deference under a contextual approach to s. 1 is the fact that the legislation is meant to protect a vulnerable group. In such a case, the importance of deferring to the government's decision in balancing competing interests is highlighted. However, in this case, the government claims that the group that it is in fact trying to protect is the very same group whose rights have been infringed. This should militate against an overly deferential approach. If the government wishes to help people by infringing their constitutional rights, the courts should not, given the peculiarities of such an approach, be overly deferential in assessing the objective of the impugned provision or whether the means used were minimally impairing to the right in question.

(1) Objective - Pressing and Substantial

263 In his reasons, Robert J.A. held that for the purposes of the *Oakes* test, it is the objective of the distinction that should be analysed. In doing so, he determined that the distinction served two purposes: (1) to avoid attracting young adults to social assistance, and (2) to facilitate integration into the workforce by encouraging participation in the employment programs. The appellant argues that the objective of the distinction should be analysed in light of the legislation as a whole, in particular, the explicit objective of the legislation under s. 6 to provide supplemental aid to those who fall below a subsistence level. Furthermore, she argues that the objective of the legislation cannot, pursuant to this Court's decision in *R. v. Big M Drug Mart Ltd.*, [1985] 1 S.C.R. 295 (S.C.C.), be found to have "evolved". The respondent agrees with the double objective analysis of Robert J.A.

264 In my view, the double objective analysis of Robert J.A. is correct. While the s. 1 analysis must not take place in a contextual vacuum, when a specific legislative provision has been found to infringe a *Charter* right, the s. 1 analysis must focus on the objective of that particular provision. In cases such as *Vriend* , *supra*, in which this Court focussed on the legislation as a whole, it did so because the legislation was being challenged for underinclusion; thus, there was no specific provision to be considered. Here, s. 29(*a*) is clearly the impugned provision. The s. 1 analysis must therefore focus on the distinction it creates. If too much weight is given to the objective of the legislation as a whole, this will lead the court into an inquiry of what would be the best way to formulate an entire piece of legislation. That is the province of the legislature.

265 While the "shifting emphasis" argument accepted by Robert J.A., seems to suggest a novel approach to the s. 1 analysis, I believe it was appropriate to accept it in this case. This Court has normally held that the objectives of legislation cannot be found to have evolved over time. But in this case, it was a legislative act that signalled the change in emphasis; *Big M Drug Mart, supra*. In my view, the 1984 changes to the Act, which established the educational programs and provided for an increase in assistance for those who participated in them, constituted a legislative signal that the objective of the distinction in s. 29(*a*) had, to a certain degree, shifted.

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266 Having found that the objective of the distinction had shifted towards encouraging the integration of young people into the workforce, and given the dire situation of that segment of the population during those years, I would find the objectives of s. 29(*a*) to be pressing and substantial.

(2) Rational Connection

267 The appellant attacks the rational connection between the means used by the government and its dual objective on two fronts. First, she argues that the choice of age 30 as the point of distinction was made arbitrarily and that it had no bearing on the means by which the government would achieve its objective. She argues that the government distinguished beneficiaries on the basis of age 30 simply because that distinction already existed, and therefore, in the words of a government witness, because [translation] "an opportunity was provided". She also argues that the level of assistance accorded to those under 30 who did not participate in the programs was arbitrary. In her view, if the purpose of selecting a low level of assistance was to encourage participation in the programs, then there should have been enough places available in the programs to accommodate everyone under the age of 30, which there was not.

268 The respondent agrees with Robert J.A.'s conclusion that while the connection between the means and the objective might not have been shown to be particularly strong, there was a logical link between the different treatment of those under 30 and the objective of encouraging the integration of these people into the workforce. She disagrees, however, with some of his analysis, emphasising again that the distinction made in s. 29(*a*) has to be analysed in the context of the rest of the legislation and the economic situation of the time.

269 On this issue I am again in agreement with the findings of Robert J.A. There is a logical link between the provisions of the Regulation and the objective of integrating people under 30 into the workforce. It is logical and reasonable to suppose that young people are at a different stage in their lives than those 30 and over, that it is more important, and perhaps more fruitful, to encourage them to integrate into the workforce, and that in order to encourage such behaviour, a reduction in basic benefits could be expected to achieve that objective.

(3) Minimal Impairment

270 It is on the issue of minimal impairment that Robert J.A. found that the legislation could not be upheld under s. 1. Again, I find myself in substantial agreement.

271 First, I would agree with Robert J.A.'s comments regarding the onus that the government must meet at this stage of the analysis. When analysing social legislation, it is true that the Court should avoid second-guessing government policy. The government need not have chosen the least drastic means at its disposal. Nonetheless, it must have chosen to infringe the right as little as was reasonably possible. The respondent argues that given the government's objectives and the evidence it put forth, the methods employed were reasonable and should therefore pass the minimal impairment test. I do not believe that this is the case.

272 The respondent argues that by allowing people under 30 to participate in programs in order to increase their benefits to the level of those 30 and over, the government demonstrated that the needs and concerns of young social assistance recipients were given careful consideration and were respected. She rejects the alternatives proposed by the appellant - such as the elimination of s. 29(*a*) or the creation of a universally conditional program - as either eliminating the objective completely or as being impossible to implement. An examination of the evidence, however, fails to demonstrate that such approaches would not have been appropriate. With regard to increasing the level of support provided to those under 30, the government insists that such an approach would have prevented it from achieving its objective of integrating young people into the workforce. This is presumably based on the assumption that there would be less incentive to enter the workforce or to participate in the programs if the full benefit was provided unconditionally. However, this remains unproven in the record. There is nothing to show why the response of beneficiaries under 30 would have been different from that of older beneficiaries, and nothing to show why integration in the workforce would have been superior for participants under 30 as compared to older participants. Witnesses for the respondent repeatedly

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referred to the [translation] "attraction effect" that would result from increasing the benefits of people under 30, but they failed to adduce any evidence of studies or previous experience to justify the hypothesis. Aside from supporting the contention that the provisions reflect a discriminatory and stereotypical view of irresponsible youth, such participation by some persons among those 30 and over demonstrates that tying the programs to reduced benefits was not the only option that was available to the government.

273 I also find the argument that the reforms of 1989 which made the programs universally conditional could not have been implemented earlier to be somewhat unconvincing. When the *Charter* was passed in 1982, a three-year delay was placed on the implementation of s. 15 in recognition of the effect it could have had on government legislation and the complexity of making appropriate changes. With the passage of the omnibus *Act Respecting the Constitution Act, 1982*, the government of Quebec provided itself with two extra years to deal with the requirements of the equality provision. Therefore, as of 1982, the Quebec government had five years to consider the implications that the *Charter*'s equality provision would have for its *Social Aid Act*. Although the government demonstrated that such changes took 18 to 24 months to implement, it did not demonstrate why that process could not have begun at an earlier date.

274 Thus, it seems to me that the above alternatives cannot be characterized as unreasonable; certainly they would also have been less impairing. However, given the complexity of designing social assistance programs, I accept that the Court should not be in the business of advocating completely new policy directions for the legislature. At the time the legislation was passed, in 1984, it seems clear that the government believed that the continued distinction between those under 30 and those 30 and over was necessary in order to achieve its objective of facilitating the integration of young people into the workforce. Nevertheless, given the availability of the alternative approaches that would have been less impairing to the right, the onus is on the government to demonstrate that the approach it took was itself minimally impairing.

275 Like Robert J.A., upon examination of the manner in which the legislation in question was implemented, I have come to the conclusion that the government's initiative was not designed in a sufficiently careful manner to pass the minimally impairing test. As Robert J.A. held at p. 1084, the government has failed to show:

> [TRANSLATION]
>
> (1) that it set sufficiently flexible eligibility requirements for access to the programs; and
>
> (2) that it acted reasonably in determining the requirements for an increase in assistance, which was only possible through participation in the measures.

276 In assessing whether the legislation in place was minimally impairing to the right, the first fact that comes to light is that only 11 percent of social assistance recipients under the age of 30 were in fact enrolled in the employment programs that allowed them to receive the base amount allocated to beneficiaries 30 years of age and over. This in and of itself is not determinative of the fact that the legislation was not minimally impairing, but it does bring to our attention the real possibility that the programs were not designed in a manner that would infringe upon the appellant's rights as little as is reasonably possible. In examining the record, I have found four areas in which the structure of the legislation and the programs can be shown to have been designed in a manner that was not minimally impairing of the appellant's rights.

277 First, one major branch of the scheme, the Remedial Education Program, did not provide for full benefits for those who participated, leaving them $100 short of the base benefit. Thus, the government foresaw, in the creation of its programs, that a large number of even those who participated in the programs would, in return for their efforts, continue to receive less than the amount received by those 30 and over who were not participating in the programs. As mentioned earlier, the most uneducated, the illiterate, were originally left out of this program entirely. The government argues that the amount of assistance must be examined in tandem with the government student loan and bursary program. However, because the Remedial Education students were in high school, the government witness admitted that the only money that they would receive through student loans would be to pay for specific school-related expenses such as books and school supplies. As such, the student loan program did not raise the Remedial Education participant's benefits to the

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same level as those 30 and over. In reality, given that almost 50 percent of participants under 30 were involved with the Remedial Education Program, this meant that a very large portion of the participants would not be receiving the full amount of benefits that those 30 and over were receiving.

278 It might be argued that the value of the education and experience being derived from such programs cannot be calculated on a purely pecuniary basis. I would agree that the power of education can be invaluable to its recipient. However, the strength of this argument is diminished by the fact that the cost of this education is, in this case, the reduction of benefits that are supposed to guarantee certain standards of minimal subsistence. While the long-term value of the education and experience is certainly important, this must be balanced against the short-term need for survival that social assistance is intended to placate. Moreover, those people who participated in the programs who were not under 30 were not required to make a similar sacrifice.

279 Second, the design of the programs was not tailored in such a way as to ensure that there would always be programs available to those who wanted to participate. For instance, for a student who could not find a job after finishing school, the Remedial Education Program was only available after 9 months. The On-the-job Training Program was only available after 12 months. This left the Community Work Program, which, given its very remedial nature, may not have been useful to everyone, and was prioritized for those who had been on social assistance for more than 12 months. The existence of this priority is itself evidence that the programs were not available to all applicants at all times. For someone who had completed CEGEP, the Remedial Education and On-the-job Training Programs would simply be unavailable. Even if he or she were then able to participate in the Community Work Program, this would only last for one year, after which the young social assistance recipient would, because of the 12-month limit on the program, be left with no program in which to participate. Take someone like Ms. Gosselin, whose prospects for moving into the private workforce, like many in her situation, do not, unfortunately, appear to have been very promising. After one year in a Community Work Program (and, if they could find one, a year in an On-the-job Training placement), she would be unable to receive the same benefit as someone 30 or over. Thus, in reality, the system of training and education gave social assistance recipients under 30 who were able to access programs two years to get a job before they had their benefit reduced to $170 per month - with some extra time available at a moderately reduced rate for those who had not yet received their high school diploma.

280 Another substantive flaw in the design of the programs was that faced by illiterate or severely undereducated persons, who were unable to participate in the Remedial Education Program. While ineligible for the Remedial Education Program, such persons would also face difficulty entering On-the-job Training, and would thus be left with the Community Work Program, which, as has been noted, was limited to one year. This flaw was apparently addressed in 1989 with the creation of a special literacy program, but it nonetheless serves as an example of another situation where even those participants who were willing to participate were at times unable to do so.

281 Third, in addition to the problems with the design of the programs, their implementation presented still more hurdles which young recipients were forced to overcome. For instance, when a person under 30 years of age found himself or herself on social assistance, he or she would have to organize a meeting with a social aid worker. An "evaluation interview" would follow, sometimes several, in order to determine what type of program would be best suited to the recipient. This process would sometimes take several weeks. Then, once it was determined which program would be best, there was often another delay, as space in the program in which the recipient could participate had to be found. If, for instance, someone wanted to participate in the Remedial Education Program in June, he or she would have to wait until September, for school to start. In the case of the On-the-job Training Program, the process provided that one would have to wait until a suitable employer was found. Also, the employer had the final say as to whether he or she wished to hire a particular individual. This caused more delay. Once a placement was completed, this process was started all over again. Thus, in the course of his or her time on social assistance, a young person desiring to receive the full benefit of the programs would most likely spend at least a month or two on the reduced benefit.

282 Given the precarious situation of those on social assistance, even a short lapse in additional benefits was certainly enough to cause major difficulties in the recipients' lives, difficulties that someone 30 and over would not have to face.

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Ms. Gosselin herself spent a considerable amount of time between programs, this sometimes leading to periods of mental breakdown. One government witness described the situation of many of those young people on social assistance as being an existence "on the edge of capacity" - walking a tightrope along the border of aptness and inaptitude for work. Falling back onto the reduced amount was therefore a very real possibility that could have exaggerated effects on the capacity of young recipients to cope with life.

283 A fourth and final reason why the approach taken by the government was not reasonably minimally impairing was the fact that even though 85 000 single people under 30 years of age were on social assistance, the government at first only made 30000 program places available. The respondent argues, and Baudoin J.A. agreed, that the government should not have been forced to open up places for everyone when it knew that not everyone would participate. I think this is right. The government did not have to prove that it had 85 000 empty chairs waiting in classrooms and elsewhere. However, the very fact that it was expecting such low levels of participation brings into question the degree to which the distinction in s. 29(*a*) was geared towards improving the situation of those under 30, as opposed to simply saving money. The government noted that many places did not have to be made available because 50 percent of young people were thought to be living with their parents. As noted earlier, this was not proven and if true would have left 50 percent of recipients in an unjustified state of deprivation. Also, it is by no means clear why young persons living at home would not want to take advantage of such programs if they provided them with an extra $296 per month. Moreover, it is not clear why, if the object of s. 29(*a*) was to encourage the integration of young people into the workforce, the government would not expect or want those on social assistance who were living at home to participate in the programs.

284 The government maintains that it always had more places available if the need arose, but the evidence has left me questioning how a program such as On-the-job Training which relied on private enterprises to provide jobs could provide an endless stream of positions for any young person on social assistance who wanted one. It also seems somewhat disingenuous to suggest that there were unlimited spaces in the program when the program profiles clearly outline that some groups were to be specifically targeted, others given preference. How can there be preferences when access to the programs is unlimited? It also seems odd that a government that claims it would not have been able to eliminate the reduced benefit level for people under 30 for economic reasons would have been able to support a program in which a significant portion of those persons participated in the programs and, therefore, had their benefits increased to the normal level. If legislation is found to infringe upon a group's right and the government claims that the right is minimally impaired due to the operation of another program, the fact that only 20 percent of the affected group participates would seem to suggest that the right was not being reasonably infringed.

285 Accordingly, I would hold that, even according a high degree of deference, the respondent has failed to demonstrate that the provision in question constituted a means of achieving the legislative objective that was reasonably minimally impairing in respect of the appellant's equality rights. Other reasonable alternatives to achieve the objective were available. The approach taken by the government involved providing a vulnerable group with a base amount of money that was one third of the level the government itself had deemed to be a subsistence level for others and, moreover, the programs themselves were additionally found to have several important shortcomings. This was not minimally impairing of the right. The respondent has therefore failed to meet its burden of demonstrably justifying the limitation on the appellant's rights.

286 Even accepting the general approach of differentiating between those under 30 and those 30 and over that the legislature adopted to achieve its objectives, there are several other means by which the substantive equality of young people would have been considerably more respected and less impaired. First, as Robert J.A. suggested, the full benefit could have been extended to those individuals who had expressed their willingness to participate in a program, as opposed to requiring them to be at all times participating in programs that, by their design and implementation, did not allow for constant participation. Another approach, given the government's opinion that the majority of young people on welfare were living at home and therefore did not require the full benefit, would have been to tie the benefits to whether the recipient - whatever his or her age - was actually living at home. This was already being done for other recipients since anyone 30 or over living with family had his or her benefits reduced by $85. This would have had the effect of recognizing

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that many young people did not require the full amount of social assistance, while basing the amount awarded on their actual situation as opposed to the proxy of age.

287 Having found that the legislation was not minimally impairing of the appellant's right to equality, I would hold that the legislation was not a reasonable limit on the right that was demonstrably justified. The final branch of the *Oakes* test need not therefore necessarily be addressed. However, given the deleterious effect that the legislation had on the appellant's right it would, I believe, be useful to consider that branch of the test as well.

(4) Proportionality

288 At this stage of the *Oakes* test, a court must determine whether the deleterious effects that a legislative provision has on a given rights holder are outweighed by the salutary effects of the same legislation in achieving the stated government objective. Here, again, I agree with Robert J.A. It is clear from the evidence that $170 per month is not enough money for one to live on. While the government claims that those under 30 had the right to increased benefits if they participated in the programs, there were clear holes in the programs which prevented certain individuals, at certain times, from accessing the additional benefits. Moreover, Remedial Education students never achieved parity. In fact, though this is not determinative, only 11 percent of single persons under 30 years of age who were on social assistance actually received what the government had determined to be the basic amount needed to support one's self. This constitutes a severe deleterious effect on the equality and self-worth of the appellant and those in her group. With respect to the salutary effects side of the equation, the government was not required to demonstrate that the programs had any actual significant salutary effect on the well-being of young people; it nevertheless had to demonstrate that the reduction in benefits would reasonably be expected to facilitate the integration of the younger social assistance beneficiaries in the workplace.. This onus has not been met.

289 The respondent argues that government cannot be held responsible for the "partial failures" of legislation. She insists that the government had a real concern for the situation in which young people found themselves and attempted to craft a program that would benefit them. While the effects stage of the *Oakes* test should not be an opportunity for courts to punish governments for failed legislative undertakings, when the potential deleterious effects of the legislation are so apparent, I do not believe that it is asking too much of the government to craft its legislation more carefully. Given the economic data that the government has presented in evidence, it was entirely foreseeable that upon completion of the programs, the opportunities for young people to integrate into the workforce would continue to be limited. There was no justification presented for leaving them on the reduced benefit at that point in time, regardless of the problem of delays earlier discussed.

290 Accordingly, I find that s. 29(*a*) of the Regulation's *Charter* breach should not be upheld as a justified and reasonable limit under s. 1. In the legislative and social context of the legislation, which provided a safety net for those without means to support themselves, a rights-infringing limitation must be carefully crafted. In this case, the programs left too many opportunities for young people to fall through the seams of the legislation. This is borne out to some degree by the low participation rate among beneficiaries under the age of 30 and the fact that there was no basis for the assumption that beneficiaries under 30 were living with their parents and had lesser needs. While the respondent argues that no evidence was presented to show that most if any of the 73 percent of recipients under 30 were not participating in the programs for anything more than personal reasons, I would point out that at the s. 1 stage of analysis, it is the government's responsibility to show that the legislation limits the right as little as reasonably possible.

4. Remedy

291 The appellant argued that if s. 29(*a*) was found to have been an infringement on her *Charter* rights, it should be declared invalid under s. 52(1) of the *Constitution Act, 1982*, and that she and the members of her class should be compensated for their losses under s. 24(1) of the *Charter*. Engaging in an elaborate analysis of the proper type of declaratory relief to extend in this case borders on the absurd, given the fact that the legislation in question has been repealed for over a decade. Determining, for instance, the proper duration for which any declaration might be suspended

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in order to give the government an opportunity to amend its legislation is a purely hypothetical exercise. Nonetheless, given the appellant's claim for pecuniary relief under s. 24(1), a brief outline of the factors to be considered in fashioning a declaration of invalidity in this case may be warranted.

292 In determining the appropriate remedy in the case of legislation that is found to violate a *Charter* right, courts must walk a fine line between fulfilling their judicial role of protecting rights and intruding on the legislature's role; *Schachter* , *supra*. Simply striking down s. 29(*a*) would have lead to the result that all social assistance beneficiaries would have received the full benefit unconditionally. The respondent has argued that the government would never have adopted such a measure, and more importantly, that it would have been unable, from a financial standpoint, to fulfill such a legislative commitment. It is in recognition of this that Robert J.A. held that s. 23 of the Regulation, which set the actual amounts of the benefits, should also be invalidated so that the legislative intent of the Act would not be distorted by the court. The problem that this approach raises is that it may in fact lead to an even more severe transgression of the legislature's intention; it could mean that the *Social Aid Act* no longer supplies anyone with benefits. At the very least, the provision of benefits unconditionally to those under 30 would help to fulfill the statute's objective of providing for the needy. To declare s. 23 invalid would be to completely eliminate the legislative objective.

293 In *Schachter* , *supra*, Lamer C.J. held that a delayed declaration of invalidity would be appropriate when striking down unconstitutional legislation if immediate relief (1) posed a danger to the public, (2) threatened the rule of law, or (3) deprived deserving persons of benefits. In this case, the invalidation of s. 29(*a*) would not pose a danger to the public, nor would it deprive deserving persons of benefits, since it would expand the category of beneficiaires. However, given the broad impact of this legislation on Quebec society, as well as the wide range of alternatives that might be taken in order to bring complex social legislation such as this into line with constitutional standards, I believe that suspension of the declaration would have been appropriate in this case. Given the large sums of money spent by legislatures on social assistance programs such as this and the complexity of the programs at issue, a court should not intrude too deeply into the role of legislature in this field. As noted earlier, given that the provision in question is no longer in force, this issue is moot. However, if the legislation was still in place, I would have ordered that the declaration of invalidity be suspended for a period of 18 months, the period that the government demonstrated would be required to implement changes to the legislation.

294 The appellant also requests that this Court make an order under s. 24(1) of the *Charter* compensating the members of her group for the difference between the full benefit and the reduced amount during the time they were on the reduced benefit. The appellant argues that without such an order, her rights will not have been given any real effect.

295 On this point, I find myself in substantial agreement with the conclusion of Robert J.A., who refused to grant a monetary award under s. 24(1). As Lamer C.J. held in *Schachter* , where a provision is struck down under s. 52, a retroactive s. 24(1) remedy will not generally be available. The appellant argues that the odd facts of this case may make it one of those extraordinary occasions in which a s. 24(1) remedy could be added to a s. 52 declaration. The facts of this case do not allow for such a result.

296 First, I agree with Robert J.A. that because this case involves a class action, there is more difficulty in ordering a s. 24(1) remedy. It would be impossible for this Court to determine the precise amount that was owed to each individual in the class.Who participated in the programs, and who did not, the number of months during which they did not participate, the amount of the shortfall in benefits at different times, are all impossible to determine.

297 Second, the significant cost that would be incurred by the government were it required to pay damages must be considered. As Lamer C.J. held in *Schachter* ; while a consideration of expenses might not be relevant to the substantive *Charter* analysis, it is relevant to the determination of the remedy. Requiring the government to pay out nearly half a billion dollars, the amount requested, would have a significant impact on the government's fiscal situation, and potentially on the general economy of the province of Quebec.

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298 Thirdly, as I have shown in my reasons, the creation of a social assistance program that is respectful of the equality rights of young people need not necessarily have involved increasing the benefit levels of those under 30 to the level of the 30-year-old beneficiaries. The government might have chosen to improve the coverage given by the programs to those under 30, or, as it did in 1989, to impose conditions on all beneficiaries.

299 Accordingly, I would deny the appellant's request for an order for damages pursuant to s. 24(1) of the *Charter*.

C. Quebec Charter of Human Rights and Freedoms

Section 45 of the Quebec Charter

300 The appellant also claims that s.29(*a*) violated her s. 45 rights under the *Quebec Charter*. Section 45 of the *Quebec Charter* reads as follows:

> **45.** Every person in need has a right, for himself and his family, to measures of financial assistance and to social measures provided for by law, susceptible of ensuring such person an acceptable standard of living.

The respondent argues that the terms "provided for by law" and "susceptible" have the effect of limiting the degree to which the government must act to provide a decent standard of living. She argues that the section means that the government need only provide, in an efficient manner, the assistance that it defines in its own legislation. In his reasons, Robert J.A. engaged in an extensive analysis of international human rights documents in order to offer context to the interpretation of the section, and in particular, the aforementioned terms. He found that in the context of the other social rights enumerated in the *Quebec Charter*, as well as the language of international social charters, the terms "provided by law" and "susceptible" should not be read restrictively. The appellant, likewise, argues that those terms, instead of limiting the right, create a positive obligation on the state to put in place social assistance by law.

301 When compared to the other social rights enumerated in the *Quebec Charter*, in particular those that are limited by the words "*to the extent* provided by law" (emphasis added) (e.g., s. 44), I would agree with the appellant that the term "provided for by law" should not be read too restrictively. In my view, the word "susceptible" defines the nature of the benefit to be provided which could encompass social programs such as the ones that were established under the legislation impugned in these proceedings. Thus, I would find that, on its face, s. 45 does create some form of positive right to a minimal standard of living.

302 There is no need, however, to enter into a lengthy examination of whether the legislation in question here provided for social assistance which met the standard required by s. 45. This is because the section must be interpreted in light of the remedial provisions of the Quebec *Charter*. Section 52 of the Quebec *Charter* reads as follows:

> **52.** No provision of any Act, even subsequent to the Charter, may derogate from sections 1 to 38, except so far as provided by those sections, unless such Act expressly states that it applies despite the Charter.

In my view, it is quite clear that the court has no power to declare any portion of a law invalid due to a conflict with s. 45. Section 52 simply cannot apply.

303 The appellant also argues that she should be entitled to damages pursuant to s. 49 of the *Quebec Charter*. Section 49 reads as follows:

> **49.** Any unlawful interference with any right or freedom recognized by this Charter entitles the victim to obtain the cessation of such interference and compensation for the moral or material prejudice resulting therefrom.

This Court interpreted s. 49 in *F.E.E.S.P. c. Béliveau St-Jacques*, [1996] 2 S.C.R. 345 (S.C.C.). In that case, Gonthier J. held (at paras. 119-21) that:

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> **In my view, the first paragraph of s. 49 and art. 1053 C.C.L.C. are based on the same legal principle of liability associated with wrongful conduct**.
>
> It is thus clear that the violation of a right protected by the *Charter* is equivalent to a civil fault. The *Charter* formalizes standards of conduct that apply to all individuals. The legislative recognition of these standards of conduct has to some extent exempted the courts from clarifying their content. This recognition does not, however, make it possible to distinguish in principle the standards of conduct in question from that under art. 1053 *C.C.L.C.*, which the courts apply to the circumstances of each case. The violation of one of the guaranteed rights is therefore wrongful behaviour, which, as the Court of Appeal has recognized, breaches the general duty of good conduct.
>
> The nature of the damages that may be obtained under the first paragraph of s. 49 reinforces the parallel with civil liability. It is understood that the moral and material damages awarded by a court following a Charter violation are strictly compensatory in nature. The wording of the provision leaves no doubt in this regard, since it entitles the victim of an unlawful interference with a protected right to obtain "compensation for the moral or material prejudice resulting therefrom".

In, *Québec (Curateur public) c. Syndicat national des employés de l'hôpital St-Ferdinand*, [1996] 3 S.C.R. 211 (S.C.C.), L'Heureux-Dubé J. clarified this further by holding, for a unanimous Court (at para. 116), that:

> To find that there has been unlawful interference, it must be shown that a right protected by the *Charter* was infringed and that the infringement resulted from wrongful conduct. A person's conduct will be characterized as wrongful if, in engaging therein, he or she violated a standard of conduct considered reasonable in the circumstances under the general law. ...

304 Thus, in order to substantiate a s. 49 claim against the government for having drafted legislation that violates a *Quebec Charter* right, one would need to demonstrate that the legislature has breached a particular standard of care in drafting the legislation. It seems to me unlikely that a government could, under s. 49, be held responsible for having simply drafted faulty legislation. This view was shared by Gonthier J. in *Guimond* , *supra*, at para. 13, where he quoted approvingly Delisle J.A.:

> [TRANSLATION]
>
> In terms of the civil law, there is no doubt that the Crown is not negligent when it enacts a law that is subsequently declared invalid, any more than the public official who attends to its implementation.

Thus, on the s. 45 issue, I would find that while the section appears to create some form of right to a statutory social assistance regime providing a minimum standard of living, in this case, that right is unenforceable; neither s. 52 nor s. 49 applies.

305 The appellant argues that it makes no sense to have a section that is of no effect. My response to that is two-fold. First, no s. 49 remedy could be substantiated in this case because no wrongful conduct was found to exist. This does not mean that a private actor, or a state official, acting in a wrongful manner, could not, in another case, be found to have violated someone's s. 45 rights. In such a case, the court would be free to award damages. Secondly, even though the section does not provide for financial redress from the government in this case, the section is not without value. Indeed it is not uncommon for governments to outline non-judiciable rights in human rights charters. Courts are not the only institutions mandated to enforce constitutional documents. Legislatures also have a duty to uphold them. If, in this case, the court cannot force the government to change the law by virtue of s. 45, the *Quebec Charter* still has moral and political force.

VIII. Conclusion

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306 For these reasons, I would allow the appeal. I would declare s. 29(*a*) of the *Regulation Respecting Social Aid* unconstitutional. The constitutional questions are answered as follows:

> 1. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* on the ground that it established a discriminatory distinction based on age with respect to individuals, capable of working, aged 18 to 30 years?
>
> Yes.
>
> 2. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> No.
>
> 3. Did s. 29(*a*) of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 7 of the *Canadian Charter of Rights and Freedoms* on the ground that it deprived those to whom it applied of their right to security of the person contrary to the principles of fundamental justice?
>
> No
>
> 4. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*.
>
> It is not necessary to answer this question.

***Arbour J.*:**

307 The facts, as well as the history of this litigation, are set out at length in my colleagues' opinions and I need not repeat them here. Essentially, the appellant asserts on her own behalf and on behalf of a class of claimants that a provision of the regulations under the *Social Aid Act*, R.S.Q., c. A-16, in force between 1984 and 1989 which provided for lesser benefits for single adults under the age of 30 than for those 30 and over was unconstitutional as violating ss. 7 and 15 of the *Canadian Charter of Rights and Freedoms*.

308 I would allow this appeal on the basis of the appellant's s. 7 *Charter* claim. In doing so, I conclude that the s. 7 rights to "life, liberty and security of the person" include a positive dimension. Few would dispute that an advanced modern welfare state like Canada has a positive moral obligation to protect the life, liberty and security of its citizens. There is considerably less agreement, however, as to whether this positive moral obligation translates into a legal one. Some will argue that there are interpretive barriers to the conclusion that s. 7 imposes a positive obligation on the state to offer such basic protection.

309 In my view these barriers are all less real and substantial than one might assume. This Court has never ruled, nor does the language of the *Charter* itself require, that we must reject any positive claim against the state — as in this case — for the most basic positive protection of life and security. This Court has consistently chosen instead to leave open the possibility of finding certain positive rights to the basic means of subsistence within s. 7. In my view, far from resisting this conclusion, the language and structure of the *Charter* — and of s. 7 in particular — actually *compel* it. Before demonstrating all of this it will be necessary to deconstruct the various firewalls that are said to exist around s. 7, precluding this Court from reaching in this case what I believe to be an inevitable and just outcome.

I. Preliminary Concerns

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310 It is often suggested that s. 7 of the *Charter* cannot impose positive legal obligations on government. Before embarking on the usual textual, purposive and contextual analysis required in constitutional interpretation, it is therefore necessary to address the barriers that are traditionally said to preclude *a priori* a positive claim against the state under s. 7.

A. Economic Rights

311 There was some discussion in the courts below concerning whether s. 7 extends its protection to the class of so-called "economic rights". That discussion gets its impetus from certain dicta of Dickson C.J. in *Irwin Toy Ltd. c. Québec (Procureur général)*, [1989] 1 S.C.R. 927 (S.C.C.). In *Irwin Toy*, Dickson C.J. compared the wording of s. 7 to similar provisions in the *American Bill of Rights* and noted the following, at p. 1003:

> The intentional exclusion of property from s. 7, and the substitution therefor of "security of the person" ... leads to a general inference that economic rights as generally encompassed by the term "property" are not within the perimeters of the s. 7 guarantee.

This has no relevance to the present appeal. On its face, the statement purports to rule out of s. 7 only those economic rights that are generally encompassed by the term "property". The appellant in this case makes no claim that could reasonably be construed as a claim to a right of property. Indeed, the claim she does make — namely, to a level of social assistance adequate for the provision of her basic needs of subsistence — is one which Dickson C.J. explicitly excepted from his statement in *Irwin Toy*, at p.1003-4:

> This is not to declare, however, that no right with an economic component can fall within "security of the person". Lower courts have found that the rubric of "economic rights" embraces a broad spectrum of interests, ranging from such rights, included in international covenants, as rights to social security, equal pay for equal work, adequate food, clothing and shelter, to traditional property-contract rights. To exclude all of these at this early moment in the history of *Charter* interpretation seems to us to be precipitous. We do not, at this moment, choose to pronounce upon whether those economic rights fundamental to human life or survival are to be treated as though they are of the same ilk as corporate-commercial economic rights.

This prudent exercise in judicial restraint was understandable given that, unlike the case here, the question was not directly relevant in *Irwin Toy*. The instant appeal, in contrast, makes obvious why "those economic rights fundamental to human life or survival" should not in fact be treated as of the same ilk as corporate-commercial economic rights. Simply put, the rights at issue here are so intimately intertwined with considerations related to one's basic health (and hence "security of the person") — and, at the limit, even of one's survival (and hence "life") — that they can readily be accommodated under the s. 7 rights of "life, liberty and security of the person" without the need to constitutionalize "property" rights or interests.

312 Indeed, the rights at issue in this case are so connected to the sorts of interests that fall under s. 7 that it is a gross mischaracterization to attach to them the label of "economic rights". Their only kinship to the economic "property" rights that are *ipso facto* excluded from s. 7 is that they involve some economic value. But if this is sufficient to attract the label "economic right", there are few rights that would not be economic rights. It is in the very nature of rights that they crystallize certain benefits, which can often be quantified in economic terms. What is truly significant, from the standpoint of inclusion under the rubric of s. 7 rights, is not therefore whether a right can be expressed in terms of its economic value, but as Dickson C.J. suggests, whether it "fall[s] within 'security of the person'" or one of the other enumerated rights in that section. It is principally because corporate-commercial "property" rights fail to do so, and not because they contain an economic component *per se*, that they are excluded from s. 7. Conversely, it is because the right to a minimum level of social assistance is clearly connected to "security of the person" and "life" that it distinguishes itself from corporate-commercial rights in being a candidate for s. 7 inclusion.

313 In my view, this tells decisively against any argument that relies upon a supposed economic rights prohibition within s. 7 of the *Charter*. There is, however, a related argument, advanced by Professor Hogg among others, to suggest

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that the kind of interest claimed by the appellant in this case cannot fall within the scope of s. 7 (P. W. Hogg, *Constitutional Law of Canada* (loose-leaf ed.), vol. 2, at p. 44-12.1):

> The trouble ... is that it accords to s. 7 an economic role that is incompatible with its setting in the legal rights portion of the Charter — a setting that the Supreme Court of Canada has relied upon as controlling the scope of s. 7.

As I understand the argument it purports to rule out the kind of interest claimed here, not so much because it has an economic component (though that is ostensibly part of the objection), but because it fails to exhibit the characteristics of a "legal right". I take this last point to be the real thrust of the objection, since the argument would lose its teeth against an historically recognized legal right which nevertheless also had an economic component: for example, the right to a trial by jury in certain criminal cases, which right inevitably involves incurring additional costs in the administration of justice. I will now turn to this specific issue.

B. Legal Rights

314 The argument is that s. 7 is an umbrella of legal rights and that ss. 8 to 14, using a kind of *ejusdem generis* rule, inform and limit its scope. This restrictive interpretation of s. 7 formed no part of the reasoning in *Irwin Toy* that excluded corporate-commercial property rights from s. 7. Rather, it seems to have had its genesis in the concurring reasons of Lamer J. (as he then was) in *Reference re ss. 193 & 195.1(1)(c) of the Criminal Code (Canada)*, [1990] 1 S.C.R. 1123 (S.C.C.) ("*Prostitution Reference*"), at pp. 1171-74, where he observed that:

> [T]he guarantees of life, liberty and security of the person are placed together with a set of provisions ... which are mainly concerned with criminal and penal proceedings. ... It is significant that the rights guaranteed by s. 7 as well as those guaranteed in ss. 8-14 are listed under the title "Legal Rights", or in the French version "*Garanties juridiques*". The use of the term "Legal Rights" suggests a distinctive set of rights different from the rights guaranteed by other sections of the *Charter*. ...
>
> . . . . .
>
> Section 7 and more specifically ss. 8-14 protect individuals against the state when it invokes the judiciary to restrict a person's physical liberty through the use of punishment or detention, when it restricts security of the person, or when it restricts other liberties by employing the method of sanction and punishment traditionally within the judicial realm.

315 This approach to s. 7, curtailing its footprint to "legal rights" of the type contained in ss. 8 to 14, has been attenuated in more recent cases. For example, in *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, 2000 SCC 44 (S.C.C.), this Court held (at para. 46) that "[s]ection 7 can extend beyond the sphere of criminal law, *at least* where there is 'state action which directly engages the justice system and its administration'" (emphasis added). The recognition in that case that s. 7 protection extends beyond the criminal or penal context was in itself nothing new. What was noteworthy in Bastarache J.'s dictum was the suggestion, implied by his use of the phrase "at least", that s. 7 might even extend beyond the justice system and its administration. That his use of this phrase should be interpreted permissively rather than restrictively was later confirmed indirectly in *Winnipeg Child & Family Services (Central Area) v. W. (K.L.)*, [2000] 2 S.C.R. 519, 2000 SCC 48 (S.C.C.). In that case, this Court found that apprehension of a child by an agent of the state, pursuant to legislative authority and in the absence of a judicial order, constituted a deprivation of the parents' security of the person. While the Court went on to find the deprivation to be in conformity with the principles of fundamental justice, what is significant for present purposes is that the right to security of the person was found to be implicated by state action that had little relation to any judicial or quasi-judicial proceeding. The apprehension itself was entirely disconnected from the justice system and its administration and simply involved implementation of a legislative provision by a government official.

316 In the light of these recent developments, I think that there is considerable room for doubt as to whether the placement of s. 7 within the "Legal Rights" portion of the *Charter* is controlling of its scope. Moreover, the appeal to a

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Charter subheading as a way of limiting the kinds of interests that are protected by a rights-granting provision appears to be at odds with the generous and purposive approach that this Court has repeatedly identified as the proper approach to the interpretation of *Charter* rights: *Canada (Director of Investigation & Research, Combines Investigation Branch) v. Southam Inc.*, [1984] 2 S.C.R. 145 (S.C.C.); *R. v. Big M Drug Mart Ltd.*, [1985] 1 S.C.R. 295 (S.C.C.); *R. v. Therens*, [1985] 1 S.C.R. 613 (S.C.C.); *Reference re s. 94(2) of the Motor Vehicle Act (British Columbia)*, [1985] 2 S.C.R. 486 (S.C.C.); *Thomson Newspapers Ltd. v. Canada (Director of Investigation & Research)*, [1990] 1 S.C.R. 425 (S.C.C.); *Young v. Young*, [1993] 4 S.C.R. 3 (S.C.C.); *R. v. S. (R.J.)*, [1995] 1 S.C.R. 451 (S.C.C.); *Vriend v. Alberta*, [1998] 1 S.C.R. 493 (S.C.C.). Indeed, it is more consistent with the kind of "legalistic" interpretation associated with cases decided under the *Canadian Bill of Rights*, R.S.C. 1985, App. III, and that Dickson J. (as he then was) specifically contrasted with the purposive approach in *R. v. Big M Drug Mart Ltd.* , *supra*, at p. 344:

> The meaning of a right or freedom guaranteed by the *Charter* [is] to be ascertained by an analysis of the purpose of such a guarantee; it [is] to be understood, in other words, in the light of the interests it [is] meant to protect.
>
> The interpretation should be, as the judgment in *Southam* emphasizes, a generous rather than a legalistic one, aimed at fulfilling the purpose of the guarantee and securing for individuals the full benefit of the *Charter*'s protection. [Emphasis added; emphasis in original deleted.]

Whereas the course of s. 7 jurisprudence may have once supported a legalistic reliance on the subheading "Legal Rights" as a way of delimiting the scope of s. 7 protection, the more recent turn in s. 7 jurisprudence indicates that this interpretive device has been supplanted by a purposive and contextual approach to the recognition of constitutionally protected rights.

317 Finally, one should not underestimate the significance of the historical context in which Lamer J. made his comments in the *Prostitution Reference, supra*. At the time, almost all s. 7 cases involved challenges to state action in the context of criminal proceedings. It might then have appeared that this was the range of interests that s. 7 was meant to protect. The evolution of the case law no longer compels that conclusion. As s. 7 jurisprudence has developed, new kinds of interests, quite apart from those engaged by one's dealings with the justice system and its administration, have been asserted and found to be deserving of s. 7 protection. To now continue to insist upon the restrictive significance of the placement of s. 7 within the "Legal Rights" portion of the *Charter* would be to freeze constitutional interpretation in a manner that is inconsistent with the vision of the Constitution as a "living tree" which has always been part of the Canadian constitutional landscape. As this Court recognized in *Reference re Provincial Electoral Boundaries*, [1991] 2 S.C.R. 158 (S.C.C.), at p. 180:

> The doctrine of the constitution as a living tree mandates that narrow technical approaches are to be eschewed. ... It also suggests that the past plays a critical but non-exclusive role in determining the content of the rights and freedoms granted by the *Charter*. The tree is rooted in past and present institutions, but must be capable of growth to meet the future.

318 In spite of this, some will suggest that we must distinguish cases like *K.L.W., supra*, from the instant appeal on the basis that it is difficult to point to any affirmative state action in the present case which could properly be said to constitute a violation of one of the enumerated rights in s. 7. Whatever the merits of this argument, it is important to keep it distinct from the "Legal Rights" argument which has been the focus of the present discussion. The significance of cases like *Blencoe* and *K.L.W.* in the context of this discussion is that they make room for the kind of interest at issue in this appeal by relaxing any supposed requirement that the right claimed under s. 7 display the characteristics of a "legal right" similar in nature to those at stake in the administration of criminal justice. Whether these cases — or others — would also bar the present action by imposing another requirement of affirmative (or positive) state action as a *sine qua non* of s. 7 protection is a different question, to which I now turn.

C. Negative vs. Positive Rights and the Requirement of State Action

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319 There is a suggestion that s. 7 contains only negative rights of non-interference and therefore cannot be implicated absent any positive state action. This is a view that is commonly expressed but rarely examined. It is of course true that in virtually all past s. 7 cases it was possible to identify some definitive act on the part of the state which could be said to constitute an interference with life, liberty or security of the person and consequently ground the claim of a s. 7 violation. It may also be the case that no such definitive state action can be located in the instant appeal, though this will largely depend on how one chooses to define one's terms and, in particular, the phrase "state action". One should first ask, however, whether there is in fact any requirement, in order to ground a s. 7 claim, that there be some affirmative state action interfering with life, liberty or security of the person, or whether s. 7 can impose on the state a duty to act where it has not done so. (I use the terms "affirmative", "definitive" or "positive" to mean an identifiable action in contrast to mere inaction). No doubt if s. 7 contemplates the existence only of negative rights, which are best described as rights of "non-interference", then active state interference with one's life, liberty or security of the person by way of some definitive act will be necessary in order to engage the protection of that section. But if, instead, s. 7 rights include a positive dimension, such that they are not merely rights of non-interference but also what might be described as rights of "performance", then they may be violable by mere inaction or failure by the state to actively provide the conditions necessary for their fulfilment. We must not sidestep a determination of this issue by assuming from the start that s. 7 includes a requirement of affirmative state action. That would be to beg the very question that needs answering.

320 It is not often clear whether the theory of negative rights underlying the view that s. 7 can only be invoked in response to a definitive state action is intended to be one of general application, extending to the *Charter* as a whole, or one that applies strictly to s. 7. As a theory of the *Charter* as a whole, any claim that only negative rights are constitutionally recognized is of course patently defective. The rights to vote (s. 3), to trial within a reasonable time (s. 11(*b*)), to be presumed innocent (s. 11(*d*)), to trial by jury in certain cases (s. 11(*f*)), to an interpreter in penal proceedings (s. 14), and minority language education rights (s. 23) to name but some, all impose positive obligations of performance on the state and are therefore best viewed as positive rights (at least in part). By finding that the state has a positive obligation in certain cases to ensure that its labour legislation is properly inclusive, this Court has also found there to be a positive dimension to the s. 2(*d*) right to associate (*Dunmore v. Ontario (Attorney General)*, [2001] 3 S.C.R. 1016, 2001 SCC 94 (S.C.C.)). Finally, decisions like *Schachter v. Canada*, [1992] 2 S.C.R. 679 (S.C.C.), and *Vriend* , *supra*, confirm that "[i]n some contexts it will be proper to characterize s. 15 as providing positive rights" (*Schachter* , *supra*, at p. 721). This list is illustrative rather than exhaustive.

321 Moreover, there is no sense in which the actual language of s. 7 limits its application to circumstances where there has been positive state interference. It is sometimes suggested that the requirement is implicit in the use of the concept of "deprivation" within s. 7. This is highly implausible. *The Shorter Oxford English Dictionary* (3rd ed. 1973), vol. 1, at p. 524, defines the term "deprive" in such a way as to include, not only active taking away, divesting, or dispossession, but also mere "keep[ing] out *of* [or] debar[ing] *from*". In other words, the concept of deprivation is sufficiently broad to embrace withholdings that have the effect of erecting barriers in the way of the attainment of some object.

322 Nor does the phrase "principles of fundamental justice" contain a requirement of positive state action by necessary implication, particularly when one rejects a restrictive interpretation of s. 7 confining it to a "Legal Rights" umbrella. If s. 7 were nothing more than a composite of the other "legal rights", one might think that it only comes into play when the machinery of justice is activated by the state. But I have already indicated why in my view we must reject the assumption that s. 7 protects only against the kinds of incursions one might expect to suffer in connection with one's dealings with the justice system and its administration. This obliterates the foundation for the idea that the phrase "principles of fundamental justice" includes an implicit requirement of positive state action. It also leaves s. 7 bereft of any trace of language that might contain a requirement of positive state action before a breach may occur.

323 In fact, the context in which s. 7 is found within the *Charter*'s structure favours the conclusion that it can impose on the state a positive duty to act. Even though s. 7 cannot be reduced to an "umbrella" of the "legal rights" contained in ss. 8 to 14, there is often overlap between the two. This Court has in the past emphasized the connection of these sections to s. 7 itself. In *Re B.C. Motor Vehicle Act, supra*, at pp. 502-3, Lamer J. indicated that ss. 8 to 14 are "illustrative"

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of the principles of fundamental justice that are referred to in s. 7 (see also, the *Prostitution Reference, supra*, at pp. 1171-72). Given this, if some of these "principles of fundamental justice" in ss. 8 to14 entrench positive rights, one should expect that s. 7 rights would also contain a positive dimension. No doubt this is what prompted Lamer C.J. to make the following observation in *Schachter* , *supra*, at p. 721: "the right to life, liberty and security of the person is in one sense a negative right, but the requirement that the government respect the 'fundamental principles of justice' may provide a basis for characterizing s. 7 as a positive right in some circumstances".

324 Finally, the case law is consistent with the view that s. 7 includes a positive dimension. In *New Brunswick (Minister of Health & Community Services) v. G. (J.)*, [1999] 3 S.C.R. 46 (S.C.C.), at para. 107, this Court explicitly held that s. 7 provided a positive right to state-funded counsel in the context of a child custody hearing. Lamer C.J. put the point quite baldly: "The omission of a positive right to state-funded counsel in s. 10 ... does not preclude an interpretation of s. 7 that imposes a positive constitutional obligation on governments to provide counsel in those cases when it is necessary to ensure a fair hearing."

325 One must resist the temptation to dilute the obvious significance of this decision by attempting to locate the threat to security of the person in *G. (J.)* in state action. It is of course true that the proceedings at issue in *G. (J.)* were initiated by the government. But Lamer C.J. pointed out that it was not the actions of the state in initiating the proceedings, *per se*, that gave rise to the potential s. 7 violation. Rather, "[t]he potential s. 7 violation ... would have been the result of the failure of the Government of New Brunswick to provide the appellant with state-funded counsel ... *after* initiating proceedings under Part IV of the *Family Services Act*" *(G. (J.), supra*, at para. 92 (emphasis added)). This focus on state omission rather than state action is consistent with Lamer C.J.'s characterisation of the state's obligation to provide counsel as a positive obligation. It is in the very nature of such obligations that they can be violated by mere inaction, or failure to perform the actions that one is duty-bound to perform.

326 In *Blencoe* , *supra*, this Court considered whether a state-caused delay in moving forward a human rights complaint violated the psychological integrity, and hence personal security, of the individual against whom the complaint was being made by subjecting him to prolonged and undue stigma. Bastarache J. stated at para. 57 that in order for state interference with an individual's psychological integrity to engage s. 7, "the psychological harm must be state imposed, meaning that the harm must result from the actions of the state" (emphasis deleted). This passage may appear to support the idea that positive state action is required to engage s. 7. There are, however, good reasons to find that it is not. For example, there are special problems relating to causation in the context of s. 7 claims involving psychological integrity which may support the need for a requirement of state action in such cases, without importing that requirement into s. 7 as a whole. Moreover, while this Court found on the particular facts of that case that there was no s. 7 violation, it also allowed that such state-caused delay might sometimes constitute a s. 7 violation, even if "only in exceptional cases" (*Blencoe* , at para. 83). In other words, *Blencoe* held that state-caused delay — the inertia (or lack of action) in moving a case forward — was not in itself incompatible with the s. 7 requirement that the impugned harm must result from "actions of the state". Therefore, *Blencoe* does not hold that all s. 7 protection is limited to cases in which one's life, liberty or security of the person is violated by positive state action. Quite the contrary, it implies that such protection will sometimes be engaged by mere state inaction.

327 Nor does there appear to be any support for the opposite conclusion in other case law emanating from this Court. Far from it, by impliedly sanctioning state inaction as a sufficient ground for making a s. 7 claim in at least some circumstances, *Blencoe* and *G. (J.)* are entirely consistent with other Supreme Court case law on point, sparse as it is. Thus, in *Dunmore* , *supra*, at para. 22, this Court held that "exclusion from a protective regime may in some contexts amount to an affirmative interference with the effective exercise of a protected freedom". *Dunmore* confirms that state inaction — the mere failure of the state to exercise its legislative choice in connection with the protected interests of some societal group, while exercising it in connection with those of others — may at times constitute "affirmative interference" with one's *Charter* rights. Thus in certain contexts, the state is under a positive duty to extend legislative protections where it fails to do so inclusively.

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328 Of course, it may well be that in order for such positive obligations to arise the state must first do *something* that will bring it under a duty to perform. But even if this is so, it is important to recognize that the kind of state action required will not be action that is causally determinative of a right violation, but merely action that "triggers", or gives rise to, a positive obligation on the part of the state. Depending on the context, we might even expect to see altogether different kinds of state action giving rise to a positive obligation under s. 7. In the judicial context, it will be natural to find such a state action in the initiation by the state of judicial proceedings. In the legislative context, however, it may be more appropriate, following cases like *Vriend* and *Dunmore* , to search for it in the state's decision to exercise its legislative choice in a non-inclusive manner that significantly affects a person's enjoyment of a *Charter* right. In other words, in certain contexts the state's choice to legislate over some matter may constitute state action giving rise to a positive obligation under s. 7.

329 The finding that s. 7 may impose positive obligations on the state brings us directly to a frequently expressed objection in the context of claims like the ones at issue in the present case that courts cannot enforce positive rights of an individual to the basic means of basic subsistence. The suggestion is that they cannot do so without being drawn outside their proper judicial role and into the realm of deciding complex matters of social policy better left to legislatures. I turn now to this concern.

D. Justiciability

330 I found the obstacles to positive claims considered in the last sections to be unfounded under a correct interpretation of the *Charter*. In contrast, the concern I discuss now may present a barrier to some claimants under particular circumstances. However, it does not do so in the present case for reasons I explain below. The ostensible difficulty that confronts the appellant here is the general assertion that positive claims against the state for the provision of certain needs are not justiciable because deciding upon such claims would require courts to dictate to the state how it should allocate scarce resources, a role for which they are not institutionally competent. Professor Hogg, *supra*, puts the point as follows (at p. 44-12.1):

> [This] involves a massive expansion of judicial review, since it would bring under judicial scrutiny all of the elements of the modern welfare state. ... As Oliver Wendell Holmes would have pointed out, these are the issues upon which elections are won and lost. ...

331 While the claim asserted here hardly in itself has the potential to bring "all of the elements of the modern welfare state" under judicial scrutiny, the concern raised by this justiciability argument is a valid one. Questions of resource allocation typically involve delicate matters of policy. Legislatures are better suited than courts to addressing such matters, given that they have the express mandate of the taxpayers as well as the benefits of extensive debate and consultation.

332 It does not follow, however, that courts are precluded from entertaining a claim such as the present one. While it may be true that courts are ill-equipped to decide policy matters concerning resource allocation — questions of how much the state should spend, and in what manner — this does not support the conclusion that justiciability is a threshold issue barring the consideration of the substantive claim in this case. As indicated above, this case raises altogether a different question: namely, whether the state is under a positive obligation to provide basic means of subsistence to those who cannot provide for themselves. In contrast to the sorts of policy matters expressed in the justiciability concern, this is a question about what kinds of claims individuals can assert against the state. The role of courts as interpreters of the *Charter* and guardians of its fundamental freedoms against legislative or administrative infringements by the state requires them to adjudicate such rights-based claims. One can in principle answer the question of whether a *Charter* right exists — in this case, to a level of welfare sufficient to meet one's basic needs — without addressing how much expenditure by the state is necessary in order to secure that right. It is only the latter question that is, properly speaking, non-justiciable.

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333 Of course, in practice it will often be the case that merely knowing whether the right exists is of little assistance to the claimant. For, unless we also know what is required, or how much expenditure is needed, in order to safeguard the right, it will usually be difficult to know whether the right has been violated. This difficulty does not arise in the present case. Once a right to a level of welfare sufficient to meet one's basic needs is established, there is no question on the facts of this case that the right has been violated. This Court need not enter into the arena of determining what would satisfy such a "basic" level of welfare because that determination has already been made by the legislature, which is itself the competent authority to make it.

334 Indeed, the very welfare scheme that is challenged here includes provisions that set out the basic amount. Section 23 of the *Regulation respecting social aid*, R.R.Q. 1981, c. A-16, r. 1, provides that the amount receivable is established according the "ordinary needs" ("*besoins ordinaires*") of the recipients. The bare minimum a single adult aged 30 or over can receive is $466. This is the amount that was deemed by the legislature itself to be sufficient to meet the "ordinary needs" of a single adult. The present case comes before us on the basis that the government failed to provide a level of assistance that, according to its own standards, was necessary to meet the ordinary needs of adults aged 18 to 30. The only outstanding questions are whether this is in fact established and, if so, whether the claimants had a right to the provision of their ordinary needs.

335 Thus any concern over the justiciability of positive claims against the state has little bearing on this case. At any rate, these issues, to some extent, obscure the real question. At this stage we are less concerned with what, if anything, the state must do in order to bring itself under a positive obligation than with whether s. 7 can support such positive obligations to begin with. I have already indicated several reasons for thinking that it can. I now want to supplement these reasons by means of an interpretive analysis of s. 7. As it turns out, any acceptable approach to *Charter* interpretation — be it textual, contextual, or purposive — quickly makes apparent that interpreting the rights contained in s. 7 as including a positive component is not only possible, but also necessary.

II. Analysis of Section 7 of the Charter

A. Textual Interpretation: The Language of Section 7

336 My colleague Bastarache J. rightly notes that "[w]ithout some link to the language of the *Charter*, the legitimacy of the entire process of *Charter* adjudication is brought into question" (para. 214). With this in mind, I set out s. 7 in its entirety:

> **7.** Everyone has the right to life, liberty and security of the person <u>and</u> the right not to be deprived thereof except in accordance with the principles of fundamental justice. [Emphasis added.]

I have drawn attention to the conjunction in s. 7 for two reasons: first, it constitutes an integral part of the grammatical structure of the section; and second, up until now, it has not been the subject of much judicial attention.

337 This is surprising. The two parts of the section could as easily have been punctuated to form more or less separate sentences. Indeed the French version of s. 7 is so punctuated. It reads as follows:

> **7.** Chacun a droit à la vie, à la liberté et à la sécurité de sa personne; il ne peut être porté atteinte à ce droit qu'en conformité avec les principes de justice fondamentale.

My reasons for emphasizing this grammatical point are straightforward. Past judicial treatments of the section have habitually read out of the English version of s. 7 the conjunction and, with it, the entire first clause. The result is that we typically speak about s. 7 guaranteeing only the right not to be deprived of life, liberty and security of the person except in accordance with the principles of fundamental justice. On its face, this is a questionable construction of the language of s. 7: for it equates the protection of the second clause alone with the protection of the section as a whole. We no doubt would be less likely to make this equation had the two clauses been punctuated rather than conjoined. As it turns out,

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moreover, our failure to have due regard for the structure of the section has potentially dramatic consequences for the scope of the s. 7 guarantee. This was implicitly recognized by Lamer J. in *Re B.C. Motor Vehicles Act, supra*, at p. 500:

> It is clear that s. 7 surely protects the right not to be deprived of one's life, liberty and security of the person when that is done in breach of the principles of fundamental justice. The outcome of this case is dependent upon the meaning to be given to that portion of the section which states "and the right not to be deprived thereof except in accordance with the principles of fundamental justice". On the facts of this case it is not necessary to decide whether the section gives any greater protection, such as deciding whether, absent a breach of the principles of fundamental justice, there still can be, given the way the section is structured, a violation of one's rights to life, liberty and security of the person under s. 7. [Emphasis added.]

The quoted passage indicates that, from the earliest stages of s. 7 interpretation, this Court has considered it a very live issue whether the first clause in s. 7 involves some greater protection than that accorded by the second clause alone.

338 It is in fact arguable, as Professor Hogg, *supra*, points out (at p. 44-3), "that s. 7 confers two rights": a right, set out in the section's first clause, to "life, liberty and security of the person" full stop (more or less); and a right, set out in the section's second clause, not to be deprived of life, liberty or security of the person except in accordance with the principles of fundamental justice. Wilson J. explicitly considered this interpretation of s. 7 in *Operation Dismantle Inc. v. R.*, [1985] 1 S.C.R. 441 (S.C.C.), at p. 488. Although in that case she expressed misgivings regarding the feasibility of the interpretation, she ultimately left its status undecided. In fact, in *Re B.C. Motor Vehicle Act, supra*, at p. 523, which was heard later in the same year, she may have overcome her earlier misgivings and impliedly accepted the two-rights interpretation by stating that a deprivation of life, liberty or security of the person would require s. 1 justification even if the principles of fundamental justice were satisfied. Her statement in this regard is consistent with the notion that the first clause in s. 7 affords additional protection, over and above that afforded in the second clause, with the result that mere compliance with the principles of fundamental justice does not in itself guarantee that the rights to life, liberty and security of the person will not be violated.

339 The two-rights interpretation of s. 7 has fallen into relative obscurity since these latest references to it by Lamer and Wilson JJ. in *Re B.C. Motor Vehicle Act, supra*. To some extent, this was to be expected. As indicated above, this Court has most often had occasion to visit issues of s. 7 interpretation in criminal, or quasi-criminal, contexts. In those contexts, there is little need to concern ourselves with any potentially self-standing right in the first clause of s. 7. Since what we are concerned with in such penal cases is the constitutional validity of positive state action that actively deprives individuals of their liberty, it is not surprising that the s. 7 analysis would focus only upon the second clause, which deals with those types of deprivation. *Re B.C. Motor Vehicles Act* was a case in point. Unlike Lamer J. in that case, however, we have not always been careful in such cases to delineate the scope of our s. 7 discussion. This has led to a general impression that s. 7 is reduced to the right contained in the second clause.

340 As I have already suggested, this is not a plausible construction of the text of s. 7. Only by ignoring the structure of s. 7 — by effectively reading out the conjunction and, with it, the first clause — is it possible to conclude that it protects exclusively "the right not to be deprived of life, liberty or security of the person except in accordance with the principles of fundamental justice". There may be some question as to how far, precisely, the protection of s. 7 extends beyond this, but that the section's first clause affords some additional protection seems, as a purely textual matter, beyond reasonable objection.

341 The instant appeal requires us to consider, perhaps for the first time, what this additional protection might consist of. Without wanting to limit the possibilities at this early stage of interpreting the first clause, there are at least two alternatives that present themselves. The first was alluded to by both Lamer and Wilson JJ. in *Re B.C. Motor Vehicle Act, supra*. In essence, it entails reading the first clause as providing for a completely independent and self-standing right, one which can be violated even absent a breach of fundamental justice, but requiring a s. 1 justification in the event of such violation. This interpretation gets its starting point from the fact that the first clause of s. 7 makes no mention of the principles of fundamental justice. It follows, the thinking goes, that the right to life, liberty and security of the person

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provided for in the first clause can be violated even where the state conducts itself in accordance with the principles of fundamental justice. And since the justificatory analysis under s. 1 was, at an early stage of *Charter* jurisprudence, given a very limited role in the context of s. 7 violations primarily because it was thought that the violation of a right in breach of fundamental justice could almost never be justified, this interpretation restores to s. 1 a more active role to play in the context of at least some s. 7 violations.

342 Another possible interpretation of what the additional protection afforded by the first clause of s. 7 consists of focuses less on the omission of any reference to the principles of fundamental justice, and more on its failure to make any mention of the term "deprivation". There is indeed something plausible in the idea that, by omitting such language, the first clause extends the right to life, liberty and security of the person beyond protection against the kinds of state action that have habitually been associated with the term "deprivation". Essentially, this interpretation would suggest that by omitting the term "deprivation" in the first clause, the section implies that it is at most in connection with the right afforded in the second clause, if at all (see *supra*, at para. 321), that there must be positive state action in order to ground a violation; the right granted in the first clause would be violable merely by state inaction.

343 I need not decide here which of these two interpretations, if any, is to be preferred. Indeed, they do not appear to be mutually exclusive. For the purposes of the present appeal, it suffices to raise the following two points: first, either interpretation is preferable to the way s. 7 has habitually been interpreted to this point in time, not only textually but also, as I will now demonstrate, from the standpoints of contextual and purposive analysis; and second, either interpretation accommodates — indeed demands — recognition of the sort of interest claimed by the appellant in this case.

B. Purposive Analysis

344 The proper approach to the definition of the rights and freedoms guaranteed by the *Charter* is, as I have mentioned (*supra*, at para. 316), a purposive one. In *R. v. Big M Drug Mart Ltd.* , *supra*, Dickson J. stated at p. 344:

> The meaning of a right or freedom guaranteed by the *Charter* [is] to be ascertained by an analysis of the purpose of such a guarantee; it [is] to be understood, in other words, in the light of the interests it [is] meant to protect.
>
> The interpretation should be, as the judgment in *Southam* emphasizes, a generous rather than a legalistic one, aimed at fulfilling the purpose of the guarantee and securing for individuals the full benefit of the *Charter*'s protection. [Emphasis deleted.]

An interpretation of s. 7 which reduces it to the right contained in the second clause — the "deprivation" clause — is seriously at odds with any purposive interpretation of the right to life guaranteed by the section. Indeed, if that interpretation were to be accepted, it would effectively denude the right to life of any purpose whatsoever, rendering it essentially vacuous.

345 Professor Hogg, *supra*, implies as much when he argues that "[s]o far as 'life' is concerned, the section has little work to do" (p. 44-6). This is only true, however, if we understand the s. 7 guarantee as it has been habitually understood. For in that case, the protection of the section would extend only to "deprivations" of life that were not in accordance with the principles of fundamental justice. And since "principles of fundamental justice" has so far been interpreted to invoke the basic tenets of the "legal system", narrowly defined to include only courts and tribunals that perform court-like functions, the purpose of guaranteeing the right to life would seem limited on this interpretation to guarding against capital punishment, which is the only obvious way in which the "legal system", so defined, could potentially trench on a person's right to life. But, as Professor Hogg points out, such a purpose might just as well be served by s. 12 of the *Charter*, which protects individuals against cruel and unusual punishment. In effect, then, on this interpretation the s. 7 guarantee of the right to life would be purposeless, and the right itself emptied of any meaningful content.

346 One should not readily accept that the right to life in s. 7 means virtually nothing. To begin with, this result violates basic standards of interpretation by suggesting that the *Charter* speaks essentially in vain in respect of this fundamental right. More importantly, however, it threatens to undermine the coherence and purpose of the *Charter* as a whole. After

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all, the right to life is a prerequisite — a *sine qua non* — for the very possibility of enjoying all the other rights guaranteed by the *Charter*. To say this is not to set up a hierarchy of *Charter* rights. No doubt a meaningful right to life is reciprocally conditioned by these other rights: they guarantee that human life has dignity, worth and meaning. Nevertheless, the centrality of the right to life to the *Charter* as a whole is obvious. Indeed, it would be anomalous if, while guaranteeing a complex of rights and freedoms deemed to be necessary to human fulfilment within society, the *Charter* had nothing of significance to say about the one right that is indispensable for the enjoyment of all of these others.

347 Thus, in my view, any interpretation of the *Charter* that leaves the right to life such a small role to play is one that threatens to impugn the coherence of the whole *Charter*. Far from being a poor relation of other *Charter* rights — one which deserves protection merely as a negative right, while certain other *Charter* rights are granted recognition as full-blown positive rights — the right to life is, in a very real sense, their essential progenitor. So much so that to deny any real significance to the *Charter* guarantee of the right to life would be to undercut the significance of every other *Charter* guarantee.

348 A purposive interpretation of s. 7 as a whole requires that all the rights embodied in it be given meaning. But by leaving no meaningful role to be played by the right to life, the habitual interpretation of s. 7 threatens not only the coherence, but also the purpose of the *Charter* as a whole. In order to avoid this result, we must recognize that the state can potentially infringe the right to life, liberty and security of the person in ways that go beyond violating the right contained in the second clause of s. 7. Whether one chooses to characterize matters by stating: (a) that it is not merely active "deprivations" of life, liberty and security of the person (as opposed to the mere withholdings) that s. 7 is concerned with; or (b) that s. 7 can be violated even absent a breach of the "principles of fundamental justice"; the basic point is that s. 7 must be interpreted as protecting something more than merely negative rights. Otherwise, the s. 7 right to life will be reduced to the function of guarding against capital punishment — a possibly redundant function in light of s. 12 — with all of the intolerable conceptual difficulties attendant upon such an interpretation.

C. Contextual Analysis

349 Quite apart from its specific relation to the right to life guaranteed in s. 7, the structure and purpose of the *Charter* also provide relevant context for the interpretation of *Charter* rights more generally. This idea was implicit in this Court's dicta regarding constitutional interpretation in *Reference re Secession of Quebec*, [1998] 2 S.C.R. 217 (S.C.C.), at para. 50:

> Our Constitution has an internal architecture, or what the majority of this Court in *OPSEU v. Ontario (Attorney General)*, [1987] 2 S.C.R. 2, at p. 57, called a "basic constitutional structure". The individual elements of the Constitution are linked to the others, and must be interpreted by reference to the structure of the Constitution as a whole.

What holds for "the Constitution as a whole" also holds for its constituent parts, including the *Charter*. Individual elements in the *Charter* are linked to one another, and must be understood by reference to the structure of the *Charter* as a whole. Support for this interpretive approach can be located in *R. v. Big M Drug Mart Ltd.* , *supra*, at p. 344: "the purpose of [any] right or freedom ... is to be sought by reference to the character and the larger objects of the *Charter* itself".

350 Clearly, positive rights are not at odds with the purpose of the *Charter*. Indeed, the *Charter* compels the state to act positively to ensure the protection of a significant number of rights, including, as I mentioned earlier (*supra* at para. 320), the protection of the right to vote (s. 3), the right to an interpreter in penal proceedings (s. 14), and the right of minority English- or French-speaking Canadians to have their children educated in their first language (s. 23). Positive rights are not an exception to the usual application of the *Charter*, but an inherent part of its structure. The *Charter* as a whole can be said to have a positive purpose in that at least some of its constituent parts do.

351 Also instructive is s. 1. The great conceptual challenge faced by courts under s. 1 is to identify limitations to individual rights or freedoms that properly respect those rights or freedoms, without subverting them to majoritarian interests. Questions regarding the limits of individual rights can be characterized just as well in terms of delineating the

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scope of those rights. We can therefore expect to learn a great deal about rights definition in general, and in the context of this case specifically, by paying careful attention to the way in which this Court has handled such issues in the context of s. 1. Properly understood, the justificatory enterprise in s. 1 demonstrates that the rights-granting provisions in the *Charter* include a positive dimension.

352 This Court developed early on a general approach to s. 1 justification, focussing on the kinds of considerations appropriate to the justificatory analysis. That general approach was expressed in Dickson C.J.'s landmark judgment in *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.), at p. 135:

> It is important to observe at the outset that s. 1 has two functions: first, it constitutionally guarantees the rights and freedoms set out in the provisions which follow; and, second, it states explicitly the exclusive justificatory criteria (outside of s. 33 of the *Constitution Act, 1982*) against which limitations on those rights and freedoms must be measured.

We sometimes lose sight of the primary function of s. 1 — to constitutionally guarantee rights — focussed as we are on the section's limiting function.

353 Our oversight in this regard is perhaps exacerbated by the fact that the two functions served by s. 1 appear, at first blush, to conflict with one another. In what sense, after all, can one be said to be guaranteeing *Charter* rights, even as one places limits upon them? The answer lies in part in the other "limiting" sections (s. 33 and s. 38 of the *Consitution Act, 1982*): the justified limits to *Charter* rights that are permitted under s. 1 must not be confused with exceptions, denials, or other forms of restriction that would abrogate or derogate from the rights themselves (*Quebec Assn. of Protestant School Boards v. Quebec (Attorney General) (No. 2)*, [1984] 2 S.C.R. 66 (S.C.C.), at p. 88). Dickson C.J. provides the remainder of the solution in the passage that follows, *R. v. Oakes* , *supra*, at p. 136:

> A second contextual element of interpretation of s. 1 is provided by the words "free and democratic society". Inclusion of these words as the final standard of justification for limits on rights and freedoms refers the Court to the very purpose for which the *Charter* was originally entrenched in the Constitution: Canadian society is to be free and democratic. The Court must be guided by the values and principles essential to a free and democratic society. ... <u>The underlying values and principles of a free and democratic society are the genesis of the rights and freedoms guaranteed by the *Charter* and the ultimate standard against which a limit on a right or freedom must be shown, despite its effect, to be reasonable and demonstrably justified</u>. [Emphasis added.]

In this way, the two functions served by s. 1 are prevented from operating at cross purposes, as it were, because the very values that underlie and are the genesis of the rights and freedoms guaranteed by the *Charter* are the values that must be invoked in demonstrating that a limit on those rights and freedoms is justified. This "unity of values" underlying the dual functions of s. 1 ensures that due regard and protection is given to *Charter* rights even as justified limits are placed upon them (see L. E. Weinrib, "The Supreme Court of Canada and Section One of the Charter" (1988), 10 *Sup. Ct. L. Rev.* 469, at p. 483). In fact, it would not be far from the truth to state that the types of limits that are justified under s. 1 are those, and *only* those, that not only respect the content of *Charter* rights but also *further* those rights in some sense — or to use the language of s. 1 itself, "guarantee" them — by further advancing the values at which they are directed.

354 To say this is in part to recognize that limitations on rights are necessary if only to harmonize competing rights, or to give the fullest expression possible to conflicting rights. Freedom of religion, for example, can only be fulfilled for all by guarding against establishment, thereby ensuring the existence of the positive conditions necessary for all to express their own religious views: *R. v. Big M Drug Mart Ltd.* , *supra*; *Plantation Indoor Plants Ltd. v. Alberta (Attorney General)*, [1985] 1 S.C.R. 366 (S.C.C.). Freedom of the press cannot trump the right to a fair trial (see *Dagenais v. Canadian Broadcasting Corp.*, [1994] 3 S.C.R. 835 (S.C.C.); *Canadian Broadcasting Corp. v. New Brunswick (Attorney General)*, [1996] 3 S.C.R. 480 (S.C.C.), which in turn cannot override privacy interests (see *R. v. O'Connor*, [1995] 4 S.C.R. 411 (S.C.C.); *R. v. Mills*, [1999] 3 S.C.R. 668 (S.C.C.) In every case, the courts will search for the proper accommodation

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that will give the fullest expression to each of the clashing rights. See also *R. v. McClure*, [2001] 1 S.C.R. 445, 2001 SCC 14 (S.C.C.); *Smith v. Jones*, [1999] 1 S.C.R. 455 (S.C.C.).

355 In that sense, *Charter* rights and freedoms find protection in s. 1, not only because they are guaranteed in that section, but because limitations on some rights are required by the positive protection of others. This approach to s. 1 justification, which invokes the values that underpin the *Charter* as the only suitable basis for limiting those rights, confirms that *Charter* rights contain a positive dimension. Constitutional rights are not simply a shield against state interference with liberty; they place a positive obligation on the state to arbitrate competing demands arising from the liberty and rights of others.

356 In other words, the justificatory mechanism in place in s. 1 of the *Charter* reflects the existence of a positive right to *Charter* protection asserted in support of alleged interference by the state with the rights of others. If such positive rights exist in that form in s. 1, they must, *a fortiori*, exist in the various *Charter* provisions articulating the existence of the rights. For instance, if one's right to life, liberty and security of the person can be limited under s. 1 by the need to protect the life, liberty or security of others, it can only be because the right is not merely a negative right but a positive one, calling for the state not only to abstain from interfering with life, liberty and security of the person but also to actively secure that right in the face of competing demands.

357 This concludes my interpretive analysis of s. 7. In my view, the results are unequivocal: every suitable approach to *Charter* interpretation, including textual analysis, purposive analysis, and contextual analysis, mandates the conclusion that the s. 7 rights of life, liberty and security of the person include a positive dimension.

358 It remains to show that the interest claimed in this case falls within the range of entitlements that the state is under a positive obligation to provide under s. 7. In one sense it seems obvious that it does. As I have already suggested, a minimum level of welfare is so closely connected to issues relating to one's basic health (or security of the person), and potentially even to one's survival (or life interest), that it appears inevitable that a positive right to life, liberty and security of the person must provide for it. Indeed in this case the legislature has in fact chosen to legislate in respect of welfare rights. Thus determining the applicability of the foregoing general principles to the case at bar requires only that we analyse this case through the lens of the underinclusiveness line of cases, of which *Dunmore* , *supra*, is the chief example.

III. Application to the Case at Bar

359 As my colleague Bastarache J. observes, "the question of whether a fundamental freedom can be infringed through the lack of government action was canvassed most recently in the case of *Dunmore* " (para. 220). This Court recognized in that case that underinclusive legislation might in some contexts constitute "affirmative interference with the effective exercise of a protected freedom" (para. 22). In the process, we confirmed, at para. 23, L'Heureux-Dubé J.'s earlier comment in *Haig v. R.*, [1993] 2 S.C.R. 995 (S.C.C.), at p. 1039, that "a situation might arise in which, in order to make a fundamental freedom meaningful, a posture of restraint would not be enough, and positive governmental action might be required".

360 The combined effect of these statements is at least two-fold. Most obviously, they stand for the proposition that the *Charter*'s fundamental freedoms can be infringed even absent overt state action. Mere restraint on the part of government from actively interfering with protected freedoms is not always enough to ensure *Charter* compliance; sometimes government inaction can effectively constitute such interference.

361 Beyond that, however, the statements also confirm that in some contexts the fundamental freedoms enumerated in the *Charter* place the state under a positive obligation to ensure that its legislation is properly inclusive. Indeed, as I have already stressed, positive rights distinguish themselves from negative rights precisely in that they are violable by mere inaction, such as the failure on the part of the state to include all those who should be included under a regime of protective legislation. Thus, in holding that the state cannot shield itself from *Charter* scrutiny under the pretext that

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underinclusive legislation does not constitute active interference with a fundamental freedom, *Dunmore* affirmed that the *Charter* provides for positive rights.

362 Of course, such positive rights to inclusion in a legislative regime had previously been recognized by this Court in the s. 15(1) context in *Vriend* , *supra*. In that case, a unanimous Court observed that there is nothing in the wording of s. 32 "to suggest that a *positive act* encroaching on rights is required" (emphasis in original). Rather, s. 32 is "worded broadly enough to cover positive obligations on a legislature such that the *Charter* will be engaged even if the legislature refuses to exercise its authority" (para. 60, quoting D. Poirier "The Sounds of Silence: Charter Application when the Legislative Declines to Speak" (1996), 7 *Constitutional Forum* 113, at p. 115). The primary significance of *Dunmore* , from the perspective of the instant appeal, is that it extended the positive right to legislative inclusion to *Charter* claims going beyond the equality context.

363 It would, in my view, be inaccurate to suggest in the light of this that claims of underinclusion are the natural province of s. 15. I think it is preferable to approach such claims by first attempting to ascertain the threat that is posed by a given piece of underinclusive legislation. Where the threat is to one of the specifically enumerated fundamental rights and freedoms guaranteed by the *Charter*, it will be appropriate to entertain the claim of underinclusion under the section that provides for that freedom. Admittedly, there will be cases in which underinclusion is based on a prohibited ground and threatens human dignity, and therefore is properly treated under s. 15(1), even though it does not implicate any of the other enumerated *Charter* rights. To that extent, s. 15(1) is perhaps the proper venue for addressing certain kinds of claims of underinclusion *per se*.

364 But we must not conclude from this that claims based upon the underinclusiveness of legislation sit uneasily under the protection provided by other specifically enumerated *Charter* rights. As my colleague observes, total exclusion of a group from a statutory scheme protecting a certain right may in some circumstances engage that right to such an extent that the exclusion in essence infringes the substantive right as opposed to the equality right protected under s. 15(1).

365 *Dunmore* articulated the criteria necessary for making a *Charter* claim based on underinclusion outside the context of s. 15. In my view, these criteria are satisfied in this case. They are as follows:

> 1. **The claim must be grounded in a fundamental *Charter* right or freedom rather than in access to a particular statutory regime (*Dunmore*, at para. 24)**.
>
> 2. **A proper evidentiary foundation must be provided, before creating a positive obligation under the *Charter*, by demonstrating that exclusion from the regime constitutes a substantial interference with the exercise and fulfillment of a protected right (*Dunmore*, at para. 25)**.
>
> 3. It must be determined whether the state can truly be held accountable for any inability to exercise the right or freedom in question (*Dunmore*, at para. 26).

These criteria are directed at ensuring that the necessary conditions for making out virtually any *Charter* claim are in place. To begin with, the claim must be grounded in an appropriate *Charter* right. That is, it must be grounded in a substantive right outside of s. 15, rather than in exclusion from a statutory regime itself, which exclusion could at best implicate the equality guarantee. Beyond this, however, all successful *Charter* claims require that the claimant establish both that his or her right has been interfered with and that it is the government that is responsible for such interference. The second and third criteria are directed at establishing the presence of these two conditions. While establishing their presence is often a relatively straightforward matter in cases where it is the infringement of a negative right that is claimed — one must simply be able to point to a positive government action that infringes the right or freedom — the case is somewhat different here. Because claims based upon underinclusion essentially call upon the courts to find a positive obligation on the part of government to actively secure fulfilment of a *Charter* right, it would be both extremely difficult (if not impossible) for claimants to point to some positive state act that constitutes an interference with their *Charter* rights, and inappropriate to expect this of them. Instead, their claim will essentially be grounded in a lack of effective

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state action. We must be sensitive to this difference in conducting our analysis of the criteria. With this in mind, I will now consider each of them in turn.

A. Is the Claim Grounded in an Appropriate Charter Right?

366 In *Dunmore* , this Court distinguished underinclusion cases that are superficially similar such as *Haig* , *supra*, and *Native Women's Assn. of Canada v. R.*, [1994] 3 S.C.R. 627 (S.C.C.) ("*NWAC*"), on the basis that the *Charter* claims made in the latter cases constituted nothing more than a demand for access to a particular statutory regime (para. 24):

> [I]n Haig, the majority of this Court held that "(a) government is under no constitutional obligation to extend (a referendum) to anyone, let alone to everyone" (emphasis in original), and further that "(a) referendum as a platform of expression is ... a matter of legislative policy and not of constitutional law" (p. 1041). Similarly, in *NWAC*, the majority of this Court held that "[i]t cannot be claimed that NWAC has a constitutional right to receive government funding aimed at promoting participation in the constitutional conferences" (p. 654). In my view, the appellants in this case do not claim a constitutional right to general inclusion in (a statutory regime), but simply a constitutional freedom to organize a trade association. This freedom to organize exists independently of any statutory enactment. ...

The instant appeal is also distinguishable from *Haig* and *NWAC*, and on all fours with *Dunmore* itself, in this respect.

367 Though it is true that the claimants in the present case attack the underinclusiveness of the regulations under the *Social Aid Act* under s. 15 on the basis that exclusion from the statutory regime on a prohibited ground in itself constitutes an affront to human dignity, their s. 7 claim is entirely independent of this. Under s. 7, their claim is not that exclusion from the statutory regime is illicit *per se*, but that it violates their self-standing right to security of the person (and potentially their right to life as well). As in *Dunmore* , this right exists independently of any statutory enactment.

368 The distinction between the s. 7 claim and the s. 15 claim can be illustrated as follows: if it were the case that the claimants could meet their basic needs through means outside of the *Social Aid Act* — for instance through an independent government program providing for subsidized housing, food vouchers, etc., in exchange for the performance of works of public service — their s. 7 claim would entirely disappear, but their s. 15 claim would potentially remain intact inasmuch as it would still be open to them to argue that being forced to resort to these alternative means somehow violated their human dignity. The problem in this case, by way of contrast, is that exclusion from this statutory regime effectively excludes the claimants from any real possibility of having their basic needs met through any means whatsoever. Thus, it is not exclusion from the *particular* statutory regime that is at stake but, more basically, the claimants' fundamental rights to security of the person and life itself.

B. Is there a Sufficient Evidentiary Basis to Establish that Exclusion from the Social Aid Act Substantially Interfered with the Fulfilment and Exercise of the Claimants' Fundamental Right to Security of the Person?

369 In order to address adequately the question that is posed here, we must first be clear about what would be sufficient to constitute the required evidentiary basis. In *Dunmore* , *supra*, at para. 25, Bastarache J. stated the requirement as follows:

> [T]he evidentiary burden in these cases is to demonstrate that exclusion from a statutory regime permits a substantial interference with the exercise of protected s. 2(*d*) activity. Such a burden was implied by Dickson C.J. in the *Alberta Reference* ... where he stated that positive obligations may be required "where the absence of government intervention may in effect substantially impede the enjoyment of fundamental freedoms" (p. 361). [Emphasis deleted.]

For clarity, Bastarache J. went on to add that "[t]hese dicta *do not require that the exercise of a fundamental freedom be impossible*, but they do require that the claimant seek more than a particular channel for exercising his or her fundamental freedoms" (para. 25 (emphasis added)).

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370 In view of this, one must avoid placing undue emphasis on whatever (often remote) possibility there might have been that the claimants could have satisfied their basic needs through private means, whether in the open market or with the assistance of other private actors such as family members or charitable groups. There is simply no requirement that they prove they exhausted all other avenues of relief before turning to public assistance. On the contrary, all that is required is that the claimants show that the lack of government intervention "substantially impede[d]" the enjoyment of their s. 7 rights. This requirement is best put in language that mirrors that used by L'Heureux-Dubé J. in *Haig* , *supra*, that the claimants must show that government intervention was necessary in order to render their s. 7 rights meaningful.

371 There is ample evidence in this case that the legislated exclusion of young adults from the full benefits of the social assistance regime substantially interfered with their s. 7 rights, in particular their right to security of the person. Welfare recipients under the age of 30 were allowed $170/month. The various remedial programs put in place in 1984 simply did not work: a startling 88.8 percent of the young adults who were eligible to participate in the programs were unable to increase their benefits to the level payable to adults 30 and over. In these conditions, the physical and psychological security of young adults was severely compromised during the period at issue. This was compellingly illustrated by the appellant's own testimony and by that of her four witnesses: a social worker, a psychologist, a dietician and a community physician. The sizeable volume of the appellant's record prohibits an exhaustive exposé of the dismal conditions in which many young welfare recipients lived. I will nevertheless outline the evidence illustrating how the exclusion of young adults from the full benefits of the social assistance regime amounted to a substantial interference with their fundamental right to security of the person and drove them to resort to other demeaning and often dangerous means to ensure their survival.

372 On $170/month, paying rent is impossible. Indeed, in 1987, the rent for a bachelor apartment in the Montreal Metropolitan Area was approximately $237 to $412/month, depending on the location. Two-bedroom apartments went for about $368 to $463/month. As a result, while some welfare recipients were able to live with parents, many became homeless. During the period at issue, it is estimated that over 5,000 young adults lived on the streets of the Montreal Metropolitan Area. Arthur Sandborn, a social worker, testified that young welfare recipients would often combine their funds and share a small apartment. After paying rent however, very little money was left to pay for the other basic necessities of life, including hot water, electricity and food. No telephone meant further marginalization and made job hunting very difficult, as did the inability to afford suitable clothes and transportation.

(1) Interference with Physical Security of the Person

373 The exclusion of welfare recipients under the age of 30 from the full benefits of the social assistance regime severely interfered with their physical integrity and security. First, there are the health risks that flow directly from the dismal living conditions that $170/month afford. Obviously, the inability to pay for adequate clothing, electricity, hot water or, in the worst cases, for any shelter whatsoever, dramatically increases one's vulnerability to such ailments as the common cold or influenza. According to Dr. Christine Colin, persons living in poverty are six times more likely to develop diseases like bronchial infections, asthma and emphysema than persons who live in decent conditions. Dr. Colin also testified that the poor not only develop more health problems, but are also more severely affected by their ailments than those who live in more favourable conditions.

374 Second, the malnourishment and undernourishment of young welfare recipients also result in a plethora of health problems. In 1987, the cost of proper nourishment for a single person was estimated at $152/month, that is 89 percent of the $170/month allowance. Jocelyne Leduc-Gauvin, a dietician, gave detailed evidence of the effects of poor and insufficient nourishment. Malnourished young adults suffer from lethargy and from various chronic problems such as obesity, anxiety, hypertension, infections, ulcers, fatigue and an increased sensitivity to pain. Malnourished women are prone to gynecological disorders, high rates of miscarriage and abnormal pregnancies. Children born to malnourished mothers tend to be smaller and are often afflicted by congenital deficiencies such as poor vision and learning disorders. Like many welfare recipients under the age of 30, the appellant suffered the consequences of malnutrition. As noted by Ms. Leduc-Gauvin, there is a sad irony in the fact that those who were left to fend for themselves on a lean $170/month — young adults aged 18 to 30 — in fact required a higher daily intake of calories and nutrients than older adults.

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375 In order to eat, many young welfare recipients benefited from food banks, soup kitchens and like charitable organizations. But since these could not be relied upon consistently other avenues had to be pursued. While some resorted to theft, others turned to prostitution. Dumpsters and garbage cans were scavenged in search of edible morsels of food, exposing the hungry youths to the risks of food poisoning and contamination. In one particular case reported by Mr. Sandborn, two young adults paid a restauranteur $10/month for the right to sit in his kitchen and eat whatever patrons left in their plates.

(2) Interference with Psychological Security of the Person

376 The psychological and social consequences of being excluded from the full benefits of the social assistance regime were equally devastating. The hardships and marginalization of poverty propel the individual into a spiral of isolation, depression, humiliation, low self-esteem, anxiety, stress and drug addiction. According to a 1987 enquiry by Santé Québec, one out of five indigent young adults attempted suicide or had suicidal thoughts. The situation was even more alarming among homeless youths in Montreal, 50 percent of whom reportedly attempted to take their own lives.

377 In my view, this evidence overwhelmingly demonstrates that the exclusion of young adults from the full benefits of the social assistance regime substantially interfered with their fundamental right to security of the person and, at the margins, perhaps with their right to life as well. Freedom from state interference with bodily or psychological integrity is of little consolation to those who, like the claimants in this case, are faced with a daily struggle to meet their most basic bodily and psychological needs. To them, such a purely negative right to security of the person is essentially meaningless: theirs is a world in which the primary threats to security of the person come not from others, but from their own dire circumstances. In such cases, one can reasonably conclude that positive state action is what is required in order to breathe purpose and meaning into their s. 7 guaranteed rights.

C. Can the State Be Held Accountable for the Claimants' Inability to Exercise their Section 7 Rights?

378 In one sense, there appears to be considerable overlap between this third criterion for making out a successful underinclusion claim and the second criterion just discussed. In fact, once one establishes in accordance with the second criterion that a claimant's fundamental rights cannot be effectively exercised without government intervention, it is difficult to see what more would be required in order to demonstrate state accountability.

379 The absence of a direct, positive action by the state may appear to create particular problems of causation. Of course, state accountability in this context cannot be conceived of along the same lines of causal responsibility as where there is affirmative state action that causally contributes to, and in some cases even determines, the infringement. By contrast, positive rights are violable by mere inaction on the part of the state. This may mean that one should not search for the same kind of causal nexus tying the state to the claimants' inability to exercise their fundamental freedoms. Such a nexus could only ever be established by pointing to some positive state action giving rise to the claimants' aggrieved condition. While this focus on state action is appropriate where one is considering the violation of a negative right, it imports a requirement that is inimical to the very idea of positive rights.

380 Among the immediate implications of this is that the claimants in this case need not establish, in order to satisfy the third criterion, that the state can be held causally responsible for the socio-economic environment in which their s. 7 rights were threatened, nor do they need to establish that the government's inaction worsened their plight. Here, as in all claims asserting the infringement of a positive right, the focus is on whether the state is under an obligation of performance to alleviate the claimants' condition, and not on whether it can be held causally responsible for that condition in the first place.

381 All of which indicates that government accountability in the context of claims of underinclusion is to be understood simply in terms of the existence of a positive state obligation to redress conditions for which the state may or may not be causally responsible. On this view, the third criterion serves the purpose of ensuring not only that government intervention is needed to secure the effective exercise of a claimant's fundamental rights or freedoms, but also that it is

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obligatory. This accords with much of the dicta in *Dunmore* explaining how it is possible for government accountability to be established, not only by underinclusion that "orchestrates" or "encourages" the violation of fundamental freedoms, but also by underinclusion that "sustains" the violation (*Dunmore* , at para. 26). In conceiving of state accountability in terms of the breach of a positive duty of performance, it becomes possible for the first time to recognize how underinclusive legislation can violate a fundamental right by effectively turning a blind eye to, or *sustaining*, independently existing threats to that right.

382 A focus on state obligation was also the driving force behind this Court's finding in *Dunmore* that the government could be held accountable for the violation of the claimants' s. 2(*d*) rights in that case. It led to the search for a "minimum of state action" (para. 28) that would bring the government within reach of the *Charter* by engaging s. 32. Ultimately, the minimum of state action was satisfied in *Dunmore* by the mere fact that the government had chosen to legislate over matters of association. In this Court's view, that choice triggerd a state obligation that invoked *Charter* scrutiny and removed any possibility of the state claiming lack of responsibility for the violation of associational rights (at para. 29):

> Once the state has chosen to regulate a private relationship such as that between employer and employee ... it is unduly formalistic to consign that relationship to a "private sphere" that is impervious to *Charter* review. As Dean P. W. Hogg has stated, "(t)he effect of the governmental action restriction is that there is a private realm in which people are not obliged to subscribe to 'state' values, and into which constitutional norms do not intrude. The boundaries of that realm are marked, not by an *a priori* definition of what is 'private', but by the absence of statutory or other governmental intervention" (see *Constitutional Law of Canada* (loose-leaf ed.), at p. 34-27).

There can be no doubt that these dicta apply with equal force to the instant appeal.

383 The *Social Aid Act* is quite clearly directed at addressing basic needs relating to the personal security and survival of indigent members of society. It is almost a cliché that the modern welfare state has developed in response to an obvious failure on the part of the free market economy to provide these basic needs for everyone. Were it necessary, this Court could take judicial notice of this fact in assessing the relevance of the *Social Aid Act* to the claimants' s. 7 rights. As it happens, any such necessity is mitigated by the fact that s. 6 of the Act explicitly sets out its objective: to provide supplemental aid to those who fall below a *subsistence level*.

384 Additional support for the proposition that the *Social Aid Act* is directed at securing the interests that s. 7 of the *Charter* was meant to protect can be found in various statements made by the Quebec government in a policy paper that ultimately led to the reform of the social assistance regime in 1989, putting an end to the differential treatment between younger and older welfare recipients. This paper was published in 1987 by the government of Quebec, and signed by Pierre Paradis (the then Minister of Manpower and Income Security). It is entitled *Pour une politique de sécurité du revenu*. In it, the Quebec government unequivocally states that it [translation] "recognizes its duty and obligation to provide for the essential needs of persons who are unable to work." It then goes on to state that it must [translation] "resolutely tackle the deficiencies" of the social assistance programs, which, it admits, "remain barriers to the autonomy and emancipation of welfare recipients." On the same page, the government specifically identifies the difference in treatment between younger and older welfare recipients as such a deficiency, describing it as a [translation] "problem".

385 At the very least, these statements indicate that the *Social Aid Act* constituted an excursion into regulating the field of interests that generally fall within the rubric of s. 7 of the *Charter*. Legislative intervention aimed at providing for essential needs touching on the personal security and survival of indigent members of society is sufficient to satisfy whatever "minimum state action" requirement might be necessary in order to engage s. 32 of the *Charter*. By enacting the *Social Aid Act*, the Quebec government triggered a state obligation to ensure that any differential treatment or underinclusion in the provision of these essential needs did not run afoul of the fundamental rights guaranteed by the *Charter*, and in particular by s. 7. It failed to discharge this obligation. The evidence shows that the underinclusion of welfare recipients aged 18 to 30 under the *Social Aid Act* substantially impeded their ability to exercise their right to personal security (and potentially even their right to life). In the circumstances, I must conclude that this effective lack of government intervention constituted a violation of their s. 7 rights.

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IV. The Principles of Fundamental Justice

386 Under most circumstances, it would now be necessary to determine whether this *prima facie* violation of the appellant's s. 7 rights was "in accordance with the principles of fundamental justice". Such an enquiry appears to have no application to this case for two reasons. First, my analysis indicates that the protection of positive rights is most naturally grounded in the first clause of s. 7, which provides a free-standing right to life, liberty and security of the person and makes no mention of the principles of fundamental justice. Moreover, as Lamer J. observed in *Re B.C. Motor Vehicle Act*, supra, at p. 503 "*the principles of fundamental justice are to be found in the basic tenets of our legal system. They do not lie in the realm of general public policy but in the inherent domain of the judiciary as guardian of the justice system.*" *But positive rights, by nature violable by mere inaction on the part of the state, do not bring the* justice system into motion by empowering agents of the state to actively curtail the life, liberty and security of the person of individuals. The source of a positive rights violation is in the legislative process, which is of course itself quite distinct from the "inherent domain of the judiciary"and "the justice system" as it has been traditionally conceived. Indeed, the kinds of considerations that would serve to justify the decision to enact one form of protective legislation over another "lie in the realm of public policy", which this Court has specifically divorced from the principles of fundamental justice. The principles of fundamental justice therefore have little relevance in the present circumstances, which invoke the inherent domain of the legislature and not that of the justice system.

387 In view of this, any limitation that might be placed on the s. 7 right asserted in this case — if not in all cases where it is a positive right that is asserted — must be found, not in the principles of fundamental justice, but in the reasonable limits prescribed by law that can be justified in a free and democratic society. Accordingly, it is to s. 1 that we must turn.

V. Section 1 of the Charter

388 As is apparent from the above, there is an onerous burden placed on claimants who seek to establish a positive right violation under s. 7 of the *Charter*. Apart from the justiciability concern — which, though not an issue in this case, may at times present a significant obstacle in the way of finding such a violation — claimants are faced with the unenviable task of providing a sound evidentiary basis for the conclusion that their s. 7 rights are rendered essentially meaningless without active government intervention.

389 The difficulty faced by claimants in this regard is partially justified by the fact that, once a violation of s. 7 has been established and there is a shift in the burden of showing that the violation is demonstrably justified as a reasonable limit prescribed by law, a similarly onerous task awaits the government. Lamer C.J.'s comments in *G. (J.)* , *supra*, at para. 99, indicate why this must be so:

> Section 7 violations are not easily saved by s. 1. ... This is so for two reasons. First, the rights protected by s. 7 — life, liberty, and security of the person — are very significant and cannot ordinarily be overridden by competing social interests. Second, rarely will a violation of the principles of fundamental justice ... be upheld as a reasonable limit demonstrably justified in a free and democratic society.

Of course, only the first of these two rationales applies to the case at bar. Since there is no need to find that the violation of a positive right under s. 7 accords with the principles of fundamental justice, the second rationale does not come into play. To that extent, the violation of such a right may be somewhat easier to justify under s. 1. Still, the rights enshrined in s. 7, whether positive or negative, are of sufficient importance that they "cannot ordinarily be overridden by competing social interests".

390 There are, in addition, more general constraints on s. 1 justification discussed above, such that a limitation on *Charter* rights under that section will only be justified where it furthers the values at which the rights are themselves directed. These constraints magnify the difficulty of the government's task in showing that the impugned violation is justified.

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391 In this case, the legislated differential treatment, or underinclusion, is purportedly directed at: (1) preventing the attraction of young adults to social assistance; and (2) facilitating their integration into the workforce by encouraging participation in the employment programs. Insofar as either of these "double objectives" is understood as being principally driven by cost considerations, it would fail (barring cases of prohibitive cost) to be pressing and substantial. However, it is possible to frame these objectives in such a way as to ensure that they are properly adapted to the justificatory analysis under s. 1 by focusing instead on their long-term tendency to promote the liberty and inherent dignity of young people. Thus framed, they might indeed satisfy the "pressing and substantial objective" requirement under *Oakes* .

392 The problem, in my view, is that subsequent stages of the *Oakes* analysis raise doubts concerning the appropriateness of framing the objectives in this manner. For example, it is difficult to accept that denial of the basic means of subsistence is rationally connected to values of promoting the long-term liberty and inherent dignity of young adults. Indeed, the long-term importance of continuing education and integration into the workforce is undermined where those at whom such "help" is directed cannot meet their basic short-term subsistence requirements. Without the ability to secure the immediate needs of the present, the future is little more than a far-off possibility, remote both in perception and in reality. We have already seen, for example, how the inability to afford a telephone, suitable clothes and transportation makes job hunting difficult if not impossible. More drastically, inadequate food and shelter interfere with the capacity both for learning as well as for work itself. There appears, therefore, to be little rational connection between the objectives, as tentatively framed, and the means adopted in pursuit of those objectives.

393 Moreover, I agree with Bastarache J.'s finding that those means were not minimally impairing in a number of ways: (1) not all of the programs provided participants with a full top-up to the basic level; (2) there were temporal gaps in the availability of the various programs to willing participants; (3) some of the most needy welfare recipients — the illiterate and severely undereducated — could not participate in certain programs; (4) only 30,000 program places were made available in spite of the fact that 85,000 single young adults were on social assistance at the time. As my colleague points out, this last factor in particular "brings into question the degree to which s. 29(*a*) was geared towards improving the long-term situation of those under 30, as opposed to simply saving money"(para. 283). Thus, at the minimal impairment stage of the *Oakes* test, there is additional cause for doubting whether the legislated distinction at issue can be properly characterized as being directed at furthering the long-term liberty and dignity of the claimants.

394 This is sufficient, in my view, to establish that the government has not in this case discharged the always heavy burden of justifying a *prima facie* violation of s. 7 under s. 1. I note in passing that it will be a rare case indeed in which the government can successfully claim that the deleterious effects of denying welfare recipients their most basic requirements are proportional to the salutary effects of doing so in contemplation of long-term benefits, for reasons that are largely encompassed by my discussion of rational connection. This is not that rare case. For this reason among others, I find that the violation of the claimants' right to life, liberty and security of the person is not saved by s. 1.

VI. Section 15(1) of the Charter

395 Having found a violation of s. 7 of the *Charter*, it is not strictly necessary for me to determine whether the impugned provisions also violate s. 15(1). I am, however, in general agreement with my colleague Bastarache J.'s analysis and conclusions on that issue. As he does, I would find that the impugned provision of the regulations under the *Social Aid Act* infringes s. 15 of the *Charter* and that the infringement is not saved by s. 1. The infringement cannot be saved by s. 1 for substantially the same reasons discussed above in relation to the s. 7 violation.

VII. Section 45 of the Quebec Charter

396 I also agree with my colleague Bastarache J. that s. 45 of the Quebec *Charter of Human Rights and Freedoms*, R.S.Q., c. C-12, establishes a positive right to a minimal standard of living but that this right cannot be enforced under ss. 52 or 49 in the circumstances of this case. Indeed, s. 45 falls outside the expressly defined ambit of s. 52; it is consequently

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of no assistance to the appellant. Moreover, since there is no question of wrongful conduct or negligence on the part of the legislature, s. 49 cannot be resorted to either. The right that is provided for in s. 45, while not enforceable here, stands nevertheless as a strong political and moral benchmark in Quebec society and a reminder of the most fundamental requirements of that province's social compact. In that sense, its symbolic and political force cannot be underestimated.

VIII. Damages

397 Finally, I am in substantial agreement with the analysis of my colleague Bastarache J. with regard to remedy. Were the impugned provision of the Regulations still in force, I would have declared it unconstitutional pursuant to s. 52 of the *Constitution Act, 1982* as it violates the fundamental right to security of the person guaranteed under s. 7 of the *Charter*. I would have also ordered that the declaration of invalidity be suspended for a sufficient period of time to give the government an adequate opportunity to correct the legislation. However, the impugned social assistance regime having been repealed, this point is now moot.

398 The appellant also seeks monetary compensation for herself and for the members of her class. For the reasons invoked by Bastarache J., I too find this case ill-suited for the concomitant application of s. 52 of the *Constitution Act, 1982* and s. 24 of the *Charter*. I wish to note however that the financial impact of an hypothetical award on the province of Quebec would probably be less of a burden than surmised by my colleague. Indeed, the various remedial programs that failed to address the appellant's needs in this case were *Charter* proof until April 1989, protected as they were by a notwithstanding clause in their enabling statute (S.Q. 1984, c. 5, s. 4). This means that the programs' role in the *Charter* violation in this case could only be assessed within a 4-month window, representing the time between the expiry of the notwithstanding clause and the repeal of the impugned legislation.

399 Even though this affects the extent of the violation, it has no impact in my view on the usefulness of the whole of the evidence presented in this case as to the existence of the right and the nature of the infringement. The fact that *An Act to Amend the Social Aid Act*, S.Q. 1984, c. 5 and the programs it enacted were shielded from the *Charter* until April 1989 is a matter that goes to the scope or extent of the breach. It does not change the fact that a breach occurred.

IX. Conclusion

400 For these reasons, I would allow the appeal and I would answer the stated constitutional questions as follows:

> 1. Did s. 29(*a*) of the *Regulation Respecting Social Aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* on the ground that it established a discriminatory distinction based on age with respect to individuals, capable of working, aged 18 to 30 years?
>
> Yes.
>
> 2. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> No.
>
> 3. Did s. 29(*a*) of the *Regulation Respecting Social Aid*, R.R.Q. 1981, c. A-16, r. 1, adopted under the *Social Aid Act*, R.S.Q., c. A-16, infringe s. 7 of the *Canadian Charter of Rights and Freedoms* on the ground that it deprived those to whom it applied of their right to security of the person contrary to the principles of fundamental justice?
>
> Yes, the section infringed s. 7 by denying those to whom it applied of their right to security of the person.
>
> 4. If so, is the infringement justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?

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No.

***LeBel J.*:**

I. Introduction

401 I have read with interest the opinion of my colleague Justice Bastarache. I am in overall agreement with his reasons concerning the application of s. 15 of the *Canadian Charter of Rights and Freedoms* ("*Canadian Charter*") and I concur in the disposition he proposes. However, while I acknowledge that the appellant was unable to establish a violation of s. 7 of the *Canadian Charter*, I am unable, with respect, to agree with the interpretation and application he suggests. Finally, in the discussion of s. 45 of the Quebec *Charter of Human Rights and Freedoms*, R.S.Q., c. C-12 ("*Quebec Charter*"), I believe that certain unique aspects of the *Quebec Charter*, and the nature of the economic rights that it protects, merit a few additional comments.

II. Section 15 of the Canadian Charter

402 It is not disputed in this case that s. 29(*a*) of the *Regulation respecting social aid* establishes a formal distinction between the appellant (and members of her group) and other social aid recipients based on a personal characteristic, namely age. The appeal essentially relates to the third element in the analysis under s. 15 of the *Canadian Charter*, which involves determining whether the distinction in issue is discriminatory. For the reasons given by my colleague Bastarache J., and for the following reasons, I am of the opinion that s. 29(*a*), when taken in isolation or considered in light of all employability programs, discriminates against recipients under 30 years of age.

403 Differential treatment becomes discriminatory when it violates the human dignity and freedom of the individual. This will be the case where the differential treatment reflects a stereotypical application of presumed personal or group characteristics, or where it perpetuates or promotes the view that the individual concerned is less capable or less worthy of respect and recognition as a human being or as a member of Canadian society.

404 It should first be noted that in this case, the distinction was based on a ground expressly enumerated in s. 15(1) of the *Canadian Charter*. In such circumstances, it is much easier to conclude that the distinction violates the innate dignity of the individual, as Iacobucci J. held in *Law v. Canada (Minister of Employment & Immigration)*, [1999] 1 S.C.R. 497 (S.C.C.). However, when compared to the other enumerated or analogous grounds, age is unique in that a distinction based on age may, in some cases, reflect the needs and abilities of individuals. In *Law* , for example, the Supreme Court upheld a distinction based on age in the Canada Pension Plan (CPP) on the ground that the distinction was not discriminatory. The CPP provided that a person must have reached the age of 35 in order to receive surviving spouse benefits. This Court reached that conclusion because the distinction based on age is justified by the *actual* (not stereotypical) capacity of individuals under the age of 35 to support themselves in the *long term*.

405 In this case, the distinction based on age, unlike the distinction at issue in *Law v. Canada (Minister of Employment & Immigration)*, does not reflect either the needs or the abilities of social aid recipients under 30 years of age. The ordinary needs of young people are not so different from the needs of their elders as to justify such a pronounced discrepancy between the two groups' benefits. As well, young people are no more able to find or keep a job during an economic slowdown than are their elders. In fact, young people are the first to feel the impact of an economic crisis on the labour market. Because they have little experience or seniority, they are at the top of the list for termination and lay-off (see the report by Louis Ascah, *La discrimination contre les moins de trente ans à l'aide sociale du Québec: un regard économique* (1988)). Also, because the distinction made by the social aid scheme was justified by the fact that young people are able to survive a period of economic crisis better, I, like Bastarache J., am of the opinion that this distinction perpetuated a stereotypical view of young people's situation on the labour market.

406 My colleague Chief Justice McLachlin says that the Quebec government was under no illusions as to the ability of young people to keep a job in a period of economic crisis. In her view, the Quebec government knew perfectly

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well that they would be the first to suffer the negative effects of the difficulties in the economy. This was in fact the reason why the government created the employability programs, which were designed to make up for lack of training or experience. Those programs assisted young people to re-enter the labour market, while counteracting the negative effects on vocational development of prolonged periods out of the productive work force.

407 I am prepared to concede that the Quebec government knew that young people are particularly vulnerable during an economic slowdown. As well, I readily acknowledge that the government sincerely believed that it was helping young people by making the payment of full benefits conditional on participation in an employability program. Nonetheless, the distinction made by the social aid scheme did not reflect the needs of young social assistance recipients under the age of 30. By trying to combat the pull of social assistance, for the "good" of the young people themselves who depended on it, the distinction perpetuated the stereotypical view that a majority of young social assistance recipients choose to freeload off society permanently and have no desire to get out of that comfortable situation. There is no basis for that vision of young social assistance recipients as "parasites". It has been disproved by numerous experts. For instance, in a 1986 study prepared for the Quebec government's Commission consultative sur le travail (*Les jeunes et le marché du travail* (1986)), Prof. Gilles Guérin wrote, *inter alia* (at p. 65):

> [TRANSLATION]
>
> An estimated proportion of 91% of young people (counting only those capable of working) perceive their situation on social aid as temporary and have a fierce desire to work, to have a real job, to collect a real wage, and to acquire socio-economic autonomy. An IQOP study shows that young people value being productive workers, that it is preferable in their eyes to hold a job, even one that does not interest them, than to be unemployed. <u>The myth of the young social assistance recipient who is capable of working and is happy with social assistance is therefore completely false; work is what is most highly valued by the people around them, their friends and family and their neighbours, and by the young people themselves</u>. [Emphasis added.]

408 As well, in *Le plein emploi: pourquoi*? (1983), L. Poulin Simon and D. Bellemare found that where income was equal, a majority of people in Quebec preferred work to unemployment. While the authors made no absolute statements, they came to substantially the same conclusions with respect to those statistics (at p. 66):

> [TRANSLATION]
>
> These results add to the doubt there might be as to the strictly utilitarian economic hypothesis that predicts that where income is equal, workers generally prefer not working to working. In our opinion, that hypothesis derives from a medieval view of economic reality, where work was a degrading activity with no intrinsic value; the serfs worked while the lords were content to amuse themselves. In an advanced industrial economy, the reality of work would seem to be quite a different matter.

409 Young social assistance recipients in the 1980s certainly did not latch onto social assistance out of laziness; they were stuck receiving welfare because there were no jobs available. Economists who studied the labour market during that period unanimously recognize the gradual but universal shrinkage in the number of jobs in the economy since 1986 (and especially since 1974) as the primary factor in the meteoric rise in the unemployment rate among young people. For instance, in his report "Le chômage des jeunes au Québec: aggravation et concentration" (1984), 39 *Relations Industrielles* 419, the economist Pierre Fortin attributed three quarters of the rise in the average unemployment rate among all young people, from 6% to 23%, since 1966 to the general deterioration of the economy, together with young people's much greater vulnerability to any slowdown in overall employment prospects. In his view, the extreme sensitivity of the youth unemployment rate to general conditions in the economy confirms that a very large majority of young people want to work and are capable of doing productive work when there are jobs for them. Accordingly, the real solution to the youth unemployment rate, he says, lies in a full employment policy for all workers, and not a simple employment incentive mechanism incorporated as part of social assistance programs.

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410 Obviously, it is too easy to pass harsh judgment on the actions of a government after the fact. I certainly do not intend to dispute the appropriateness of offering incentives to work that may legitimately be the subject of a political debate. However, even if the Quebec government could validly encourage young people to work, the approach adopted discriminates between social aid recipients under 30 years of age and those who are 30 years of age and over, for no valid reason, and perpetuates the prejudiced notion that the former tend to be happy being dependent on the state, even though they are better able to make a go of things than their elders during periods of economic slowdown. With due respect for the opinion of the Chief Justice, I do not believe that the only way for the Quebec government to secure participation in those programs was to make the payment of full benefits conditional on participation in an employability program. There is nothing in the evidence that establishes that the people who did participate in the programs would not have participated without a financial incentive, nor is there anything from which that can be assumed. In my view, the Quebec government could have achieved its objective of developing employability just as well without abandoning recipients under the age of 30 to these paltry benefits.

411 In addition to the underlying stereotypes, the social aid scheme has too many other defects that would be sufficient on their own to support a finding that s. 15 of the *Canadian Charter* was violated. My colleague Bastarache J. alluded to, *inter alia*, the restrictions placed on participation in employability programs. I will not repeat his comments, but I would like to add that the programs lasted for a maximum of 12 months. At the end of that time, recipients did not qualify for full benefits. They had to participate in an employability program again (and even several times) in order to avoid the harsh reality of reduced benefits. As well, if they were still unable to find a job, young social assistance recipients, even those who had participated in all the programs offered, would again receive the "small scale". In my view, once a recipient had participated in a program and made every effort to find a job, the scheme should have provided for payment of benefits equivalent to the benefits paid to recipients 30 years of age and over.

412 In addition to these inconsistencies in the system, the evidence shows that implementation of the programs was delayed by administrative constraints, and some recipients therefore had to wait several months before they were able to take part in an employability program. Louise Bourassa, director of work force and income security programs, in fact acknowledged in her testimony that the Department had received complaints that some recipients were on waiting lists. It appears that between the time someone registered for a program and the time the program started, reduced benefits continued to be paid.

413 All of these defects in the scheme, together with the preconceived ideas that underpinned it, necessarily lead to the conclusion that s. 29(*a*) of the *Regulation respecting social aid* infringed the equality right of recipients under 30 years of age. For the reasons given by Bastarache J., s. 29(*a*) is not saved by s. 1 of the *Canadian Charter*.

III. Section 7 of the Canadian Charter

414 Having regard to the foregoing conclusion, I see no point in any further consideration of whether s. 29(*a*) of the *Regulation respecting social aid* violates s. 7 of the *Canadian Charter*. While I agree with Bastarache J.'s conclusion that the appellant failed to establish a violation of s. 7, I would note that I agree with the part of the reasons of the Chief Justice in which she writes that it is not appropriate, at this point, to rule out the possibility that s. 7 might be invoked in circumstances unrelated to the justice system. In the case of s. 7, the process of jurisprudential development is not complete. With respect, I am afraid that an interpretation such as is suggested by Bastarache J. unduly circumscribes the scope of the section, in a manner contrary to the cautious, but open, approach taken in the decisions of this Court on the question. It having been established that s. 7 does not apply, we must now review the arguments made by the appellant concerning the interpretation and application of s. 45 of the *Quebec Charter*.

IV. Section 45 of the Quebec Charter

415 The appellant submits that s. 45 of the *Quebec Charter* recognizes the right to an acceptable standard of living, as a substantive right. She cites the dissenting opinion of Robert J.A. in the Court of Appeal ([1999] R.J.Q. 1033 (C.A.

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Que.)), in which he found s. 45 to have independent legal effect, based on a difference between the wording of that section and of the other provisions that the *Quebec Charter* contains under the heading of social and economic rights. The respondent submits that s. 45 is no more than a mere policy statement, implementation of which may be ascertained from the relevant legislation. In the words of Baudouin J.A. in the Court of Appeal, the respondent argues that s. 45 does not authorize the courts to review the sufficiency of social measures that the legislature has chosen to adopt, in its political discretion. For the following reasons, I am of the opinion that while s. 45 is not without any binding content, it does not operate to place a duty on the Quebec legislature to guarantee persons in need an acceptable standard of living. That interpretation is supported by the wording and legislative history of s. 45 and its position in the *Quebec Charter* and by the interaction between that section and the other provisions of the *Quebec Charter*.

A. The wording of section 45 and its placement in the Quebec Charter

416 As Robert J.A. correctly observed, the *Quebec Charter* operates as a fundamental statute in the law of Quebec, and its unique nature is apparent in a variety of ways. First, it may be distinguished from other provincial human rights statutes in that its content goes well beyond the framework of mere prohibitions on discrimination. In addition to the very special importance that it assigns to the right to equality, the *Quebec Charter* protects a large number of other rights, including fundamental rights and freedoms and legal, political, social and economic rights. As well, while the *Canadian Charter* contains a justification clause that may apply to the violation of protected rights, the rights and freedoms guaranteed by the *Quebec Charter* are guaranteed without restriction, other than the restrictions inherent in the rights and freedoms themselves (with the exception, however, of the fundamental rights and freedoms in Chapter I, which may be justifiably limited under s. 9.1). In terms of remedies, the *Quebec Charter* differs from the *Canadian Charter* in that it offers various methods for compensating individuals whose rights are violated in private relationships. A final distinction worth noting is that the *Quebec Charter* is practically the only fundamental legislation in Canada, or even North America, that expressly protects social and economic rights.

417 Pierre Bosset writes that including economic and social rights in a document that solemnly affirms the existence of fundamental rights and freedoms must have some consequence. In his view, the recognition of those rights [translation] "makes it necessary to consider the question of the protection of economic and social rights from a qualitatively different perspective, one that is appropriate to a constitutional instrument, and not as a mere branch of administrative law" (P. Bosset, "Les droits économiques et sociaux: parents pauvres de la Charte québécoise?" (1996), 75 *Can. Bar Rev.* 583, at p. 585). However, although the incorporation of social and economic rights into the *Quebec Charter* gives them a new dimension, it still does not make them legally binding. Robert J.A. is also of that opinion. In the case of s. 45 of the *Quebec Charter*, though, he creates an exception. He finds it to be binding, relying on a difference between the wording of s. 45 and the wording of the other provisions in the same chapter. In my view, that exception does not stand up to careful scrutiny of the chapter in question, the provisions of which are as follows:

> **Chapter IV Economic and Social rights**
>
> **39.** Every child has a right to the protection, security and attention that his parents or the persons acting in their stead are capable of providing.
>
> **40.** Every person has a right, <u>to the extent and according to the standards provided for by law</u>, to free public education.
>
> **41.** Parents or the persons acting in their stead have a right to require that, in the public educational establishments, their children receive a religious or moral education in conformity with their convictions, <u>within the framework of the curricula provided for by law</u>.
>
> **42.** Parents or the persons acting in their stead have a right to choose private educational establishments for their children, provided such establishments <u>comply with the standards prescribed or approved by virtue of the law</u>.

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43. Persons belonging to ethnic minorities have a right to maintain and develop their own cultural interests with the other members of their group.

44. Every person has a right to information to the extent provided by law.

45. Every person in need has a right, for himself and his family, to measures of financial assistance and to social measures provided for by law, susceptible of ensuring such person an acceptable standard of living.

46. Every person who works has a right, in accordance with the law, to fair and reasonable conditions of employment which have proper regard for his health, safety and physical well-being.

47. Married or civil union spouses have, in the marriage or civil union the same rights, obligations and responsibilities.

Together they provide the moral guidance and material support of the family and the education of their common offspring.

48. Every aged person and every handicapped person has a right to protection against any form of exploitation.

Such a person also has a right to the protection and security that must be provided to him by his family or the persons acting in their stead. [Emphasis added.]

418 Chapter IV is remarkable for the presence of both intrinsic and extrinsic limitations on the rights created in it. First, six of the ten sections in the chapter contain a reservation (worded differently from one section to another) indicating that the exercise of the rights they protect depends on the enactment of legislation. For instance, to cite a few examples, the right to free public education is guaranteed "to the extent and according to the standards provided for by law", the right of parents to have their children receive religious instruction in conformity with their convictions is guaranteed "within the framework of the curricula provided for by law" and the right to information is guaranteed "to the extent provided by law". As well, all of the rights in the chapter are excluded from the preponderance that s. 52 assigns to the other rights and freedoms guaranteed by the *Quebec Charter*. Accordingly, any interference with any of those rights may not result in a declaration under s. 52 that the legislation in question is of no force and effect. Nonetheless, it is possible, under s. 49, to obtain cessation of any interference with such a right, and compensation for the moral or material prejudice resulting therefrom.

419 In the opinion of Robert J.A., the differences in wording among the sections in Chapter IV are of merely aesthetic significance. He is of the view that the expression "provided for by law" used in s. 45 to qualify the financial assistance and social measures that the legislature must adopt in order to ensure an acceptable standard of living does not mean the same thing as the other expressions used in the other sections in Chapter IV. While those other expressions, in his view, indicate that the rights are granted only to the extent provided for by law, the expression "provided for by law" refers, rather, to the methods by which the legislature has committed itself to providing the measures to ensure an acceptable standard of living. That interpretation, he says, is consistent with art. 11 of the *International Covenant on Economic, Social and Cultural Rights*, 993 U.N.T.S. 3, to which s. 45 bears an undeniable resemblance:

Article 11.

1. The States Parties to the present Covenant recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions. The States Parties will take appropriate steps to ensure the realization of this right, recognizing to this effect the essential importance of international co-operation based on free consent.

420 The apparent similarity between s. 45 and art. 11 of the Covenant does not necessarily mean that the Quebec legislature intended to entrench the right to an acceptable standard of living in the *Quebec Charter*. In fact, the wording

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of s. 45 itself seems to negate that possibility. Section 45 does not guarantee the right to an acceptable standard of living, as art. 11 does; rather, it guarantees the right to social measures. In my view, that distinction supports the assertion that s. 45 protects a *right of access* to social measures for anyone in need. The fact that anyone in need is entitled not to measures to ensure him or her an acceptable standard of living, but to measures *susceptible* of ensuring him or her that standard of living, is also revealing. It seems to suggest that the legislature did not intend to give the courts the power to review the adequacy of the measures adopted, or to usurp the role of the legislature in that regard.

421 As well, the expression "provided for by law" must be considered in light of the other provisions of Chapter IV that have a direct impact on the financial resources of the state. Those provisions all contain a reservation (worded in different ways from one section to another). Those reservations confirm that the rights are protected only to the extent provided for by law. It would be most surprising if the Quebec legislature had committed itself unconditionally to ensuring an acceptable standard of living for anyone in need at the same time as limiting the exercise of all of the other rights that call for it to make a direct financial investment to what is prescribed by law (M.-J. Longtin and D. Jacoby, "La Charte vue sous l'angle du législateur" in *La nouvelle Charte sur les droits et libertés de la personne* (1977), 4, at p. 24).

422 The final point is that the interpretation adopted by Robert J.A. does not seem to be supported by the opinions expressed during the parliamentary debates that led to the enactment of the *Quebec Charter*. The Quebec Minister of Justice referred to social and economic rights in the broader framework of a charter that was intended to be a synthesis of certain democratic values accepted in Quebec, Canada and the West, and described the rationale for those provisions as follows (*Journal des débats*, vol. 15, No. 79, November 12, 1974, at p. 2744):

> [TRANSLATION]
>
> These rights are of special importance. Some may say that in certain cases they are expressions of good intentions, but I think that the fact that they are recognized in a bill like this one will give them an important place in the context of the democratic values to which I have referred, that is, that a number of these social and economic rights in a way summarize certain things, certain principles, certain values that we hold dear in Quebec. Despite the fact that some of them are subject to the effect of other government legislation, which I certainly do not deny, they nonetheless represent part of our democratic heritage. That is why we have included them in this Charter.

423 It therefore seems obvious that the Quebec legislature did not intend to give the social and economic rights guaranteed by the *Quebec Charter* independent legal effect. As well, there is nothing in the debates to suggest the intention of creating an exception with respect to s. 45.

B. Case law concerning section 45

424 The Quebec courts have generally taken the position that s. 45, and all of the rights in Chapter IV of the *Quebec Charter*, were positive rights, the exercise of which depended on the enactment of legislation. In *Lévesque c. Québec (Procureur général)* (1987), [1988] R.J.Q. 223 (C.A. Que.), the Court of Appeal held (at p. 226):

> [TRANSLATION]
>
> In 1975, in Chapter IV, Social and Economic Rights, the Charter granted all individuals the right to social measures, but because that provision does not prevail over the other laws of Quebec, the right to financial assistance must be determined under the appropriate legislation and regulations, in this case, the Act.

425 As well, in *Lecours v. Québec (Ministère de la Main d'oeuvre et de la sécurité du revenu)*, J.E. 90-638, the Superior Court held that s. 45 of the *Quebec Charter* did not grant a universal right to social assistance; that right must be provided by law.

426 There is, however, one decision of the Quebec Court of Appeal that is an exception. That judgment, in *Johnson c. Québec (Commission des affaires sociales)*, [1984] C.A. 61 (C.A. Que.), relied on s. 45 of the *Quebec Charter* in holding

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that a statutory provision declaring a person who is unemployed because of a labour dispute to be ineligible for social assistance could not be applied to a striker. Johnson and his wife had found themselves without income the day after a strike vote was held. Because he was not a union member, Johnson could not receive strike pay. He then tried to obtain unemployment insurance benefits, but was unsuccessful. As a last resort, he applied for social aid, which he was denied on the ground that s. 8 of the *Social Aid Act*, R.S.Q., c. A-16, excluded persons who had lost their job because of a labour dispute from benefits. He then challenged the validity of s. 8 on the ground that it was contrary to ss. 10 and 45 of the *Quebec Charter*.

427 Bisson J.A., writing for the Court of Appeal, held that s. 8 of the Act was not based on one of the grounds of discrimination listed in s. 10 of the *Quebec Charter* because being unemployed as a result of a labour dispute was not included in the concept of social condition. That did not conclude his analysis, and he went on to declare that s. 8 was of no force and effect as against the appellant on the ground that it was contrary to a number of the principles laid down in the *Quebec Charter* and in the *Social Aid Act* (at p. 70).

> [TRANSLATION]
>
> Having found that s. 8 was valid legislation, I am nevertheless compelled to acknowledge that, as happens in the case of some legislation, a provision that is perfectly legal may, inadvertently, produce effects that the legislature did not anticipate.
>
> That is the case with s. 8 as it relates to the appellants. The effect of that statutory provision, which was intended to prevent strikes being funded by social aid, is that because of the special situation of the appellants, s. 34 of the Charter must be applied.

428 It is difficult to view *Johnson* as an express recognition of the binding effect of s. 45. For one thing, it is obvious that the Court of Appeal was influenced by the exceptional circumstances in the case before it: a worker who had been on probation had been unable to participate in the strike vote and was not entitled to union benefits. The court was dealing with legislation that was perfectly valid but that produced effects the legislature had not anticipated. As Pierre Bosset, *supra*, points out, that case is in fact an atypical case, in which the basis for the judgment is extremely uncertain (at p. 593):

> [TRANSLATION]
>
> When restricted to the applicant's particular case, the declaration that the law was of no force and effect is perhaps not very dissimilar to a judgment in equity. However, we may also regard it as an implied application of the rule of interpretation stated in s. 53 of the *Charter*, which provides that if any doubt arises in the interpretation of a provision of the Act, it shall be resolved in keeping with the intent of the *Charter*.

429 Accordingly, other than in exceptional circumstances, it does not seem that s. 45 is capable of having independent legal effect. Robert J.A. thought that this interpretation should be rejected on the ground that it reduced s. 45 to a mere obligation that [translation] "theoretically ... could be no more than symbolic and purely optional" (p. 1100). His opinion, however, was not based on a proper assessment of the nature of the obligational content of s. 45. The right of access to measures of financial assistance and social measures without discrimination would not be guaranteed by the *Quebec Charter* were it not for s. 45, the reason for this being that s. 10 of the *Quebec Charter* does not create an independent right to equality. In the first decision on this point, *Québec (Commission des droits de la personne) c. St-Jean-sur-Richelieu (Commission scolaire)*, [1991] R.J.Q. 3003 (T.D.P.Q.), aff'd [1994] R.J.Q. 1227 (C.A. Que.), the Human Rights Tribunal explained the complex interaction between the right to equality and economic and social rights, in that case the right to free public education, as follows (at p. 3037):

> [TRANSLATION]
>
> [W]hile the *Charter* allows for the exercise of the right to free public education to be affected by various statutory restrictions, and even for it to be subject to certain limits (such as charging tuition fees at the college and university

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level, for example), it prohibits limitations that have an effect on the exercise of that right that is discriminatory on one of the grounds enumerated in s. 10.

430 The symbiosis between s. 10 and the other rights and freedoms is a direct result of the wording of s. 10, which creates not an independent right to equality but a method of particularizing the various rights and freedoms recognized (*Québec (Commission des droits de la personne) c. Desroches*, [1997] R.J.Q. 1540 (C.A.), at p. 1547). Section 10 sets out the right to equality, but only in the recognition and exercise of the rights and freedoms guaranteed. Accordingly, a person may not base an action for a remedy on the s. 10 right to equality as an independent right. However, a person may join s. 10 with another right or freedom guaranteed by the *Quebec Charter* in order to obtain compensation for a discriminatory distinction in the determination of the terms and conditions on which that right or freedom may be exercised (P. Carignan, "L'égalité dans le droit: une méthode d'approche appliquée à l'article 10 de la Charte des droits et libertés de la personne" in *De la Charte québécoise des droits et libertés: origine, nature et défis* (1989), 101, at pp. 136-37).

431 While it is true that the existence of that right of access is itself subject to the enactment of legislation, there is opinion that suggests that a minimum duty to legislation could be inferred from the inclusion of economic and social rights in the *Quebec Charter*. That idea is argued by Pierre Bosset, *supra*, at p. 602, who sees it as an alternative to the refusal by the Quebec courts to recognize the rights set out in Chapter IV of the *Quebec Charter* as having binding effect:

> [TRANSLATION]
>
> Unless we are to think that the legislature spoke for no purpose when it included economic and social rights in the *Charter*, we must take seriously the hypothesis of minimum obligational content, of a "hard core" of rights that may be asserted against the state, despite the fact that the provisions in question do not, properly speaking, prevail over legislation. The idea of a hard core, which is more in keeping with the spirit of the *Charter* and the way that we normally think about rights and obligations than is the idea of a "purely optional" obligation, involves, at a minimum, the creation of a legal framework that favours the attainment of social and economic rights. Accordingly, failure to legislate — particularly where the way in which the right is worded expressly refers to the law — would be inconsistent with the obligations imposed by the *Charter*. Legislating solely as a matter of form, in legislation devoid of substance, would be no less problematic an idea.

432 However, that interpretation would not give the courts the power to review the adequacy of the measures adopted. Nonetheless, the task it would assign them might be incompatible with their function, which is to determine what types of measures are likely to allow for the exercise of rights.

433 In conclusion, the wording of s. 45 and its placement in the *Quebec Charter* confirm that it does not confer an independent right to an acceptable standard of living for anyone in need. That interpretation is the one most consistent with the intention of the Quebec legislature. Although it might be desirable, entrenching economic and social rights in a charter of rights is not essential to recognition of those rights in positive law. Social law had in fact developed in Quebec well before the enactment of the *Quebec Charter*.

V. Conclusion

434 For these reasons, the appeal should be allowed, in accordance with the disposition proposed by my colleague Bastarache J.

Appeal dismissed.

Pourvoi rejeté.

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Supreme Court of Canada

Eldridge v. British Columbia (Attorney General)

1997 CarswellBC 1939, 1997 CarswellBC 1940, [1997] 3 S.C.R. 624, [1997] S.C.J. No. 86, [1998] 1 W.W.R. 50, 151 D.L.R. (4th) 577, 155 W.A.C. 81, 218 N.R. 161, 38 B.C.L.R. (3d) 1, 3 B.H.R.C. 137, 46 C.R.R. (2d) 189, 74 A.C.W.S. (3d) 41, 96 B.C.A.C. 81, J.E. 97-1910

Robin Susan Eldridge, John Henry Warren and Linda Jane Warren, Appellants v. The Attorney General of British Columbia and the Medical Services Commission, Respondents and The Attorney General of Canada, the Attorney General for Ontario, the Attorney General of Manitoba, the Attorney General of Newfoundland, the Women's Legal Education and Action Fund, the Disabled Women's Network Canada, the charter Committee on Poverty Issues, the Canadian Association of the Deaf, the Canadian Hearing Society and the Council of Canadians with Disabilities, Interveners

Lamer C.J.C., La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

Heard: April 24, 1997
Judgment: October 9, 1997
Docket: 24896

Proceedings: reversing (1995), 7 B.C.L.R. (3d) 156 (C.A.); affirming (1992), 75 B.C.L..R. (2d) 68 (S.C.)

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Martha Jackman and *Arne Peltz*, for the intervener the Charter Committee on Poverty Issues.
David Baker and *Patricia Bregman*, for the interveners the Canadian Association of the Deaf, the Canadian Hearing Society and the Council of Canadians with Disabilities.

Subject: Constitutional; Public; Human Rights

APPEAL from decision of British Columbia Court of Appeal, reported at (1995), 7 B.C.L.R. (3d) 156, 125 D.L.R. (4th) 323, 59 B.C.A.C. 254, 98 W.A.C. 254 (C.A.), affirming decision of British Columbia Supreme Court, reported at (1992), 75 B.C.L.R. (2d) 68 (S.C.), dismissing application for declaration that certain sections of *Hospital Insurance Act* (B.C.) and *Medical and Health Care Services Act* (B.C.) violated s. 15(1) of *Canadian Charter of Rights and Freedoms*.

Pourvoi à l'encontre d'un arrêt de la Cour d'appel de la Colombie-Britannique, publié à (1995), 7 B.C.L.R. (3d) 156, 125 D.L.R. (4th) 323, 59 B.C.A.C. 254, 98 W.A.C. 254 (C.A.), confirmant la décision de la Cour suprême de la Colombie-Britannique, publiée à (1992), 75 B.C.L.R. (2d) 68 (C.S.), rejetant une requête visant à obtenir un jugement déclaratoire à l'effet que certains articles de la *Hospital Insurance Act* (B.C.) et de la *Medical and Health Care Services Act* (B.C.) violaient l'art. 15(1) de la *Charte canadienne des droits et libertés*.

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The judgment of the court was delivered by *La Forest J.*:

1 This appeal raises the question whether a provincial government's failure to provide funding for sign language interpreters for deaf persons when they receive medical services violates s. 15(1) of the *Canadian Charter of Rights and Freedoms*. The appellants assert that, because of the communication barrier that exists between deaf persons and health care providers, they receive a lesser quality of medical services than hearing persons. The failure to pay for interpreters, they contend, infringes their right to equal benefit of the law without discrimination based on physical disability.

Factual Background

2 Medical care in British Columbia is delivered through two primary mechanisms. Hospital services are funded by the government through the *Hospital Insurance Act*, R.S.B.C. 1979, c. 180 [now R.S.B.C. 1996, c. 204], which reimburses hospitals for the medically required services they provide to the public. Funding for medically required services delivered by doctors and other health care practitioners is provided by the province's Medical Services Plan, which is established and regulated by the *Medical and Health Care Services Act*, S.B.C. 1992, c. 76 [now known as the *Medicare Protection Act*, R.S.B.C. 1996, c. 286]. Neither of these programs pays for sign language interpretation for the deaf.

3 Until 1990, the Western Institute for the Deaf and Hard of Hearing, a private, non-profit agency, provided free medical interpreting services for deaf persons in the lower mainland of British Columbia. This program was funded entirely from private sources without any contribution from the provincial government. In September 1990, the Institute discontinued the service because it no longer had sufficient funds to pay for it.

4 Prior to cancelling the program, the Institute made two requests of the Ministry of Health for funding. At the time, it had contracts with a number of government departments to provide sign language interpreters in connection with various services. The Institute requested similar funding for the provision of interpreters in the medical setting, suggesting that sign language interpretation be covered as an insured benefit under the Medical Services Plan. The first request was made in 1989 and was declined out of hand. The second request was made in May 1990 after the Institute had decided that it could no longer fund the service. The cost of the proposed program, which would have extended throughout the province, was estimated to be $ 150,000 per year. The Ministry turned down the request on the basis that it would strain available resources and create a precedent for the funding of similar services for the non-English speaking immigrant community.

5 Each of the appellants was born deaf. Their preferred means of communication is sign language. They contend that the absence of interpreters impairs their ability to communicate with their doctors and other health care providers, and thus increases the risk of misdiagnosis and ineffective treatment. One of the appellants, Robin Eldridge, suffers from a number of medical conditions, including diabetes. She sees a general physician and a specialist a number of times per year. Neither of these doctors knows sign language. She has also been a patient in hospital on several occasions. The hospitals did not provide her with sign language interpreters. Prior to its termination, she used the Institute's free medical interpreting service. Subsequently, she hired an interpreter when she had surgery in hospital. She testified that she would continue to hire interpreters for important medical situations but could not afford to hire one for every visit to the doctor or hospital. She finds visiting her doctors without an interpreter very stressful and confusing since, in her view, she cannot communicate adequately with them. Her specialist testified that he was satisfied with the level of communication when a sign language interpreter was present. In the absence of an interpreter, he explained, he was unsure about the accuracy of information conveyed by Ms. Eldridge. Communication with her in these circumstances, he stated, was inhibited and frustrating.

6 The other appellants, John and Linda Warren, see their doctor frequently. Although they had planned to hire an interpreter for the birth of their twin daughters, they were unable to procure one in time as the girls were born prematurely. Linda Warren testified that in the absence of an interpreter, the birth process was difficult to understand and frightening. During the birth, the nurse communicated to her through gestures that the heart rate of one of the babies

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had gone down. After the babies were born, they were immediately taken from her. Other than writing a note stating that they were "fine", no one explained their condition to her.

7 The Warrens' physician, who does not know sign language, testified that communication by written notes is time consuming, impractical and has the potential to result in harm in some circumstances. Adequate communication, she related, is particularly critical for childbirth. If the doctor can communicate with the patient so that the patient is able to help with the delivery, she explained, complications are less likely to occur and the patient is less apt to have a traumatic birth. In her view, writing notes is not effective in these circumstances; an interpreter is necessary for proper communication. At the time of the trial, the Warrens were expecting another child and wished to have an interpreter present at the birth. They stated that they would not be able to afford one for this purpose or for other visits to their doctor.

8 At trial, the appellants adduced expert testimony explaining that many deaf persons are severely limited in their ability to read and write. The average deaf person, one expert related, has a grade three literacy level. Evidence was also led indicating that miscommunication between deaf persons and their doctors may lead to misdiagnosis. It was also noted that in Alberta and Manitoba the provincial government funds interpreting services for the deaf giving the highest priority to medical interpretation.

9 The respondents presented evidence relating to the budgetary process of the Ministry of Health and the structure of the Medical Services Plan. The government, witnesses explained, does not provide any services directly. Rather, it pays for the provision of medical services by the medical and health care practitioners on a fee-for-service basis. The Plan covers most health services; however there are a number of services that are not included or are funded only in part. These include the services of clinical psychologists, occupational therapists, speech therapists, nutritional counsellors and dentists. Moreover, the province does not pay for such medically related expenses as artificial limbs, hearing aids, or wheelchairs and provides only limited funding for prescription drugs.

10 Hospitals in British Columbia are funded through lump sum "global" payments that they are for the most part free to allocate as they see fit. They are rarely ordered by government to provide specific services. In those instances, they are generally required to fund the service out of their global budgets. The government does provide some funding for specific programs, such as heart transplantation, but this is infrequent.

Judicial History

11 The appellants filed an application in the Supreme Court of British Columbia seeking, *inter alia*, a declaration that the failure to provide sign language interpreters as an insured benefit under the Medical Services Plan violates s. 15(1) of the *Charter*. Tysoe J. dismissed the application ((1992), 75 B.C.L.R. (2d) 68 (B.C. S.C.)), finding that this failure did not infringe s. 15(1). He determined that sign language interpretation is ancillary to medically required services in much the same way as is transportation to a doctor's office. Any disadvantage suffered by the deaf, he concluded, is not the result of the government's failure to provide such services, but is rather the result of a limitation that exists outside the legislation.

12 In Tysoe J.'s view, the *Charter* does not require governments to implement programs to assist disabled persons. If the government provides a benefit, he stated, s. 15(1) requires that it be distributed equally. There is no obligation, however, to provide the benefit in the first place. He thus concluded that while it is desirable that deaf persons have interpreters for medical procedures and that the cost be borne by society if they cannot afford to pay, s. 15(1) does not demand this result.

13 On appeal to the British Columbia Court of Appeal (1995), 7 B.C.L.R. (3d) 156 (B.C. C.A.), the majority (Hollinrake and Cumming JJ.A.) held that the lack of interpreting services in hospitals is not discriminatory because the *Hospital Insurance Act* does not provide any "benefit of the law" within the meaning of s. 15(1) of the *Charter*. Writing for the majority, Hollinrake J.A. noted that the extent of the services provided by each hospital is subject to its own decision as to how to spend the global grant received from government. The absence of interpreters, he thus found, results not from

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the legislation but rather from each hospital's budgetary discretion. Because hospitals are not "government" within the meaning of s. 32 of the *Charter*, he concluded, their failure to provide interpretation does not engage s. 15(1).

14 He next determined that the *Medical and Health Care Services Act* did not violate s. 15(1) of the *Charter* because it did not create a distinction between the deaf and hearing populations. The proper approach to the application of adverse effects analysis to benefit-conferring legislation, he held, was to focus on the impact of the legislation on the disadvantaged group. In considering this impact, he opined, a distinction must be drawn between effects attributable to the legislation and those that exist independently of it. In the absence of legislation, deaf people would be required to pay their doctors in addition to translators in order to receive equivalent medical services to hearing persons. The legislation removes the responsibility of both hearing and deaf persons to pay their physicians. The inequality resulting from the fact that the deaf remain responsible for the payment of translators, in his view, exists independently of the legislation. Thus, he concluded that the legislation provided the benefit of free medical services equally to the hearing and deaf populations.

15 Lambert J.A., in contrast, held that the legislation violated s. 15(1). He noted that many deaf patients, including the appellants, have difficulty communicating by writing. As a result, cases will arise where doctors will be unable to discharge their professional obligations without the aid of an interpreter. Because effective communication is an integral part of medical care, he concluded, sign language interpretation should not be considered a merely ancillary service. In his view, it is no answer to say that before the benefit was enacted, deaf persons were at a disadvantage and that this burden has not been increased by the provision of the benefit. The proper question is whether the law confers a benefit to which the disadvantaged group does not have the same access as others. He thus concluded that the *Medical and Health Care Services Act* discriminated against the appellants where they seek to obtain medical services that require, for the discharge of the practitioner's professional obligations, effective communication between the practitioner and the patient, and where effective communication can only be achieved through the provision of translation services.

16 Lambert J.A. found, however, that this infringment was justified under s. 1 of the *Charter*. He noted the *Medical and Health Care Services Act* does not ensure comprehensive health care coverage. It does not provide for a number of products and services that are required by disabled persons, such as artificial limbs, hearing aids and wheelchairs. In the allocation of scarce financial resources, he stated, governments must make choices about spending priorities. In these circumstances, he held, courts should defer to legislative policy and administrative expertise.

17 Leave to appeal to this Court was granted ([1996] 2 S.C.R. vi) and the following constitutional questions were stated:

> 1. Does the definition of "benefits" in s. 1 of the *Medical and Health Care Services Act*, S.B.C. 1992, c. 76, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* by failing to include medical interpreter services for the deaf?
>
> 2. If the answer to question 1 is yes, is the infringement demonstrably justified in a free and democratic society pursuant to s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> 3. Do ss. 3, 5 and 9 of the *Hospital Insurance Act*, R.S.B.C. 1979, c. 180, and the Regulations enacted pursuant to s. 9 of that Act, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* by failing to require that hospitals in the Province of British Columbia provide medical interpreter services for the deaf?
>
> 4. If the answer to question 3 is yes, is the infringement demonstrably justified in a free and democratic society pursuant to s. 1 of the *Canadian Charter of Rights and Freedoms*?

Issues

18 There are four principal issues to be considered in this appeal. First, it must be determined whether, and in what manner, the *Charter* applies to the decision not to provide sign language interpreters for the deaf as part of the publicly funded scheme for the provision of medical care. Second, the Court must decide whether this decision constitutes a *prima*

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facie violation of s. 15(1) of the *Charter*. Having found such a violation, it must be determined whether it is saved by s. 1. After concluding that it is not, an appropriate remedy must be crafted.

Application of the Charter

19 There are two distinct *Charter* "application" issues in this case. The first is to identify the precise source of the alleged s. 15(1) violations. As I will develop later, in my view it is not the impugned legislation that potentially infringes the *Charter*. Rather, it is the actions of particular entities - hospitals and the Medical Services Commission - exercising discretion conferred by that legislation that does so. The second question is whether the *Charter* applies to those entities. In my view, the *Charter* applies to both in so far as they act pursuant to the powers granted to them by the statutes. I deal with each of these questions in turn.

The Sources of the Alleged Charter Violations

20 Section 32(1)(*b*) of the *Charter* reads as follows:

> *32.* (1) This Charter applies
>
> . . . . .
>
> (*b*) to the legislature and government of each province in respect of all matters within the authority of the legislature of each province.

There is no question, of course, that the *Charter* applies to provincial legislation; see *Dolphin Delivery Ltd. v. R.W.D.S.U., Local 580*, [1986] 2 S.C.R. 573 (S.C.C.). There are two ways, however, in which it can do so. First, legislation may be found to be unconstitutional on its face because it violates a *Charter* right and is not saved by s. 1. In such cases, the legislation will be invalid and the Court compelled to declare it of no force or effect pursuant to s. 52(1) of the *Constitution Act, 1982*. Secondly, the *Charter* may be infringed, not by the legislation itself, but by the actions of a delegated decision-maker in applying it. In such cases, the legislation remains valid, but a remedy for the unconstitutional action may be sought pursuant to s. 24(1) of the *Charter*.

21 The s. 32 jurisprudence of this Court has for the most part focused on the first type of *Charter* violation. There is no doubt, however, that the *Charter* also applies to action taken under statutory authority. The rationale for this rule flows inexorably from the logical structure of s. 32. As Professor Hogg explains in his *Constitutional Law of Canada* (3rd ed. 1992) (loose-leaf), at pp. 34-8.3 - 34-9:

> Action taken under statutory authority is valid only if it is within the scope of that authority. Since neither Parliament nor a Legislature can itself pass a law in breach of the Charter, neither body can authorize action which would be in breach of the Charter. Thus, the limitations on statutory authority which are imposed by the Charter will flow down the chain of statutory authority and apply to regulations, by-laws, orders, decisions and all other action (whether legislative, administrative or judicial) which depends for its validity on statutory authority.

The sentiment of Lord Atkin in speaking of a constitutional prohibition addressed solely at the legislative branch is also apposite: "The Constitution", he wrote, "is not to be mocked by substituting executive for legislative interference with freedom"; see *James v. Cowan*, [1932] A.C. 542 (Australia P.C.), at p. 558.

22 The question in the present case, then, is whether the alleged breach of s. 15(1) arises from the impugned legislation itself or from the actions of entities exercising decision-making authority pursuant to that legislation. The proper framework for determining this question was set out by Lamer J. (as he then was) and approved by a majority of this Court in *Slaight Communications Inc. v. Davidson*, [1989] 1 S.C.R. 1038 (S.C.C.). In that case the Court was faced with determining the constitutionality of orders issued by an adjudicator under the *Canada Labour Code*, R.S.C. 1970, c. L-1, that were alleged to violate an employer's s. 2(*b*) right to freedom of expression. The Code endowed the adjudicator with a broad discretion to remedy the consequences of an unjust dismissal. There being no question that the *Charter*

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applied to the adjudicator, the only issue was whether it was the legislation or the order that potentially infringed the *Charter*. In determining this question, Lamer J. (as he then was) stated that legislation conferring a discretion must be interpreted, in so far as possible, consistently with the *Charter*. He explained as follows, at p. 1078:

> As the Constitution is the supreme law of Canada and any law that is inconsistent with its provisions is, to the extent of the inconsistency, of no force or effect, it is impossible to interpret legislation conferring discretion as conferring a power to infringe the *Charter*, unless, of course, that power is expressly conferred or necessarily implied. Such an interpretation would require us to declare the legislation to be of no force or effect, unless it could be justified under s. 1. Although this Court must not add anything to legislation or delete anything from it in order to make it consistent with the *Charter*, there is no doubt in my mind that it should also not interpret legislation that is open to more than one interpretation so as to make it inconsistent with the *Charter* and hence of no force or effect. Legislation conferring an imprecise discretion must therefore be interpreted as not allowing the *Charter* rights to be infringed. Accordingly, an adjudicator exercising delegated powers does not have the power to make an order that would result in an infringement of the *Charter*, and he exceeds his jurisdiction if he does so.

23 Following this schema, it is first necessary to decide whether the legislation impugned in the present appeal can be interpreted in conformity with the *Charter*. In *Slaight*, it was clear that the legislation granted the adjudicator a broad discretion. It was thus easy to conclude that it did not, either expressly or by necessary implication, confer a power to infringe the *Charter*. In the present case the task is more difficult. Indeed, in the court below the argument proceeded on the basis that the legislation was under-inclusive; that it violated s. 15(1) by failing to include medical interpreter services for the deaf in the definition of "benefits", in the case of the *Medical and Health Care Services Act*, and "general hospital services", in the case of the *Hospital Insurance Act*.

24 During the hearing before this Court, however, counsel for the appellants proposed an alternative argument akin to the framework set out in *Slaight*. She suggested that both statutes could be read to conform with s. 15(1). Under this theory, it is not the legislation that is constitutionally suspect, but rather the actions of delegated decision-makers in applying it. In my view, this is the correct approach to the *Charter* application issue in this case. In order to understand how I reach this conclusion, it is necessary to consider the statutory context of this appeal in some depth. With the exception of hospitals, which are the responsibility of the provinces by virtue of s. 92(7) of the *Constitution Act, 1867*, health is not a matter assigned solely to one level of government; see *Schneider v. R.*, [1982] 2 S.C.R. 112 (S.C.C.), at pp. 141-42 (*per* Estey J.). It is generally agreed, however, that the hospital insurance and medicare programs in force in this country come within the exclusive jurisdiction of the provinces under ss. 92(7) (hospitals), 92(13) (property and civil rights) and 92(16) (matters of a merely local or private nature); see Hogg, *supra*, at p. 6-16, and Canadian Bar Association Task Force on Health Care, *What's Law Got to Do with It? Health Care Reform in Canada* (1994), at p. 15.

25 This has not prevented the federal Parliament from playing a leading role in the provision of free, universal medical care throughout the nation. It has done so by employing its inherent spending power to set national standards for provincial medicare programs. The *Canada Health Act*, R.S.C. 1985, c. C-6, requires the federal government to contribute to the funding of provincial health insurance programs provided they conform with certain specified criteria. (The constitutionality of this kind of conditional grant, I note parenthetically, was approved by this Court in *Reference re Canada Assistance Plan (Canada)*, [1991] 2 S.C.R. 525 (S.C.C.), at p. 567.) The purpose of the Act is set out in ss. 3-4 as follows:

> *3*. It is hereby declared that the primary objective of Canadian health care policy is to protect, promote and restore the physical and mental well-being of residents of Canada and to facilitate reasonable access to health services without financial or other barriers.
>
> *4*. The purpose of this Act is to establish criteria and conditions in respect of insured health services and extended health care services provided under provincial law that must be met before a full cash contribution may be made.

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26 Sections 5 and 7 require the federal government to contribute to provincial insurance schemes where certain conditions are met:

> *5*. Subject to this Act, as part of the Canada Health and Social Transfer, a full cash contribution is payable by Canada to each province for each fiscal year.
>
> *7*. In order that a province may qualify for a full cash contribution referred to in section 5 for a fiscal year, the health care insurance plan of the province must, throughout the fiscal year, satisfy the criteria described in sections 8 to 12 respecting the following matters:
>
> (*a*) public administration;
>
> (*b*) comprehensiveness;
>
> (*c*) universality;
>
> (*d*) portability; and
>
> (*e*) accessibility.

The condition of "comprehensiveness" is of particular importance to this appeal. Its meaning is delineated in s. 9:

> *9*. In order to satisfy the criterion respecting comprehensiveness, the health care insurance plan of a province must insure all *insured health services* provided by hospitals, medical practitioners or dentists, and where the law of the province so permits, similar or additional services rendered by other health care practitioners. [Emphasis added.]

The phrase "insured health services" is defined in s. 2 of the Act to mean, *inter alia*, "hospital services" and "physician services" provided to insured persons. "Hospital services" are further described as including a number of specific services such as accommodation, nursing services and access to diagnostic and treatment facilities, so long as such services are "medically necessary for the purpose of maintaining health, preventing disease or diagnosing or treating an injury, illness or disability." The definition of "physician services" does not list any specific benefits. It states only that they consist of "any medically required services rendered by medical practitioners". The Act does not define the phrases "medically necessary" or "medically required".

27 At the time of trial, the provision of medical treatment by doctors and other health care practitioners in British Columbia was governed by the *Medical and Health Care Services Act*. (It is now known as the *Medicare Protection Act*.) Its structure accords with the criteria set out in the *Canada Health Act*. Sections 6 and 8 of the *Medical and Health Care Services Act* entitle residents of the province to the benefits provided by the Act:

> 6.(1) A resident who wishes to be enrolled as a beneficiary on his or her own behalf, or on behalf of his or her spouse or children, must apply to the commission in the manner required by the commission.
>
> (2) The commission must, after determining that the applicant, the spouse of the applicant and each of the applicant's children named in the application are residents, enrol as beneficiaries those covered by the application who are residents, effective not more than three months after receipt of the application.
>
> 8.(1) A beneficiary is, subject to sections 9 (1), 10, 13 and 14, entitled to have payment made for a *benefit* that he or she has received, in accordance with amounts in a payment schedule, less any applicable patient visit charge. [Emphasis added.]

" Benefit" is defined in s. 1 of the Act as follows:

> *1*. In this Act

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. . . . .

"benefits" means

> (a) *medically required services* rendered by a medical practitioner who is enrolled under section 12, *unless the services are determined under section 4 by the commission not to be benefits*.
>
> (b) required services prescribed as benefits under section 45 and rendered by a health care practitioner who is enrolled under section 12, or
>
> (c) medically required services performed in accordance with protocols agreed to by the commission, or on order of the referring practitioner, who is a member of a prescribed category of practitioner, in an approved diagnostic facility by, or under the supervision of, a medical practitioner who has been enrolled under section 12, unless the services are determined under section 4 by the commission not to be benefits.... [Emphasis added.]

28 Notably, the Act does not list the services that are "medically required" such that they qualify as "benefits" under the Act. With the exception of certain specialized services listed as "insured services" under the *Medical Service Act Regulations*, B.C. Reg. 144/68, s. 4.09, as amended, the legislation does not specify the benefits it provides. Section 4.04 of the Regulations does expressly state, however, that certain services, such as those provided solely for legal, industrial or insurance purposes, as well as telephone advice and cosmetic procedures, are not insured. Sign language interpretation is not included. In the usual course, the determination of what constitutes a benefit is left to the discretion of the Medical Services Commission, a 9-member panel composed of representatives from the government, the British Columbia Medical Association and health care consumers. Pursuant to s. 4(1)(j) of the Act, the Commission is authorized to "determine whether a service is a benefit or whether any matter is related to the rendering of a benefit". Conversely, s. 4(1)(c) empowers it to determine the services that are "not benefits under [the] Act". The only limit on the Commission's discretion is set out in s. 4(2), which cautions that its powers must not be exercised "in a manner that does not satisfy the criteria described in section 7 of the *Canada Health Act*".

29 Assuming that the failure to provide sign language interpreters in medical settings violates s. 15(1) of the *Charter* in some circumstances, I do not see how the *Medical and Health Care Services Act* can be interpreted as mandating that result. The legislation simply does not, either expressly or by necessary implication, prohibit the Medical Services Commission from determining that sign language interpretation is a "medically required" service and hence a benefit under the Act. Indeed, the appellants assert in relation to the s. 15(1) issue that sign language interpretation, where it is necessary for effective communication, is integrally related to the provision of general medical services. Their theory, about which I will have more to say later, is that the failure to provide sign language interpreters violates s. 15(1) because it prevents deaf patients from benefiting equally from the provision of medical services in comparison to hearing patients. If this is correct, then the *Charter* demands that free sign language interpretation be provided as part of any medical services offered to the general public, at least where the service requires a level of communication that only an interpreter can ensure. Under this approach, the legislation must be interpreted to include sign language interpretation as a "medically required service" in these circumstances. It is clear, therefore, that the failure to provide expressly for sign language interpretation in the *Medical and Health Care Services Act* does not violate s. 15(1) of the *Charter*. The Act does not list those services that are to be considered benefits; instead, it delegates the power to make that determination to a subordinate authority. It is the decision of authority that is constitutionally suspect, not the statute itself.

30 I pause to emphasize that not every conferral of statutory discretion may be interpreted consistently with the *Charter*. Some grants of discretion will necessarily infringe *Charter* rights notwithstanding that they do not expressly authorize that result; see, e.g., *Ontario Film & Video Appreciation Society v. Ontario (Board of Censors)* (1985), 5 D.L.R. (4th) 766 (Ont. C.A.), affirming (1983), 147 D.L.R. (3d) 58 (Ont. Div. Ct.). In such cases it will generally be the statute, and not its application, that attracts *Charter* scrutiny; see June M. Ross, "Applying the Charter to Discretionary Authority" (1991), 29 *Alta. L. Rev.* 382. In the present case, however, the discretion accorded to the Medical Services Commission to

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determine whether a service qualifies as a benefit does not necessarily or typically threaten the equality rights set out in s. 15(1) of the *Charter*. It is possible, of course, for the Commission to infringe these rights in the course of exercising its authority. That possibility, however, is incidental to the purpose of discretion, which is to ensure that all medically required services are paid for by the government.

31 The situation is more complicated in the case of the *Hospital Insurance Act*. Section 3(1) of the Act states that "every qualified person or beneficiary is entitled to receive the general hospital services provided under this Act". Unlike the *Medical and Health Care Services Act*, the *Hospital Insurance Act* defines the services it provides with some precision. Mirroring the definition of "hospital services" in the *Canada Health Act*, s. 5(1) of the *Hospital Insurance Act* describes the "general hospital services" that are to be provided by acute care hospitals as follows (equivalent provisions list services for extended care and out-patient (facilities):

> *5*. (1) The general hospital services provided under this Act are
>
> > (a) for qualified persons requiring treatment for acute illness or injury: the public ward accommodation, necessary operating and case room facilities, diagnostic or therapeutic Xray and laboratory procedures, anaesthetics, prescriptions, drugs, dressings, cast materials and other services prescribed by regulation;
>
> . . . . .
>
> *but do not include*
>
> > (d) transportation to or from the hospital.
> >
> > (e) services or treatment that the minister, or a person designated by him, determines, on a review of the medical evidence, the qualified persons does not require or
> >
> > (f) services or treatment for an illness or condition excluded by regulation of the Lieutenant Governor in Council. [Emphasis added.]

32 It could be argued that by including a list of the services to be provided in hospitals that does not include sign language interpretation, the *Hospital Insurance Act* implicates s. 15(1) of the *Charter*. In my view, however, it is preferable to read the Act in conformity with s. 15(1). Though the statute entitles beneficiaries to a specific list of services, hospitals are left with substantial discretion as to how to provide them. This discretion operates in two ways. First, it is clear from the regulations enacted pursuant to s. 29(b) of the Act that no individual hospital is required to offer all of the services set out in s. 5(1). Those regulations state that the hospital services to be provided shall include "such of the following services as are recommended by the attending physician and *as are available* in or through the hospital to which the person is admitted" (emphasis added); *Hospital Insurance Act Regulations*, B.C. Reg. 25/61, as amended, ss. 5.1, 5.7 and 5.8. Generally speaking, the province does not fund specific procedures or services. Instead, it provides hospitals with a global, lump sum payment intended to reimburse them for those listed services that they do in fact provide. This is clear from s. 10(1) of the Act, which reads as follows:

> *10.* (1) There shall be paid annually to every hospital from the hospital insurance fund a sum determined by the minister to reimburse the hospital, in whole or in part, for the cost of rendering to beneficiaries those general hospital services authorized by this Act the hospital is required by the minister to provide for beneficiaries admitted for treatment, excluding those sums payable to the hospital under section 5(4) and section 14.

As stated by the court below, at p. 168, "[t]he extent of the services to be provided by each hospital is thus subject to the hospital's own decision as to how to spend the global grant they receive for general hospital services...."

33 Second, the Act gives individual hospitals considerable discretion as to the manner in which the services they decide to provide are delivered. Nothing in the legislation precludes them from supplying sign language interpreters. Hospitals have the authority, for example, to provide a sign language interpreter for a diagnostic X ray procedure where one is

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required in order to ensure its efficacy. Like the *Medicare Protection Act Regulations*, moreover, the *Hospital Insurance Act* (in s. 5(1)(d)) and *Regulations* (in s. 5.22) specifically list services, such as transportation to or from hospital, *in vitro* fertilization and cosmetic procedures, that are not covered by the scheme. Sign language interpretation is not included in these lists.

34 Consequently, the fact that the *Hospital Insurance Act* does not expressly mandate the provision of sign language interpretation does not render it constitutionally vulnerable. The Act does not, either expressly or by necessary implication, forbid hospitals from exercising their discretion in favour of providing sign language interpreters. Assuming the correctness of the appellants' s. 15(1) theory, the *Hospital Insurance Act* must thus be read so as to require that sign language interpretation be provided as part of the services offered by hospitals whenever necessary for effective communication. As in the case of the *Medical and Health Care Services Act*, the potential violation of s. 15(1) inheres in the discretion wielded by a subordinate authority, not the legislation itself.

The Application of the Charter to the Medical Services Commission and Hospitals

35 Having identified the sources of the alleged s. 15(1) violations, it remains to be considered whether the *Charter* actually applies to them. At first blush, this may seem to be a curious question. As I have discussed, it is a basic principle of constitutional theory that since legislatures may not enact laws that infringe the *Charter*, they cannot authorize or empower another person or entity to do so; *Slaight*, *supra*. It is possible, however, for a legislature to give authority to a body that is not subject to the *Charter*. Perhaps the clearest example of this is the power of incorporation. Private corporations are entirely creatures of statute; they have no power or authority that does not derive from the legislation that created them. The *Charter* does not apply to them, however, because legislatures have not entrusted them to implement specific governmental policies. Of course, governments may desire corporations to serve certain social and economic purposes, and may adjust the terms of their existence to accord with those goals. Once brought into being, however, they are completely autonomous from government; they are empowered to exercise only the same contractual and proprietary powers as are possessed by natural persons. As a result, while the legislation creating corporations is subject to the *Charter*, corporations themselves are not part of "government" for the purposes of s. 32 of the *Charter*.

36 Legislatures have created many other statutory entities, however, that are not as clearly autonomous from government. There are myriad public or quasi-public institutions that may be independent from government in some respects, but in other respects may exercise delegated governmental powers or be otherwise responsible for the implementation of government policy. When it is alleged that an action of one of these bodies, and not the legislation that regulates them, violates the *Charter*, it must be established that the entity, in performing that particular action, is part of "government" within the meaning of s. 32 of the *Charter*.

37 Perhaps the fullest discussion of the meaning of "government" in s. 32 is found in *McKinney v. University of Guelph*, [1990] 3 S.C.R. 229 (S.C.C.), and its companion cases, *Harrison v. University of British Columbia*, [1990] 3 S.C.R. 451 (S.C.C.), *Stoffman v. Vancouver General Hospital*, [1990] 3 S.C.R. 483 (S.C.C.), and *Douglas/Kwantlen Faculty Assn. v. Douglas College*, [1990] 3 S.C.R. 570 (S.C.C.). There, this Court was asked to decide whether the mandatory retirement policies adopted by certain institutions (universities, colleges and hospitals) were subject to *Charter* review. In confirming and elaborating upon the view taken by McIntyre J. in *Dolphin Delivery*, *supra* (*viz.*, that the *Charter* applies only to Parliament, the provincial legislatures and entities that constitute part of the executive or administrative branches of government, and not to private activity), a majority of the Court in *McKinney, Harrison* and *Stoffman* found that the *Charter* did not apply on the facts, since the institutions whose policies were impugned were not themselves part of the apparatus of government in the sense required by s. 32(1), nor were they putting into place a government program or acting in a governmental capacity in adopting those policies.

38 In *Douglas*, however, the same majority found that the *Charter* did apply to the mandatory retirement policy at issue, on the ground that Douglas College was, in light of its constituent Act, simply an emanation of government. I described the differences between *McKinney* and *Harrison*, on the one hand, and *Douglas*, on the other, at pp. 584-85 of the latter case:

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> As its constituent Act makes clear, the college is a Crown agency established by the government to implement government policy. Though the government may choose to permit the college board to exercise a measure of discretion, the simple fact is that the board is not only appointed and removable at pleasure by the government; the government may at all times by law direct its operation. Briefly stated, it is simply part of the apparatus of government both in form and in fact. In carrying out its functions, therefore, the college is performing acts of government, and I see no reason why this should not include its actions in dealing with persons it employs in performing these functions. Its status is wholly different from the universities in the companion cases of [*McKinney*] and [*Harrison*] which, although extensively regulated and funded by government, are essentially autonomous bodies. Accordingly, the actions of the college in the negotiation and administration of the collective agreement between the college and the association are those of the government for the purposes of s. 32 of the *Charter*. The *Charter*, therefore, applies to these activities.

39 This Court's approach to *Charter* application was further elucidated in *Lavigne v. O.P.S.E.U.* (1991), [1992] 2 S.C.R. 211 (S.C.C.). There, the principal issue was whether a provision of a collective agreement compelling the appellant to pay union dues despite his non-membership in the respondent union violated the *Charter* guarantees of freedom of expression and association, in so far as the dues were being used to pay for specific political purposes chosen by the union. In addressing whether that provision was subject to the *Charter*, I found for the majority that the appellant's employer, the Ontario Council of Regents for Colleges of Applied Arts and Technology, was, in virtue of the terms of its empowering Act, an emanation of the provincial government. On this basis, I held that the *Charter* applied to the provision in question. Comparing the case to *Douglas*, *supra*, I remarked as follows, at pp. 311-12:

> [*Douglas*], like the present appeal, involved a collective agreement between the college and the Association (a union under the applicable legislation). There the Minister of Education by statute exercised a degree of control over the college that closely matched that exercised by the Ministry over the Council in the present case. It is true that in *Douglas* the college's constituent Act expressly described it as an agent of the Crown, whereas here the Act simply gives the Minister power to conduct and govern the colleges and in this endeavour the Minister is to be "assisted" by the Council. But the reality is the same. The government, through the Minister, has the same power of "routine or regular control", to use the expression of the majority of this Court, in [*Harrison*, *supra* and *Stoffman*, *supra*], companion cases to *Douglas*.

40 In *Douglas* and *Lavigne*, the argument was made that even if the entities in question were generally part of "government" for the purposes of s. 32, the *Charter* should not apply to the "private" or "commercial" arrangements they engage in. In each case, the Court rejected this contention, holding that when an entity is determined to be part of the fabric of government, the *Charter* will apply to all its activities, including those that might in other circumstances be thought of as "private". The rationale for this principle is obvious: governments should not be permitted to evade their *Charter* responsibilities by implementing policy through the vehicle of private arrangements. I put the matter thus in *Lavigne*, at p. 314:

> It was also argued that the *Charter* does not apply to government when it engages in activities that are ..." private, commercial, contractual or non-public (in) nature". In my view, this argument must be rejected. In today's world it is unrealistic to think of the relationship between those who govern and those who are governed solely in terms of the traditional law maker and law subject model. We no longer expect government to be simply a law maker in the traditional sense; we expect government to stimulate and preserve the community's economic and social welfare. In such circumstances, government activities which are in form "commercial" or "private" transactions are in reality expressions of government policy, be it the support of a particular region or industry, or the enhancement of Canada's overall international competitiveness. In this context, one has to ask: why should our concern that government conform to the principles set out in the *Charter* not extend to these aspects of its contemporary mandate? To say that the *Charter* is only concerned with government as law maker is to interpret our Constitution in light of an understanding of government that was long outdated even before the *Charter* was enacted.

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See also *Douglas*, *supra*, at p. 585.

41 While it is well established that the *Charter* applies to all the activities of government, whether or not those activities may be otherwise characterized as "private", this Court has also recognized that the *Charter* may apply to non-governmental entities in certain circumstances; see generally Robin Elliot, "Scope of the Charter's Application" (1993), 15 *Adv. Q.* 204, at pp. 208-209. It has been suggested, for example, that the *Charter* will apply to a private entity when engaged in activities that can in some way be attributed to government. This possibility was contemplated in *McKinney*, where I stated the following, at pp. 273-74:

> Though the legislature may determine much of the environment in which universities operate, the reality is that they function as autonomous bodies within that environment. *There may be situations in respect of specific activities where it can fairly be said that the decision is that of the government, or that the government sufficiently partakes in the decision as to make it an act of government*, but there is nothing here to indicate any participation in the decision by the government and ... there is no statutory requirement imposing mandatory retirement on the universities. [Emphasis added.]

I commented further on as follows, at p. 275:

> I, therefore, conclude that the respondent universities do not form part of the government apparatus, so their actions, as such, do not fall within the ambit of the *Charter. Nor in establishing mandatory retirement for faculty and staff were they implementing a governmental policy*. [Emphasis added.]

The idea that certain activities of non-governmental entities may be viewed as the responsibility of government was further elucidated in my reasons in *Lavigne* where, after discussing *McKinney, Harrison, Douglas* and *Stoffman*, I stated as follows, at p. 312:

> The majority in the above cases relied solely on the element of control in determining what fell within the apparatus of government, *although it made clear that government may, in some circumstances, be subject to Charter scrutiny in respect of activities in the private sector where the government could be said to have some responsibility for that activity*. [Emphasis added.]

42 It seems clear, then, that a private entity may be subject to the *Charter* in respect of certain inherently governmental actions. The factors that might serve to ground a finding that an activity engaged in by a private entity is "governmental" in nature do not readily admit of any *a priori* elucidation. *McKinney* makes it clear, however, that the *Charter* applies to private entities in so far as they act in furtherance of a specific governmental program or policy. In these circumstances, while it is a private actor that actually implements the program, it is government that retains responsibility for it. The rationale for this principle is readily apparent. Just as governments are not permitted to escape *Charter* scrutiny by entering into commercial contracts or other "private" arrangements, they should not be allowed to evade their constitutional responsibilities by delegating the implementation of their policies and programs to private entities. In *McKinney*, *supra*, I pointed to *Slaight*, *supra*, as an example of a situation where action taken in furtherance of a government policy was held to fall within the ambit of the *Charter*. I noted, at p. 265, that the arbitrator in that case was "part of the governmental administrative machinery for effecting the specific purpose of the statute". "It would be strange", I wrote, "if the legislature and the government could evade their *Charter* responsibility by appointing a person to carry out the purposes of the statute"; see *idem*. Although the arbitrator in *Slaight* was entirely a creature of statute and performed functions that were exclusively governmental, the same rationale applies to any entity charged with performing a governmental activity, even if that entity operates in other respects as a private actor; see A. Anne McLellan and Bruce P. Elman, "To Whom Does the Charter Apply? Some Recent Cases on Section 32" (1986), 24 *Alta. L Rev.* 361, at p. 371.

43 Two important points must be made with respect to this principle. First, the mere fact that an entity performs what may loosely be termed a "public function", or the fact that a particular activity may be described as "public" in nature,

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will not be sufficient to bring it within the purview of "government" for the purposes of s. 32 of the *Charter*. Thus, with specific reference to the distinction between the applicability of the *Charter*, on the one hand, and the susceptibility of public bodies to judicial review, on the other, I stated as follows, at p. 268 of *McKinney*:

> It was not disputed that the universities are statutory bodies performing a public service. As such, they may be subjected to the judicial review of certain decisions, *but this does not in itself make them part of government within the meaning of s. 32 of the Charter*.... In a word, the basis of the exercise of supervisory jurisdiction by the courts is not that the universities are government, but that they are public decision-makers. [Emphasis added.]

In order for the *Charter* to apply to a private entity, it must be found to be implementing a *specific* governmental policy or program. As I stated further on in *McKinney*, at p. 269, "[a] public purpose test is simply inadequate" and "...is simply not the test mandated by s. 32".

44 The second important point concerns the precise manner in which the *Charter* may be held to apply to a private entity. As the case law discussed above makes clear, the *Charter* may be found to apply to an entity on one of two bases. First, it may be determined that the entity is itself "government" for the purposes of s. 32. This involves an inquiry into whether the entity whose actions have given rise to the alleged *Charter* breach can, either by its very nature or in virtue of the degree of governmental control exercised over it, properly be characterized as "government" within the meaning of s. 32(1). In such cases, all of the activities of the entity will be subject to the *Charter*, regardless of whether the activity in which it is engaged could, if performed by a non-governmental actor, correctly be described as "private". Second, an entity may be found to attract *Charter* scrutiny with respect to a particular activity that can be ascribed to government. This demands an investigation not into the nature of the entity whose activity is impugned but rather into the nature of the activity itself. In such cases, in other words, one must scrutinize the quality of the act at issue, rather than the quality of the actor. If the act is truly "governmental" in nature - for example, the implementation of a specific statutory scheme or a government program - the entity performing it will be subject to review under the *Charter* only in respect of that act, and not its other, private activities.

45 In the present case, the controversy over the *Charter*'s application centres on the question of hospitals. The respondents argue that if the failure to provide sign language interpreters does not flow from the Act but rather from the discretion of individual hospitals, then s. 15(1) is not engaged because the *Charter* does not apply to hospitals. Hospitals, they say, are not" government" for the purposes of s. 32 of the *Charter*. In their view, this result flows from a straightforward application of this Court's decision in *Stoffman*, *supra*.

46 The foregoing analysis, however, establishes that it is not enough for the respondents to say that hospitals are not "government" for the purposes of s. 32 of the *Charter*. In *Stoffman*, the Court found that the Vancouver General Hospital was not part of the apparatus of government and that its adoption of a mandatory retirement policy did not implement a government policy. *Stoffman* made it clear that, as presently constituted, hospitals in British Columbia are non-governmental entities whose private activities are not subject to the *Charter*. It remains to be seen, however, whether hospitals effectively implement governmental policy in providing medical services under the *Hospital Insurance Act*.

47 There is language in *Stoffman* that could be read as precluding the application of the *Charter* in the circumstances of the present case. There, I wrote, at p. 516, that "there can be no question of the Vancouver General's being held subject to the *Charter* on the ground that it performs a governmental function, for ... the provision of a public service, even if it is one as important as health care, is not the kind of function that qualifies as a governmental function under s. 32". That statement, however, must be read in the context of the entire judgment. I determined only that the fact that an entity performs a "public function" in the broad sense does not render it "government" for the purposes of s. 32 and specifically left open the possibility that the *Charter* could be applied to hospitals in different circumstances. Indeed, later in the same paragraph I qualified my position in the following manner:

> I would also add that this is not a case for the application of the *Charter* to a specific act of an entity which is not generally bound by the *Charter*. The only specific connection between the actions of the Vancouver General in

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> adopting and applying Regulation 5.04 and the actions of the Government of British Columbia was the requirement that Regulation 5.04 receive ministerial approval. In light of what I have said above in regard to this requirement, a "more direct and a more precisely-defined connection", to borrow McIntyre J.'s phrase used in *Dolphin Delivery*, would have to be shown before I would conclude that the *Charter* applied on this ground.

48 As this passage alludes to, the hospital's mandatory retirement policy, which was embodied in Medical Staff Regulation 5.04, was a matter of internal hospital management. Notwithstanding the requirement of ministerial approval, the Regulation was developed, written and adopted by hospital officials. It was not instigated by the government and did not reflect its mandatory retirement policy. Hospitals in British Columbia, moreover, exhibited great variety in their approaches to retirement. That each of these policies obtained ministerial approval reflected the large measure of managerial autonomy accorded to hospitals in this area.

49 The situation in the present appeal is very different. The purpose of the *Hospital Insurance Act* is to provide particular services to the public. Although the benefits of that service are delivered and administered through private institutions - hospitals - it is the government, and not hospitals, that is responsible for defining both the content of the service to be delivered and the persons entitled to receive it. As previously noted, s. 3(1) states that every person eligible to receive benefits is "entitled to receive the general hospital services provided under this Act". Section 5(1) defines "general hospital services" to include various services normally available in hospitals. As the definition of "hospital" in s. 1 makes clear, moreover, hospitals are *required* to furnish the general hospital services specified in the Act. While no single hospital makes all of these services available, the net effect of the Act is to entitle every qualified person to receive, and to require hospitals to supply, a complete range of medically required hospital services. Indeed, if the legislation did not assure this, it would run afoul of the *Canada Health Act*. It is also apparent that while hospitals are funded on a "lump sum" and not a "fee-for-service" basis, they are not *entirely* free to spend this money as they choose. This is apparent from s. 10(1) of the Act, which mandates the annual payment of a sum "determined by the minister to reimburse the hospital ... for the cost of rendering to beneficiaries those general hospital services authorized by this Act the hospital is required by the minister to provide for beneficiaries...", as well as from s. 15(3)(c), which authorizes the minister to make "payments to hospitals for the service provided for under this Act" and s. 13(1), which provides that payments to a hospital "for services rendered by it ... shall be deemed to be payment in full for the services...."

50 The structure of the *Hospital Insurance Act* reveals, therefore, that in providing medically necessary services, hospitals carry out a specific governmental objective. The Act is not, as the respondents contend, simply a mechanism to prevent hospitals from charging for their services. Rather, it provides for the delivery of a comprehensive social program. Hospitals are merely the vehicles the legislature has chosen to deliver this program. It is true that hospitals existed long before the statute, and have historically provided a full range of medical services. In recent decades, however, health care, including that generally provided by hospitals, has become a keystone tenet of governmental policy. The inter-locking federal-provincial medicare system I have described entitles all Canadians to essential medical services without charge. Although this system has retained some of the trappings of the private insurance model from which it derived, it has come to resemble more closely a government service than an insurance scheme; see Canadian Bar Association Task Force on Health Care, *supra*, at p. 9.

51 Unlike *Stoffman*, then, in the present case there is a "direct and ... precisely-defined connection" between a specific government policy and the hospital's impugned conduct. The alleged discrimination - the failure to provide sign language interpretation - is intimately connected to the medical service delivery system instituted by the legislation. The provision of these services is not simply a matter of internal hospital management; it is an expression of government policy. Thus, while hospitals may be autonomous in their day-to-day operations, they act as agents for the government in providing the specific medical services set out in the Act. The Legislature, upon defining its objective as guaranteeing access to a range of medical services, cannot evade its obligations under s. 15(1) of the *Charter* to provide those services without discrimination by appointing hospitals to carry out that objective. In so far as they do so, hospitals must conform with the *Charter*.

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52 The case of the Medical Services Commission is more straightforward. It was not contested that the *Charter* applies to the Commission in exercising its power to determine whether a service is a benefit pursuant to s. 4(1) of the *Medical and Health Care Services Act*. It is plain that in so doing, the Commission implements a government policy, namely, to ensure that all residents receive medically required services without charge. In lieu of setting out a comprehensive list of insured services in legislation, the government has delegated to the Commission the power to determine what constitutes a "medically required" service. There is no doubt, therefore, that in exercising this discretion the Commission acts in governmental capacity and is thus subject to the *Charter*. As there is no need to do so, I refrain from commenting on whether the Commission might be considered part of government for other purposes.

Section 15(1) of the Charter

53 Having concluded that the *Charter* applies to the failure of hospitals and the Medical Services Commission to provide sign language interpreters, it remains to be determined whether that failure infringes the appellants' equality rights under s. 15(1) of the *Charter*. That provision states:

> *15.* (1) Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.

I emphasize at the outset that s. 15(1), like other *Charter* rights, is to be generously and purposively interpreted; see *Canada (Director of Investigation & Research, Combines Investigation Branch) v. Southam Inc.*, [1984] 2 S.C.R. 145 (S.C.C.), at p. 156, *R. v. Big M Drug Mart Ltd.*, [1985] 1 S.C.R. 295 (S.C.C.), at pp. 336, 344, *Reference re s. 94(2) of Motor Vehicle Act (British Columbia)*, [1985] 2 S.C.R. 486 (S.C.C.), at p. 509, *Andrews v. Law Society (British Columbia)*, [1989] 1 S.C.R. 143 (S.C.C.), at p. 175, *Cotroni c. Centre de prévention de Montréal*, [1989] 1 S.C.R. 1469 (S.C.C.), at p. 1480, and *Reference re Provincial Electoral Boundaries*, [1991] 2 S.C.R. 158 (S.C.C.), at p. 179. As Lord Wilberforce proclaimed in *Minister of Home Affairs v. Fisher* (1979), [1980] A.C. 319 (Bermuda P.C.), at p. 328, a constitution incorporating a bill of rights calls for "a generous interpretation avoiding what has been called 'the austerity of tabulated legalism,' suitable to give individuals the full measure of the fundamental rights and freedoms referred to"; see also *Hunter*, *supra*, at p. 156.

54 In the case of s. 15(1), this Court has stressed that it serves two distinct but related purposes. First, it expresses a commitment - deeply ingrained in our social, political and legal culture - to the equal worth and human dignity of all persons. As McIntyre J. remarked in *Andrews*, *supra*, at p. 171, s. 15(1) "entails the promotion of a society in which all are secure in the knowledge that they are recognized at law as human beings equally deserving of concern, respect and consideration". Secondly, it instantiates a desire to rectify and prevent discrimination against particular groups "suffering social, political and legal disadvantage in our society"; see *R. v. Turpin*, [1989] 1 S.C.R. 1296 (S.C.C.), at p. 1333 (*per* Wilson J.); see also Beverley McLachlin, "The Evolution of Equality" (1996), 54 *Advocate* 559, at p. 564. While this Court has confirmed that it is not necessary to show membership in a historically disadvantaged group in order to establish a s. 15(1) violation, the fact that a law draws a distinction on such a ground is an important *indicium* of discrimination; see *Miron v. Trudel*, [1995] 2 S.C.R. 418 (S.C.C.), at para. 15 (*per* Gonthier J.) and at paras. 148-149 (*per* McLachlin J.), and *Egan v. Canada*, [1995] 2 S.C.R. 513 (S.C.C.), at paras. 59-61 (*per* L'Heureux-Dubé J.).

55 As deaf persons, the appellants belong to an enumerated group under s. 15(1) - the physically disabled. While this fact is not contested, it is nonetheless relevant. As Wilson J. held in *Turpin*, *supra*, the determination of whether a law is discriminatory is a contextual exercise. It is important, she explained, at p. 1331, "to look not only at the impugned legislation ... but also to the larger social, political and legal context".

56 It is an unfortunate truth that the history of disabled persons in Canada is largely one of exclusion and marginalization. Persons with disabilities have too often been excluded from the labour force, denied access to opportunities for social interaction and advancement, subjected to invidious stereotyping and relegated to institutions;

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see generally M. David Lepofsky, "A Report Card on the *Charter*'s Guarantee of Equality to Persons with Disabilities after 10 Years: What Progress? What Prospects?" (1997), 7 *N.J.C.L.* 263. This historical disadvantage has to a great extent been shaped and perpetuated by the notion that disability is an abnormality or flaw. As a result, disabled persons have not generally been afforded the "equal concern, respect and consideration" that s. 15(1) of the *Charter* demands. Instead, they have been subjected to paternalistic attitudes of pity and charity, and their entrance into the social mainstream has been conditional upon their emulation of able-bodied norms; see Sandra A. Goundry and Yvonne Peters, *Litigating for Disability Equality Rights: The Promises and the Pitfalls* (1994), at pp. 5-6. One consequence of these attitudes is the persistent social and economic disadvantage faced by the disabled. Statistics indicate that persons with disabilities, in comparison to non-disabled persons, have less education, are more likely to be outside the labour force, face much higher unemployment rates, and are concentrated at the lower end of the pay scale when employed; see Minister of Human Resources Development, *Persons with Disabilities: A Supplementary Paper* (1994), at pp. 3-4, and Statistics Canada, *A Portrait of Persons with Disabilities* (1995), at pp. 46-49.

57 Deaf persons have not escaped this general predicament. Although many of them resist the notion that deafness is an impairment and identify themselves as members of a distinct community with its own language and culture, this does not justify their compelled exclusion from the opportunities and services designed for and otherwise available to the hearing population. For many hearing persons, the dominant perception of deafness is one of silence. This perception has perpetuated ignorance of the needs of deaf persons and has resulted in a society that is for the most part organized as though everyone can hear; see generally Oliver Sacks, *Seeing Voices: A Journey Into the World of the Deaf* (1989). Not surprisingly, therefore, the disadvantage experienced by deaf persons derives largely from barriers to communication with the hearing population.

58 With this context in mind, I turn to the specific elements of the appellants' s. 15(1) claim. While this Court has not adopted a uniform approach to s. 15(1), there is broad agreement on the general analytic framework; see *Eaton v. Brant (County) Board of Education* (1996), [1997] 1 S.C.R. 241 (S.C.C.), at para. 62, *Miron*, *supra*, and *Egan*, *supra*. A person claiming a violation of s. 15(1) must first establish that, because of a distinction drawn between the claimant and others, the claimant has been denied "equal protection" or "equal benefit" of the law. Secondly, the claimant must show that the denial constitutes discrimination on the basis of one of the enumerated grounds listed in s. 15(1) or one analogous thereto. Before concluding that a distinction is discriminatory, some members of this Court have held that it must be shown to be based on an irrelevant personal characteristic; see *Miron*, *supra* (*per* Gonthier J.), and *Egan*, *supra* (*per* La Forest J.) Under this view, s. 15(1) will not be infringed unless the distinguished personal characteristic is irrelevant to the functional values underlying the law, provided that those values are not themselves discriminatory. Others have suggested that relevance is only one factor to be considered in determining whether a distinction based on an enumerated or analogous ground is discriminatory; see *Miron*, *supra* (*per* McLachlin J.), and *Thibaudeau v. R.*, [1995] 2 S.C.R. 627 (S.C.C.) (*per* Cory and Iacobucci JJ.).

59 In my view, in the present case the same result is reached regardless of which of these approaches is applied; for similar reasoning, see *Benner v. Canada (Secretary of State)*, [1997] 1 S.C.R. 358 (S.C.C.) (*per* Iacobucci J. for the Court). There is no question that the distinction here is based on a personal characteristic that is irrelevant to the functional values underlying the health care system. Those values consist of the promotion of health and the prevention and treatment of illness and disease, and the realization of those values through the vehicle of a publicly funded heath care system. There could be no personal characteristic less relevant to these values than an individual's physical disability.

60 The only question in this case, then, is whether the appellants have been afforded "equal benefit of the law without discrimination" within the meaning of s. 15(1) of the *Charter*. On its face, the medicare system in British Columbia applies equally to the deaf and hearing populations. It does not make an explicit "distinction" based on disability by singling out deaf persons for different treatment. Both deaf and hearing persons are entitled to receive certain medical services free of charge. The appellants nevertheless contend that the lack of funding for sign language interpreters renders them unable to benefit from this legislation to the same extent as hearing persons. Their claim, in other words, is one of "adverse effects" discrimination.

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61 This Court has consistently held that s. 15(1) of the *Charter* protects against this type of discrimination. In *Andrews*, *supra*, McIntyre J. found that facially neutral laws may be discriminatory. "It must be recognized at once", he commented, at p. 164, "...that every difference in treatment between individuals under the law will not necessarily result in inequality and, as well, that identical treatment may frequently produce serious inequality"; see also *Big M Drug Mart Ltd.*, *supra*, at p. 347. Section 15(1), the Court held, was intended to ensure a measure of substantive, and not merely formal equality.

62 As a corollary to this principle, this Court has also concluded that a discriminatory purpose or intention is not a necessary condition of a s. 15(1) violation; see *Andrews*, *supra*, at pp. 173-74, and *Rodriguez v. British Columbia (Attorney General)*, [1993] 3 S.C.R. 519 (S.C.C.), at pp. 544-49 (*per* Lamer C.J.); see also *O'Malley v. Simpsons-Sears Ltd.*, [1985] 2 S.C.R. 536 (S.C.C.), at p. 547. A legal distinction need not be motivated by a desire to disadvantage an individual or group in order to violate s. 15(1). It is sufficient if the *effect* of the legislation is to deny someone the equal protection or benefit of the law. As McIntyre J. stated in *Andrews*, *supra*, at p. 165, "[t]o approach the ideal of full equality before and under the law ... the main consideration must be the impact of the law on the individual or the group concerned". In this the Court has staked out a different path than the United States Supreme Court, which requires a discriminatory intent in order to ground an equal protection claim under the Fourteenth Amendment of the Constitution; see *Washington v. Davis*, 426 U.S. 229 (U.S. Sup. Ct. 1976), *Arlington Heights v. Metro Housing Department*, 429 U.S. 252 (U.S. Sup. Ct. 1977), and *Personnel Administrator of Massachussetts v. Feeney*, 442 U.S. 256 (U.S. Sup. Ct. 1979).

63 This Court first addressed the concept of adverse effects discrimination in the context of provincial human rights legislation. In *Simpsons-Sears Ltd.*, *supra*, the Court was faced with the question of whether a rule requiring employees to be available for work on Friday evenings and Saturdays discriminated against those observing a Saturday Sabbath. Though this rule was neutral on its face in that it applied equally to all employees, the Court nevertheless found it to be discriminatory. Writing for the Court, McIntyre J. commented as follows, at p. 551:

> A distinction must be made between what I would describe as direct discrimination and the concept already referred to as adverse effect discrimination in connection with employment. Direct discrimination occurs in this connection where an employer adopts a practice or rule which on its face discriminates on a prohibited ground. For example, "No Catholics or no women or no blacks employed here." ... On the other hand, there is the concept of adverse effect discrimination. It arises where an employer for genuine business reasons adopts a rule or standard which is on its face neutral, and which will apply equally to all employees, but which has a discriminatory effect upon a prohibited ground on one employee or group of employees in that it imposes, because of some special characteristic of the employee or group, obligations, penalties, or restrictive conditions not imposed on other members of the work force.

See also *Central Alberta Dairy Pool v. Alberta (Human Rights Commission)*, [1990] 2 S.C.R. 489 (S.C.C.), and *Renaud v. Central Okanagan School District No. 23*, [1992] 2 S.C.R. 970 (S.C.C.). I note that in *Andrews*, McIntyre J. made it clear that the equality principles developed by the Court in human rights cases are equally applicable in s. 15(1) cases. The definition of adverse effects discrimination set out in *Simpsons-Sears Ltd.*, *supra*, moreover, has been expressly adopted in the context of s. 15(1); see *Egan*, *supra*, at para. 138 (*per* Cory J.).

64 Adverse effects discrimination is especially relevant in the case of disability. The government will rarely single out disabled persons for discriminatory treatment. More common are laws of general application that have a disparate impact on the disabled. This was recognized by the Chief Justice in his dissenting opinion in *Rodriguez*, *supra*, where he held that the law criminalizing assisted suicide violated s. 15(1) of the *Charter* by discriminating on the basis of physical disability. There, a majority of the Court determined, *inter alia*, that the law was saved by s. 1 of the *Charter*, assuming without deciding that it infringed s. 15(1). While I refrain from commenting on the correctness of the Chief Justice's conclusion on the application of s. 15(1) in that case, I endorse his general approach to the scope of that provision, which he set out as follows, at p. 549:

> Not only does s. 15(1) require the government to exercise greater caution in making express or direct distinctions based on personal characteristics, but legislation equally applicable to everyone is also capable of infringing the right

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> to equality enshrined in that provision, and so of having to be justified in terms of s. 1. Even in imposing generally applicable provisions, the government must take into account differences which in fact exist between individuals and so far as possible ensure that the provisions adopted will not have a greater impact on certain classes of persons due to irrelevant personal characteristics than on the public as a whole. In other words, to promote the objective of the more equal society, s. 15(1) acts as a bar to the executive enacting provisions without taking into account their possible impact on already disadvantaged classes of persons.

65 The Court elaborated upon this principle in its recent decision in *Eaton*, *supra*. Although *Eaton* involved direct discrimination, Sopinka J. observed that in the case of disabled persons, it is often the failure to take into account the adverse effects of generally applicable laws that results in discrimination. He remarked, at paras. 66-67:

> The principles that not every distinction on a prohibited ground will constitute discrimination and that, in general, distinctions based on presumed rather than actual characteristics are the hallmarks of discrimination have particular significance when applied to physical and mental disability. Avoidance of discrimination on this ground will frequently require distinctions to be made taking into account the actual personal characteristics of disabled persons. In *Andrews v. Law Society of British Columbia*, [1989] 1 S.C.R. 143, at p. 169, McIntyre J. stated that the "accommodation of differences ... is the essence of true equality". This emphasizes that the purpose of s. 15(1) of the *Charter* is not only to prevent discrimination by the attribution of stereotypical characteristics to individuals, but also to ameliorate the position of groups within Canadian society who have suffered disadvantage by exclusion from mainstream society as has been the case with disabled persons.
>
> The principal object of certain of the prohibited grounds is the elimination of discrimination by the attribution of untrue characteristics based on stereotypical attitudes relating to immutable conditions such as race or sex. In the case of disability, this is one of the objectives. The other equally important objective seeks to take into account the true characteristics of this group which act as headwinds to the enjoyment of society's benefits and to accommodate them. Exclusion from the mainstream of society results from the construction of a society based solely on "mainstream" attributes to which disabled persons will never be able to gain access. Whether it is the impossibility of success at a written test for a blind person, or the need for ramp access to a library, the discrimination does not lie in the attribution of untrue characteristics to the disabled individual. The blind person cannot see and the person in a wheelchair needs a ramp. Rather, it is the failure to make reasonable accommodation, to fine-tune society so that its structures and assumptions do not result in the relegation and banishment of disabled persons from participation, which results in discrimination against them. The discrimination inquiry which uses "the attribution of stereotypical characteristics" reasoning as commonly understood is simply inappropriate here. It may be seen rather as a case of reverse stereotyping which, by not allowing for the condition of a disabled individual, ignores his or her disability and forces the individual to sink or swim within the mainstream environment. It is recognition of the actual characteristics, and reasonable accommodation of these characteristics which is the central purpose of s. 15(1) in relation to disability.

66 Unlike in *Simpsons-Sears* and *Rodriguez*, in the present case the adverse effects suffered by deaf persons stem not from the imposition of a burden not faced by the mainstream population, but rather from a failure to ensure that they benefit equally from a service offered to everyone. It is on this basis that the trial judge and the majority of the Court of Appeal found that the failure to provide medically related sign language interpretation was not discriminatory. Their analyses presuppose that there is a categorical distinction to be made between state-imposed burdens and benefits, and that the government is not obliged to ameliorate disadvantage that it has not helped to create or exacerbate. Before attempting to evaluate these assumptions, it will be helpful to relate the reasoning of the courts below in more detail.

67 As previously noted, both the trial judge and majority of the Court of Appeal determined that, while the access of deaf people to medical services is limited to a certain extent by their communication handicap, this limitation does not result from the denial of any benefit of the law within the meaning of s. 15(1) of the *Charter*. They were able to come to this conclusion because of the manner in which they characterized sign language interpretation. Interpretation services,

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they held, are not medically required. Rather, they are "ancillary services", which, like other non-medical services such as transportation to a doctor's office or hospital, are not publicly funded.

68 Having determined that sign language interpretation is a discrete, non-medical "ancillary" service, the courts below were able to conclude that the appellants were not denied a benefit available to the hearing population. As the majority of the Court of Appeal explained, prior to the introduction of a universal medicare system, deaf and hearing persons were each required to pay their doctors. When necessary for effective communication, deaf persons were also obliged to pay for sign language translators. The Medical Services Plan, the court observed, removes the responsibility of both hearing and deaf persons to pay their physicians. Deaf persons, of course, remain responsible for the payment of translators in order to receive equivalent medical services as hearing persons, as they would be in the absence of the legislation. In the court's view, however, any resulting inequality exists independently of the benefit provided by the state.

69 While this approach has a certain formal, logical coherence, in my view it seriously mischaracterizes the practical reality of health care delivery. Effective communication is quite obviously an integral part of the provision of medical services. At trial, the appellants presented evidence that miscommunication can lead to misdiagnosis or a failure to follow a recommended treatment. This risk is particularly acute in emergency situations, as illustrated by the appellant Linda Warren's experience during the premature birth of her twin daughters. That adequate communication is essential to proper medical care is surely so incontrovertible that the Court could, if necessary, take judicial notice of it. As Professor Pothier observes, for the hearing population" conversation between doctor and patient is so basic to the provision of medical services that it is taken for granted"; see Dianne Pothier, "M'Aider, Mayday: Section 15(1) of the *Charter* in Distress" (1996), 6 *N.J.C.L.* 295, at p. 335.

70 The centrality of communication to the delivery of medical services is particularly evident in the context of negligence law. The duty of disclosure commands physicians to inform patients fully of the risks involved in treatment and answer their questions regarding such risks; see *Reibl v. Hughes*, [1980] 2 S.C.R. 880 (S.C.C.), at p. 884, and *Hopp v. Lepp*, [1980] 2 S.C.R. 192 (S.C.C.), at p. 210. Physicians cannot discharge this obligation without being able to communicate effectively with their patients. In the absence of sign language interpretation, there may well be cases where it will be impossible for doctors to treat deaf persons without breaching their professional responsibilities.

71 If there are circumstances in which deaf patients cannot communicate effectively with their doctors without an interpreter, how can it be said that they receive the same level of medical care as hearing persons? Those who hear do not receive communication as a distinct service. For them, an effective means of communication is routinely available, free of charge, as part of every health care service. In order to receive the same quality of care, deaf persons must bear the burden of paying for the means to communicate with their health care providers, despite the fact that the system is intended to make ability to pay irrelevant. Where it is necessary for effective communication, sign language interpretation should not therefore be viewed as an "ancillary" service. On the contrary, it is the means by which deaf persons may receive the same quality of medical care as the hearing population.

72 Once it is accepted that effective communication is an indispensable component of the delivery of medical services, it becomes much more difficult to assert that the failure to ensure that deaf persons communicate effectively with their health care providers is not discriminatory. In their effort to persuade this Court otherwise, the respondents and their supporting interveners maintain that s. 15(1) does not oblige governments to implement programs to alleviate disadvantages that exist independently of state action. Adverse effects only arise from benefit programs, they aver, when those programs exacerbate the disparities between the group claiming a s. 15(1) violation and the general population. They assert, in other words, that governments should be entitled to provide benefits to the general population without ensuring that disadvantaged members of society have the resources to take full advantage of those benefits.

73 In my view, this position bespeaks a thin and impoverished vision of s. 15(1). It is belied, more importantly, by the thrust of this Court's equality jurisprudence. It has been suggested that s. 15(1) of the *Charter* does not oblige the state to take positive actions, such as provide services to ameliorate the symptoms of systemic or general inequality; see *Thibaudeau*, *supra*, at para. 37 (*per* L'Heureux-Dubé J.). Whether or not this is true in all cases, and I do not purport to

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decide the matter here, the question raised in the present case is of a wholly different order. This Court has repeatedly held that once the state does provide a benefit, it is obliged to do so in a non-discriminatory manner; see *Tétreault-Gadoury v. Canada (Employment & Immigration Commission)*, [1991] 2 S.C.R. 22 (S.C.C.), *Haig v. R.*, [1993] 2 S.C.R. 995 (S.C.C.), at pp. 1041-42, *Native Women's Assn. of Canada v. R.*, [1994] 3 S.C.R. 627 (S.C.C.), at p. 655, and *Miron*, *supra*. In many circumstances, this will require governments to take positive action, for example by extending the scope of a benefit to a previously excluded class of persons; see *Miron*, *supra*, *Tétreault-Gadoury*, *supra*, and *Schachter v. Canada*, [1992] 2 S.C.R. 679 (S.C.C.). Moreover, it has been suggested that, in taking this sort of positive action, the government should not be the source of further inequality; *Thibaudeau*, *supra*, at para. 38 (*per* L'Heureux-Dubé J.).

74 The same principle has been applied by this Court in its interpretation of the equality provisions of provincial human rights legislation. In *Brooks v. Canada Safeway Ltd.*, [1989] 1 S.C.R. 1219 (S.C.C.), the Court found that an employer's accident and sickness insurance plan, which disentitled pregnant women from receiving benefits for any reason during a certain period, discriminated on the basis of pregnancy and hence sex. In so holding, it resoundingly rejected the reasoning of *Bliss v. Canada (Attorney General)* (1978), [1979] 1 S.C.R. 183 (S.C.C.), at p. 190, which had held that the inequality resulting from a similar benefit program was "not created by legislation but by nature".

75 In support of the view that the state has no obligation to remedy pre-existing disadvantage in providing benefits to the general population, the respondent relies on this Court's decision in *Symes v. R.*, [1993] 4 S.C.R. 695 (S.C.C.). There, the appellant, a self-employed mother, argued that the wages paid to her nanny were business expenses and that the section of the *Income Tax Act*, R.S.C. 1952, c. 148, that did not allow her to deduct the full cost of these expenses discriminated against her on the basis of sex. The Court rejected this argument, holding that the distinction created between persons who incur child care expenses and those who do not is not related to sex, despite the fact that women are responsible for a disproportionate share of the social costs of child care. Writing for the majority, Iacobucci J. held that the appellant had not proven that the actual *expenses* of child care were borne disproportionately by women. He thus concluded that the appellant had not demonstrated an adverse effect that was created or contributed to by the legislation. He stated the following, at pp. 764-65:

> If the adverse effects analysis is to be coherent, it must not assume that a statutory provision has an effect which is not proved. We must take care to distinguish between effects which are wholly caused, or are contributed to, by an impugned provision, and those social circumstances which exist independently of such a provision.

76 While this statement can be interpreted as supporting the notion that, in providing a benefit, the state is not required to eliminate any pre-existing "social" disadvantage, it should be remembered that it was made in the context of determining whether the legislation made a distinction based on an enumerated or analogous ground. In *Symes*, the appellant was unable to show that the allegedly adverse effect created by the legislation was suffered by members of such a group. There was no relationship, in other words, between the benefit provided by the government and the social disadvantage suffered by women in child-rearing. In the present case, in contrast, the alleged adverse effect *is* suffered by an enumerated group. The social disadvantage borne by the deaf is directly related to their inability to benefit equally from the service provided by the government. As a result, I do not believe that *Symes* is helpful to the respondent.

77 This Court has consistently held, then, that discrimination can arise both from the adverse effects of rules of general application as well as from express distinctions flowing from the distribution of benefits. Given this state of affairs, I can think of no principled reason why it should not be possible to establish a claim of discrimination based on the adverse effects of a facially neutral benefit scheme. Section 15(1) expressly states, after all, that every individual is "equal before and under the law and has the right to the equal protection *and* equal benefit of the law without discrimination..." (emphasis added). The provision makes no distinction between laws that impose unequal burdens and those that deny equal benefits. If we accept the concept of adverse effect discrimination, it seems inevitable, at least at the s. 15(1) stage of analysis, that the government will be required to take special measures to ensure that disadvantaged groups are able to benefit equally from government services. As I will develop below, if there are policy reasons in favour of limiting the government's responsibility to ameliorate disadvantage in the provision of benefits and services, those policies are more appropriately considered in determining whether any violation of s. 15(1) is saved by s. 1 of the *Charter*.

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78 The principle that discrimination can accrue from a failure to take positive steps to ensure that disadvantaged groups benefit equally from services offered to the general public is widely accepted in the human rights field. In *Canadian Odeon Theatres Ltd. v. Saskatchewan (Human Rights Commission)* (1985), 18 D.L.R. (4th) 93 (Sask. C.A.), leave to appeal refused *Canadian Odeon Theatres Ltd. v. Saskatchewan (Human Rights Commission)*, [1985] 1 S.C.R. vi (note) (S.C.C.), the court found that the failure of a theatre to provide a disabled person a choice of place from which to view a film comparable to that offered to the general public was discriminatory. Similarly, in *Howard v. University of British Columbia* (1993), 18 C.H.R.R. D/353 (B.C. Human Rights Council), it was held that the university was obligated to provide a deaf student with a sign language interpreter for his classes. "[W]ithout interpreters", the Human Rights Council held, at p. D/358, "the complainant did not have meaningful access to the service." And in *Centre de la communauté sourde du Montréal Métropolitain Inc. c. Québec (Régie du logement)*, [1996] R.J.Q. 1776 (T.D.P.Q.), the Quebec Tribunal des droits de la personne determined that a rent review tribunal must accommodate a deaf litigant by providing sign language interpretation. Moreover, the principle underlying all of these cases was affirmed in *Haig*, *supra*, where a majority of this Court wrote, at p. 1041, that "a government may be required to take positive steps to ensure the equality of people or groups who come within the scope of s. 15".

79 It is also a cornerstone of human rights jurisprudence, of course, that the duty to take positive action to ensure that members of disadvantaged groups benefit equally from services offered to the general public is subject to the principle of reasonable accommodation. The obligation to make reasonable accommodation for those adversely affected by a facially neutral policy or rule extends only to the point of "undue hardship"; see *Simpsons-Sears Ltd.*, *supra*, and *Central Alberta Dairy Pool*, *supra*. In my view, in s. 15(1) cases this principle is best addressed as a component of the s. 1 analysis. Reasonable accommodation, in this context, is generally equivalent to the concept of "reasonable limits". It should not be employed to restrict the ambit of s. 15(1).

80 In my view, therefore, the failure of the Medical Services Commission and hospitals to provide sign language interpretation where it is necessary for effective communication constitutes a *prima facie* violation of the s. 15(1) rights of deaf persons. This failure denies them the equal benefit of the law and discriminates against them in comparison with hearing persons.

81 I acknowledge that the standard I have set is a broad one. Given the nature of the evidentiary record before this Court, however, it would not be appropriate to elaborate it in any detail. Some guidance can be provided, however (and I stress that it is guidance - not authoritative pronouncement), by the experience in the United States under the *Rehabilitation Act*, 29 U.S.C. § 794 (1997), and the *Americans with Disabilities Act*, 42 U.S.C. §§ 12182-12189 (1997). Regulations enacted pursuant to those statutes require health care providers to supply appropriate auxiliary aids and services, including qualified sign language interpreters, to ensure "effective communication" with deaf persons; 45 C.F.R. § 84.52(c) (1997); 28 C.F.R. § 36.303(b) and (c) (1997). While the term "effective communication" is not defined in the legislation, it has been held to mean that a deaf individual "actually understood" the content of the communication; see *Bonner v. Lewis*, 857 F.2d 559 (U.S. C.A. 9th Cir. 1988), at pp. 563-64. One would suppose that it would also entail that deaf persons be able to inform medical staff of the basic circumstances surrounding their illness or injury; see Elizabeth Ellen Chilton, "Ensuring Effective Communication: The Duty of Health Care Providers to Supply Sign Language Interpreters for Deaf Patients" (1996), 47 *Hastings L.J.* 871, at p. 883.

82 This is not to say that sign language interpretation will have to be provided in every medical situation. The "effective communication" standard is a flexible one, and will take into consideration such factors as the complexity and importance of the information to be communicated, the context in which the communications will take place and the number of people involved; see 28 C.F.R. § 35.160 (1997). For deaf persons with limited literacy skills, however, it is probably fair to surmise that sign language interpretation will be required in most cases; see Chilton, *supra*, at p. 886, and the many studies there cited.

83 Finally, I note that it is not in strictness necessary to decide whether, according to this standard, the appellants' s. 15(1) rights were breached. This Court has held that if claimants prove that the equality rights of members of the group

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to which they belong have been infringed, they need not establish a violation of their own particular rights. In *Egan*, *supra*, the government contended that, given the net benefit available to them pursuant to other legislation, a homosexual couple was not negatively affected by the denial of a spousal allowance under the *Old Age Security Act*, R.S.C., 1985, c. O-9. In rejecting this submission, I commented as follows, at para. 12:

> ...the respondent contends that the appellants have suffered no prejudice.... I would simply dispose of this argument on the ground that, while this may be true in this specific instance, there is nothing to show this is generally the case with homosexual couples, which is the point the respondent must establish.

Similarly, Cory J. stated in *Egan*, at para. 153, that "the appellants must demonstrate that homosexual couples *in general* are denied equal benefit of the law, not that they themselves are suffering a particular or unique denial of a benefit" (emphasis in original). That being said, it is fair to say that the absence of a publicly funded sign language interpretation service discriminated against the appellants by denying them the equal benefit of the British Columbia health care system. The evidence at trial established that, generally speaking, the quality of care received by the appellants was inferior to that available to hearing persons.

Section 1 of the Charter

84 I come now to possible justification under s. 1 of the *Charter*, which reads:

> *1.* The *Canadian Charter of Rights and Freedoms* guarantees the rights and freedoms set out in it subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society.

In order to justify a limitation of a *Charter* right, the government must establish that the limit is "prescribed by law" and is "reasonable" in a "free and democratic society". In *R. v. Oakes*, [1986] 1 S.C.R. 103 (S.C.C.), this Court set out the analytical framework for determining whether a law constitutes a reasonable limit on a *Charter* right. A succinct restatement of that framework can be found in the reasons of Iacobucci J. in *Egan*, *supra*, at para. 182:

> First, the objective of the legislation must be pressing and substantial. Second, the means chosen to attain this legislative end must be reasonable and demonstrably justifiable in a free and democratic society. In order to satisfy the second requirement, three criteria must be satisfied: (1) the rights violation must be rationally connected to the aim of the legislation; (2) the impugned provision must minimally impair the *Charter* guarantee; and (3) there must be a proportionality between the effect of the measure and its objective so that the attainment of the legislative goal is not outweighed by the abridgement of the right. In all s. 1 cases the burden of proof is with the government to show on a balance of probabilities that the violation is justifiable.

It is not necessary to consider each of these elements in this case. Assuming without deciding that the decision not to fund medical interpretation services for the deaf constitutes a limit "prescribed by law", that the objective of this decision - controlling health care expenditures - is "pressing and substantial", and that the decision is rationally connected to the objective, I find that it does not constitute a minimum impairment of s. 15(1).

85 This Court has recently confirmed that the application of the *Oakes* test requires close attention to the context in which the impugned legislation operates; see *Attis v. New Brunswick District No. 15 Board of Education*, [1996] 1 S.C.R. 825 (S.C.C.), at para. 78. The Court has also held that where the legislation under consideration involves the balancing of competing interests and matters of social policy, the *Oakes* test should be applied flexibly, and not formally or mechanistically; see *R. v. Keegstra*, [1990] 3 S.C.R. 697 (S.C.C.), at p. 737, *McKinney*, *supra*, *Irwin Toy Ltd. c. Québec (Procureur général)*, [1989] 1 S.C.R. 927 (S.C.C.), at pp. 999-1000, *Cotroni*, *supra*, at p. 1489, *Comité pour la République du Canada - Committee for the Commonwealth of Canada v. Canada*, [1991] 1 S.C.R. 139 (S.C.C.), at p. 222 (*per* L'Heureux-Dubé J.), *Egan*, *supra*, at para. 29 (*per* La Forest J.) and at paras. 105-106 (*per* Sopinka J.), and *RJR-Macdonald Inc. c. Canada (Procureur général)*, [1995] 3 S.C.R. 199 (S.C.C.), at para. 63 (*per* La Forest J.) and at paras. 127-138 (*per* McLachlin J.). It is also clear that while financial considerations alone may not justify *Charter* infringements (*Schachter*, *supra*, at p. 709), governments must be afforded wide latitude to determine the proper distribution of resources in society;

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see *McKinney*, *supra*, at p. 288, and *Egan*, *supra*, at para. 104 (*per* Sopinka J.). This is especially true where Parliament, in providing specific social benefits, has to choose between disadvantaged groups; see *Egan*, *supra*, at paras. 105-110 (*per* Sopinka J.). On the other hand, members of this Court have suggested that deference should not be accorded to the legislature merely because an issue is a "social" one or because a need for governmental "incrementalism" is shown; see *Egan*, *supra*, at para. 97 (*per* L'Heureux-Dubé J.) and at paras. 215-216 (*per* Iacobucci J.). In the present case, the failure to provide sign language interpreters would fail the minimal impairment branch of the *Oakes* test under a deferential approach. It is, therefore, unnecessary to decide whether in this "social benefits" context, where the choice is between the needs of the general population and those of a disadvantaged group, a deferential approach should be adopted.

86 At the same time, the leeway to be granted to the state is not infinite. Governments must demonstrate that their actions infringe the rights in question no more than is reasonably necessary to achieve their goals. Thus, I stated the following for the Court in *Tétreault-Gadoury*, *supra*, at p. 44:

> It should go without saying, however, that the deference that will be accorded to the government when legislating in these matters does not give them an unrestricted licence to disregard an individual's *Charter* rights. Where the government cannot show that it had a reasonable basis for concluding that it has complied with the requirement of minimal impairment in seeking to attain its objectives, the legislation will be struck down.

87 In the present case, the government has manifestly failed to demonstrate that it had a reasonable basis for concluding that a total denial of medical interpretation services for the deaf constituted a minimum impairment of their rights. As previously noted, the estimated cost of providing sign language interpretation for the whole of British Columbia was only $150,000, or approximately 0.0025 per cent of the provincial health care budget at the time. This figure was based on an extrapolation from the services then being provided by the Western Institute for the Deaf and Hard of Hearing in the Lower Mainland area. Although there was little evidence presented of the precise content of this service, it was not suggested that its extension throughout the province would not have fulfilled the requirements of s. 15(1). In these circumstances, the refusal to expend such a relatively insignificant sum to continue and extend the service cannot possibly constitute a minimum impairment of the appellants' constitutional rights.

88 The respondents argue, however, that the situation of deaf persons cannot be meaningfully distinguished from that of other non-official language speakers. If they are compelled to provide interpreters for the former, they submit, they will also have to do so for the latter, thereby increasing the expense of the program dramatically and placing severe strain on the fiscal sustainability of the health care system. In this context, they contend, it was reasonable for the government to conclude that they impaired the rights of deaf persons as little as possible.

89 This argument, in my view, is purely speculative. It is by no means clear that deaf persons and non-official language speakers are in a similar position, either in terms of their constitutional status or their practical access to adequate health care. From the perspective of a patient, there is no real difference between sign language and oral language if there is no ability to communicate with a physician. But from the perspective of the state's obligations, there may very well be. In the present case, the only relevant constitutional provisions are ss. 15(1) and 1 of the *Charter*. In a case involving a claim for medical interpretation for hearing patients, in contrast, the analysis would be more complicated. In such a case, it would be necessary to consider the interaction between s. 15(1) and other provisions of the Constitution, specifically those related to the language obligations of governments. Moreover, the respondents have presented no evidence as to the potential scope or cost of an oral language medical interpretation program. It is possible that the nature and extent of any reasonable accommodation required for hearing persons under s. 1 would differ from that required for deaf persons. Thus, any claim for the provision of such a program, whether based on national origin or language as an analogous ground, would proceed on markedly different constitutional terrain than a claim grounded on disability.

90 Further, it is apparent that deaf persons stand in a special position in terms of their ability to communicate with the mainstream population. As I have discussed, it is extremely difficult for many deaf persons to acquire a high level of proficiency in oral languages, whether in spoken or written form. Moreover, it is apparent that the deaf have particular difficulties in obtaining the service of persons in the community who understand sign language. There is no evidentiary

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basis from which to assess whether non-official language speakers stand in a similar position. So, without wishing to minimize the difficulties faced by hearing persons whose native tongues are neither English nor French, it is by no means clear that the communications barriers they face are analogous to those encountered by deaf persons. As a result, the success of a potential s. 15(1) claim by members of the latter group cannot be predicted in advance. The possibility that such a claim might be made, therefore, cannot justify the infringement of the constitutional rights of the deaf.

91 The respondents also contend that recognition of the appellants' claim will have a ripple effect throughout the health care field, forcing governments to spend precious health care dollars accommodating the needs of myriad disadvantaged persons. "Virtually everyone in the health care system who is denied a service", they submit, "will either be medically disadvantaged or could argue that a medical disadvantage will arise from the lack of service." Similarly, in his concurring opinion in the Court of Appeal, Lambert J.A. observed that many of the medical services and products required by the disabled are not publicly funded. In these circumstances, he asserted, governments must have the freedom to allocate scarce health care dollars among various disadvantaged groups.

92 These arguments miss the mark. If effective communication is integrally connected with the provision of health care - a point that Lambert J.A. accepted - then the fact that there are number of medical services that benefit disabled persons that are not covered by medicare is immaterial. The appellants do not demand that the government provide them with a discrete service or product, such as hearing aids, that will help alleviate their general disadvantage. Their claim is not for a benefit that the government, in the exercise of its discretion to allocate resources to address various social problems, has chosen not to provide. On the contrary, they ask only for equal access to services that are available to all. The respondents have presented no evidence that this type of accommodation, if extended to other government services, will unduly strain the fiscal resources of the state. To deny the appellants' claim on such conjectural grounds, in my view, would denude s. 15(1) of its egalitarian promise and render the disabled's goal of a barrier-free society distressingly remote.

93 Viewed in this light, it is impossible to characterize the government's decision not to fund sign language interpretation as one which "reasonably balances the competing social demands which our society must address"; see *McKinney*, *supra*, at p. 314. It should be recalled that the Ministry of Health decided not to fund the interpretation program even in part. Other options, such as the partial or interim funding of the program offered by the Western Institute for the Deaf and Hard of Hearing, or the institution of a scheme requiring users to pay either a portion of the cost of interpreters or the full amount if they could afford to do so, were either not considered or were considered and rejected. In this sense, the present case is similar to *Tétreault-Gadoury*, *supra*, where the Court found that the denial of unemployment insurance benefits to persons over 65 violated s. 15(1) and could not be saved under s. 1 of the *Charter*. Writing for the Court, I found that one of the reasons that this denial failed the minimal impairment test was that persons over 65 were not entitled to *any* benefits. "Even allowing the government a healthy measure of flexibility in legislating in this area", I stated, at p. 47, "the complete denial of unemployment benefits is not an acceptable method of achieving any of the government objectives set forth above...." That being said, I do not wish to be understood as intimating that the alternative measures I have adverted to would survive s. 1 scrutiny. I refer to them solely for the purpose of demonstrating that the government did not attempt to institute a scheme that would constitute a lesser limitation on deaf persons' rights.

94 In summary, I am of the view that the failure to fund sign language interpretation is not a "minimal impairment" of the s. 15(1) rights of deaf persons to equal benefit of the law without discrimination on the basis of their physical disability. The evidence clearly demonstrates that, as a class, deaf persons receive medical services that are inferior to those received by the hearing population. Given the central place of good health in the quality of life of all persons in our society, the provision of substandard medical services to the deaf necessarily diminishes the overall quality of their lives. The government has simply not demonstrated that this unpropitious state of affairs must be tolerated in order to achieve the objective of limiting health care expenditures. Stated differently, the government has not made a "reasonable accommodation" of the appellants' disability. In the language of this Courts' human rights jurisprudence, it has not accommodated the appellants' needs to the point of "undue hardship"; see *Simpsons-Sears Ltd.*, *supra*, and *Central Alberta Dairy Pool*, *supra*.

Remedy

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95 I have found that where sign language interpreters are necessary for effective communication in the delivery of medical services, the failure to provide them constitutes a denial of s. 15(1) of the *Charter* and is not a reasonable limit under s. 1. Section 24(1) of the *Charter* provides that anyone whose rights under the *Charter* have been infringed or denied may obtain" such remedy as the court considers appropriate and just in the circumstances". In the present case, the appropriate and just remedy is to grant a declaration that this failure is unconstitutional and to direct the government of British Columbia to administer the *Medical and Health Care Services Act* [now the *Medicare Protection Act*] and the *Hospital Insurance Act* in a manner consistent with the requirements of s. 15(1) as I have described them.

96 A declaration, as opposed to some kind of injunctive relief, is the appropriate remedy in this case because there are myriad options available to the government that may rectify the unconstitutionality of the current system. It is not this Court's role to dictate how this is to be accomplished. Although it is to be assumed that the government will move swiftly to correct the unconstitutionality of the present scheme and comply with this Court's directive, it is appropriate to suspend the effectiveness of the declaration for six months to enable the government to explore its options and formulate an appropriate response. In fashioning its response, the government should ensure that, after the expiration of six months or any other period of suspension granted by this Court, sign language interpreters will be provided where necessary for effective communication in the delivery of medical services. Moreover, it is presumed that the government will act in good faith by considering not only the role of hospitals in the delivery of medical services but also the involvement of the Medical Services Commission and the Ministry of Health.

Disposition

97 I would allow the appeal. Costs are awarded to the appellants from the respondents throughout. I would answer the Constitutional Questions as follows:

> 1. Does the definition of "benefits" in s. 1 of the *Medicare Protection Act*, S.B.C. 1992, c. 76, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* by failing to include medical interpreter services for the deaf?
>
> No.
>
> 2. If the answer to question 1 is yes, is the infringement demonstrably justified in a free and democratic society pursuant to s. 1 of the *Canadian Charter of Rights and Freedoms*?
>
> Given my response to question 1, it is not necessary to answer this question.
>
> 3. Do ss. 3, 5 and 9 of the *Hospital Insurance Act*, R.S.B.C. 1979, c. 180, and the Regulations enacted pursuant to s. 9 of that Act, infringe s. 15(1) of the *Canadian Charter of Rights and Freedoms* by failing to require that hospitals in the Province of British Columbia provide medical interpreter services for the deaf?
>
> No.
>
> 4. If the answer to question 3 is yes, is the infringement demonstrably justified in a free and democratic society pursuant to s. 1 of the *Canadian Charter of Rights and Freedoms*?

Given my response to question 3, it is not necessary to answer this question.

Appeal allowed.

Pourvoi accueilli.

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2003 SCC 3, 2003 CSC 3
Supreme Court of Canada

Siemens v. Manitoba (Attorney General)

2002 CarswellMan 574, 2002 CarswellMan 575, 2003 SCC 3, 2003 CSC 3, [2002] S.C.J. No. 69, [2003] 1 S.C.R. 6, [2003] 4 W.W.R. 1, [2003] A.C.S. No. 69, 102 C.R.R. (2d) 345, 119 A.C.W.S. (3d) 564, 173 Man. R. (2d) 1, 221 D.L.R. (4th) 90, 293 W.A.C. 1, 299 N.R. 267, 34 M.P.L.R. (3d) 163, 47 Admin. L.R. (3d) 205, 55 W.C.B. (2d) 609, J.E. 2003-270, REJB 2003-36968

David Albert Siemens, Eloisa Ester Siemens and Sie-Cor Properties Inc. o/a The Winkler Inn, Appellants v. The Attorney General of Manitoba and the Government of Manitoba, Respondents and The Attorney General of Canada, the Attorney General for Ontario, the Attorney General for New Brunswick, the Attorney General for Alberta, 292129 Alberta Ltd., operating as The Empress Hotel, 484906 Alberta Ltd., operating as Lacombe Motor Inn, Leto Steak & Seafood House Ltd., Neubro Holdings Inc., operating as Lacombe Hotel, Wayne Neufeld, 324195 Alberta Ltd., operating as K.C.'s Steak & Pizza, and Katerina Kadoglou, Interveners

McLachlin C.J.C., Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour, LeBel, Deschamps JJ.

Heard: October 31, 2002
Judgment: October 31, 2002
Written reasons: January 30, 2003
Docket: 28416

Proceedings: additional reasons to 2002 CarswellMan 461 (S.C.C.); affirming 2000 MBCA 152, [2001] 2 W.W.R. 515, 153 Man. R. (2d) 106, 238 W.A.C. 106, 85 C.R.R. (2d) 59 (Man. C.A.); affirming 2000 MBQB 140, [2001] 2 W.W.R. 491, 151 Man. R. (2d) 49, 78 C.R.R. (2d) 268 (Man. Q.B.)

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Roderich Wiltshire, for intervener Attorney General for Alberta
Ronald J. Dumonceaux and *Graham K. Neill*, for interveners 292129 Alberta Ltd. et al.

Subject: Public; Constitutional; Human Rights

ADDITIONAL REASONS to appeal by plaintiffs from judgment reported at 2000 MBCA 152, 2000 CarswellMan 655, [2001] 2 W.W.R. 515, 153 Man. R. (2d) 106, 238 W.A.C. 106, 85 C.R.R. (2d) 59 (Man. C.A.), dismissing appeal of judgment reported at 2000 CarswellMan 479, 2000 MBQB 140, [2001] 2 W.W.R. 491, 151 Man. R. (2d) 49, 78 C.R.R. (2d) 268 (Man. Q.B.), dismissing their appeal from ruling that *Gaming Control Local Option (VLT) Act* is constitutional.

MOTIFS SUPPLÉMENTAIRES au pourvoi interjeté par les demandeurs à l'encontre de l'arrêt publié à 2000 MBCA 152, 2000 CarswellMan 655, [2001] 2 W.W.R. 515, 153 Man. R. (2d) 106, 238 W.A.C. 106, 85 C.R.R. (2d) 59 (Man. C.A.), qui a rejeté le pourvoi à l'encontre du jugement publié à 2000 CarswellMan 479, 2000 MBQB 140, [2001] 2 W.W.R.

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491, 151 Man. R. (2d) 49, 78 C.R.R. (2d) 268 (Man. Q.B.), qui a rejeté leur pourvoi à l'encontre de la décision ayant conclu que la *Loi sur les options locales en matière de jeu (appareils de loterie vidéo)* était constitutionnelle.

The judgment of the court was delivered by *Major J.*:

I. Introduction

1 In 1999, the Government of Manitoba enacted local option legislation enabling municipalities to hold binding plebiscites on the prohibition of video lottery terminals ("VLTs") in their communities. The legislation set out the procedure by which the plebiscites were to be initiated, held, and given effect. In addition, the legislation contained a specific section dealing with the Town of Winkler, which had held a non-binding plebiscite supporting a prohibition of VLTs the previous year. As a result of the legislation, VLTs were prohibited in Winkler until such time as a future binding plebiscite, held in accordance with the legislation, would permit their return to the municipality.

2 Both the Manitoba Court of Queen's Bench and the Court of Appeal concluded that the *Gaming Control Local Option (VLT) Act*, S.M. 1999, c. 44 ("VLT Act"), either as a whole or s. 16 in particular, was neither *ultra vires* the provincial legislature, nor did it violate the *Canadian Charter of Rights and Freedoms*. The appellants subsequently challenged the legislation before this Court on the grounds that s. 16, dealing specifically with Winkler, violates ss. 2(b), 7, and 15(1) of the *Charter*. They also argued that the legislation is *ultra vires* the provincial government because it is an affront to Parliament's exclusive jurisdiction over criminal law. On October 31, 2002, the Court unanimously dismissed their appeal. These are the reasons for that decision.

II. Facts

3 The Manitoba Lotteries Corporation ("MLC") is responsible for operating lottery schemes, including VLTs, in the province. The MLC enters into agreements with "siteholders" to place VLTs on the siteholders' property. The siteholders then receive a per centage of the VLTs' revenue. However, the VLTs remain the property of the MLC and, according to the terms of the siteholder agreement, can be removed at any time, with or without cause.

4 The appellants, David and Eloisa Siemens, are the sole shareholders of Sie-Cor Properties Inc., which purchased The Winkler Inn in 1993. They invested a considerable amount of money in the renovation and expansion of the Inn, and submitted that VLTs were an important consideration when making their investment. The appellants increased the number of VLTs from 8 to 10 when they first purchased The Winkler Inn, and then from 10 to 12 in the fall of 1994. Their mortgage payments roughly coincided with the monthly VLT revenue.

5 In August 1998, the Town of Winkler passed a resolution to hold a plebiscite regarding VLTs in the municipality. The plebiscite was held in conjunction with the October municipal elections. The question was:

> Should the Town of Winkler request that the Provincial Government ban video lottery terminals in Winkler, which would result in the Town of Winkler losing its annual municipal VLT grant?

Approximately 50 per cent of eligible voters participated in the plebiscite, including Mr. and Mrs. Siemens. A sizeable majority (77.8 per cent) of the votes cast were in favour of requesting a ban on VLTs. In response to the plebiscite, the Town of Winkler passed a resolution in December 1998 to forward the results to the Government of Manitoba. Sie-Cor Properties Inc., in turn, filed an application in the Court of Queen's Bench seeking a declaration that the resolution was invalid and an order of *certiorari* quashing it.

6 In July 1999, while Sie-Cor's application was proceeding to a hearing, the Manitoba Government passed the VLT Act. The Act permits municipalities to hold binding plebiscites regarding the prohibition of VLTs within their jurisdictions. In addition, the government used the new legislation as an opportunity to give effect to the plebiscite that had already been held in Winkler. Specifically, s. 16 of the Act seeks to terminate the siteholder agreements in Winkler and deems

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that a resolution prohibiting VLTs was passed in accordance with the Act. Pursuant to this legislation, the siteholder agreement with The Winkler Inn was terminated effective December 1, 1999.

III. Relevant Statutory Provisions

7 *The Gaming Control Local Option (VLT) Act*, S.M. 1999, c. 44

1 In this Act,

. . . . .

"plebiscite" means a vote by the electors of a municipality on a resolution approved by the council or stated on a petition

(a) to prohibit video lottery gaming within the municipality, or

(b) where video lottery gaming within the municipality is prohibited because of a plebiscite, to permit video lottery gaming within the municipality;

. . . . .

"video lottery gaming" means the operation of a lottery scheme, as defined in the *Criminal Code* (Canada), that involves the use of a video lottery terminal.

. . . . .

3(1) Notwithstanding section 3 of *The Manitoba Lotteries Corporation Act*, no person shall carry on any video lottery gaming, under a siteholder agreement or otherwise, within a municipality while a resolution prohibiting video lottery gaming within the municipality is in effect.

3(2) A resolution prohibiting video lottery gaming within a municipality comes into effect on the first day of the fifth month following the month in which it is approved by a majority of the votes cast in a plebiscite and continues in effect until a resolution permitting video lottery gaming within the municipality is approved by a majority of the votes cast in a plebiscite.

. . . . .

16(1) Each siteholder agreement existing before the coming into force of this section respecting the operation of video lottery terminals at a site located in the Town of Winkler is terminated on the first day of the fifth month following the month in which this Act comes into force, and the corporation shall remove all video lottery terminals from sites located in the Town of Winkler as soon as practicable after that day.

16(2) A resolution to prohibit video lottery gaming within the Town of Winkler is deemed for the purposes of this Act to have been approved by a plebiscite and is deemed to come into effect on the first day of the fifth month following the month in which this Act comes into force.

Criminal Code, R.S.C. 1985, c. C-46

207.1(1) Notwithstanding any of the provisions of this Part relating to gaming and betting, it is lawful

(a) for the government of a province, either alone or in conjunction with the government of another province, to conduct and manage a lottery scheme in that province, or in that and the other province, in accordance with any law enacted by the legislature of that province; . . .

Constitution Act, 1867

92. In each Province the Legislature may exclusively make Laws in relation to Matters coming within the Classes of Subjects next hereinafter enumerated; that is to say, -

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. . . . .

13. Property and Civil Rights in the Province.

. . . . .

16. Generally all Matters of a merely local or private Nature in the Province.

Canadian Charter of Rights and Freedoms

2. Everyone has the following fundamental freedoms:

. . . . .

(b) freedom of thought, belief, opinion and expression, including freedom of the press and other media of communication.

. . . . .

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

. . . . .

15.(1) Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability.

IV. Judgments Below

A. Manitoba Court of Queen's Bench (2000), [2001] 2 W.W.R. 491

8 In February 2000, Hamilton J. heard arguments on a motion to have certain questions of law determined before trial on Sie-Cor's *certiorari* application. At issue was whether the VLT Act, either as a whole or s. 16 in particular, was *ultra vires* the provincial legislature as an invasion into the federal government's criminal law power, and whether s. 16 violated ss. 2(b), 6, 7, and 15(1) of the *Charter*. It was also argued that the legislation constituted prohibited discrimination under the Manitoba *Human Rights Code*, S.M. 1987-88, c. 45. Hamilton J. rejected all the appellants' claims.

9 In dismissing the division of powers argument, Hamilton J. relied on *R. v. Furtney*, [1991] 3 S.C.R. 89 (S.C.C.). That case held that gaming was a matter within the "double aspect" doctrine, such that both Parliament and the provincial legislatures had jurisdiction to legislate in that area. She found that the VLT Act was, therefore, *prima facie* within the legislative authority of the Manitoba Government. She also found that the VLT Act was not an attempt to enact criminal law, as the legislation lacked both penal consequences and a criminal law purpose.

B. Manitoba Court of Appeal (2000), [2001] 2 W.W.R. 515

10 In a short oral judgment delivered by Twaddle J.A. (Kroft and Steel JJ.A. concurring), the Manitoba Court of Appeal dismissed the appeal on all grounds, expressing that it was in "substantial agreement" with Hamilton J., "both with respect to the declarations made and her reasons for them."

V. Issues

11 By order of the Chief Justice dated December 19, 2001, the following constitutional questions were stated for the Court's consideration:

(1) Is *The Gaming Control Local Option (VLT) Act*, S.M. 1999, c. 44, in its entirety *ultra vires* the Legislature of the Province of Manitoba as it relates to a subject matter which is within the exclusive jurisdiction of the Parliament of Canada under s. 91(27) of the *Constitution Act, 1867*?

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(2) Is s. 16(1) of *The Gaming Control Local Option (VLT) Act*, S.M. 1999, c. 44, *ultra vires* the Legislature of the Province of Manitoba as it relates to a subject matter which is within the exclusive jurisdiction of the Parliament of Canada under s. 91(27) of the *Constitution Act, 1867*?

(3) Is s. 16 of *The Gaming Control Local Option (VLT) Act* inconsistent with s. 2(b) of the *Canadian Charter of Rights and Freedoms*?

(4) If the answer to question 3 is in the affirmative, is s. 16 of *The Gaming Control Local Option (VLT) Act* nevertheless justified by s. 1 of the *Canadian Charter of Rights and Freedoms*?

(5) Is s. 16 of *The Gaming Control Local Option (VLT) Act* inconsistent with s. 7 of the *Canadian Charter of Rights and Freedoms*?

(6) If the answer to question 5 is in the affirmative, is s. 16 of *The Gaming Control Local Option (VLT) Act* nevertheless justified by s. 1 of the *Canadian Charter of Rights and Freedoms*?

(7) Is s. 16 of *The Gaming Control Local Option (VLT) Act* inconsistent with s. 15(1) of the *Canadian Charter of Rights and Freedoms*?

(8) If the answer to question 7 is in the affirmative, is s. 16 of *The Gaming Control Local Option (VLT) Act* nevertheless justified by s. 1 of the *Canadian Charter of Rights and Freedoms*?

VI. Analysis

A. Interpreting the VLT Act

12 A significant portion of the appellants' submissions focused on the proper characterization and interpretation of the VLT Act, and particularly s. 16 of that Act. The main thrust of their argument was that s. 16 of the VLT Act did not "give effect" to the plebiscite that occurred in Winkler in 1998 and that, therefore, the constitutionality of the legislation must be assessed without reference to that plebiscite. They noted that s. 16 does not explicitly refer to the 1998 plebiscite, and that s. 16(2) refers to the indefinite "a plebiscite" rather than the definite "the plebiscite." As well, they submitted that the subsection deems a resolution prohibiting gaming to have been passed by a municipal plebiscite in Winkler, when no such resolution was ever approved by the town council. These characteristics allegedly demonstrate that s. 16 of the VLT Act did not give effect to the plebiscite that actually occurred in Winkler in the fall of 1998, and that it unfairly attributes a binding plebiscite to the residents of Winkler, who never voted in such a plebiscite.

13 The appellants expressed puzzlement at being affected by the 1998 plebiscite, as that plebiscite was not held pursuant to a resolution prohibiting VLTs, as required by the Act. The answer to that puzzlement is that the VLT Act has a more general application, and, in accordance with the principles of purposive interpretation, that s. 16 was intended to incorporate the wishes already expressed by Winkler voters into the broader provincial scheme.

14 No doubt the legislation could have been drafted in a way that more explicitly expressed the purpose of s. 16. Nevertheless, given the entire context of the legislation, the legislative purpose is clear. The Town of Winkler held a non-binding plebiscite in the fall of 1998, in which a majority of votes cast supported a request to remove VLTs from the community. The town council forwarded the results of the plebiscite to the provincial government. In response, the provincial government enacted legislation prohibiting the operation of VLTs in Winkler and terminating all siteholder agreements in that community.

15 The appellants acknowledged at the appeal that, if the government had wished to enact legislation dealing solely with the prohibition of VLTs in the Town of Winkler, it could legitimately have done so. However, instead of giving effect to the Winkler plebiscite in an Act designed solely for that purpose, the government incorporated a section prohibiting VLTs in Winkler into a larger statute that established a scheme for all municipalities to prohibit or reinstate VLTs through

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binding plebiscites. I cannot see how the legislative structure chosen by the government affects the Act's constitutionality. Through the VLT Act, the province attempted to bring Winkler within the larger scheme of VLT plebiscites in the province. In order to do so, it deemed that Winkler voters had approved a VLT prohibition in accordance with the Act. All the parties agree that the Winkler plebiscite did not, in fact, approve such a prohibition. Indeed, since the Winkler plebiscite preceded the introduction of the VLT Act, it was impossible for voters to do so. Regardless, the legislature had the latitude to give effect to the Winkler plebiscite by various means, including the deeming provision it used. Unless the legislation is otherwise unconstitutional, the particular means chosen by the legislature cannot be used as a basis to declare it invalid.

16 It should be noted that the less-than-ideal legislative drafting is not an independent ground upon which legislation can be found unconstitutional. The wording of the statute is only relevant to the analysis in so far as it informs the determination of the pith and substance of the legislation. As long as the pith and substance of s. 16 falls within the provincial sphere of legislative authority, it is immaterial whether it could have been drafted in clearer terms.

17 Similarly, it cannot be concluded that the wording of s. 16 dictates that the appellants' *Charter* claims must be assessed without considering the Winkler plebiscite of 1998. This Court has stated on numerous occasions that the evaluation of *Charter* claims should be contextual: *R. v. Big M Drug Mart Ltd.*, [1985] 1 S.C.R. 295 (S.C.C.), at p. 344 (*per* Dickson J. (as he then was)), *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326 (S.C.C.), at pp. 1355-1356 (*per* Wilson J.), *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154 (S.C.C.), at pp. 224-226 (*per* Cory J.), *Thomson Newspapers Co. v. Canada (Attorney General)*, [1998] 1 S.C.R. 877 (S.C.C.), at para. 87 (*per* Bastarache J.), *Law v. Canada (Minister of Employment & Immigration)*, [1999] 1 S.C.R. 497 (S.C.C.), at para. 62 (*per* Iacobucci J.). The purpose and effects of the legislation cannot be examined in a vacuum, but must be considered in light of the facts as they are known to both the claimant and the legislator.

18 The rationale for contextual analysis is particularly strong in this case. But for the 1998 Winkler plebiscite, the provincial government would never have enacted s. 16 of the VLT Act. The legislature did not single out the Town of Winkler on an arbitrary basis; rather, it enacted s. 16 to respond to the wishes of Winkler voters. If the Court were to ignore the 1998 plebiscite in assessing the *Charter* claims, it would be ignoring the very circumstances that gave rise to the impugned section. This is both logically and legally flawed. Nevertheless, the analysis of the *Charter* claims is not dependent on the existence of the 1998 plebiscite, and the legislation would have been upheld in any event. The contextual analysis merely strengthens that conclusion.

B. The Division of Powers Claim

19 To determine whether the Manitoba Government had legislative authority to enact the VLT Act, it is necessary to identify the pith and substance of that legislation. In *Kitkatla Band v. British Columbia (Minister of Small Business, Tourism & Culture)*, 2002 SCC 31 (S.C.C.), at para. 53, it was held that the pith and substance analysis involves an inquiry into both the purpose of the legislation and its effects. LeBel J. also wrote that, where a specific section of the legislation is being challenged, its pith and substance should be identified before that of the Act as a whole. If the impugned section is *ultra vires*, it may still be upheld if it is sufficiently integrated into a valid provincial legislative scheme (para. 58). However, since the appellants in the present case have challenged both s. 16 and the VLT Act as a whole, it is necessary to identify the pith and substance of both in any event.

20 The purpose of s. 16 of the VLT Act is to prohibit VLTs in Winkler and to cancel all existing siteholder agreements with respect to VLTs. The legislative debates on the VLT Act indicate that s. 16 was enacted to give effect to the plebiscite that had already been held in Winkler, albeit before the Act came into force. The responsible Minister said:

> As you may be aware, Madam Speaker, last fall the citizens of Winkler conducted a plebiscite requesting the removal of VLTs from that community. This legislation supports that community's will. This legislation will recognize the legitimacy of the 1998 VLT plebiscite in Winkler.

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(Manitoba, Legislative Assembly, *Debates and Proceedings* (Hansard), 5th Sess., 36th Leg., vol. XLIX, No. 57A, July 8, 1999, at p. 4092 (Ms Render))

The effect of s. 16(1) of the VLT Act was to cancel the siteholder agreement with The Winkler Inn. Further, as indicated, s. 16(2) attempted to bring the non-binding Winkler plebiscite within the local option scheme outlined in the other sections of the Act. The Act allows plebiscites to be held on whether to prohibit VLTs within the municipality or, where a VLT prohibition is already in effect, on whether to reinstate VLTs within the municipality. Thus, by deeming a resolution prohibiting VLTs to have been approved in Winkler in accordance with the Act, the effect of s. 16(2) is to put the Town of Winkler into the "starting position" of prohibiting VLTs. If a subsequent VLT plebiscite is to be held in Winkler, the question will ask whether to reinstate VLTs in that community.

21 More broadly, the purpose of the VLT Act as a whole seems to be, quite simply, to allow municipalities to express, by binding plebiscite, whether they wish VLTs to be permitted or prohibited within their communities. This purpose is evident from the title of the Act, *The Gaming Control Local Option (VLT) Act*, which clearly expresses the government's desire to obtain local input on the issue of VLTs. The VLT Act was the government's response to two reports: the Manitoba Lottery Policy Review's *Working Group Report* (1995) (the "Desjardins Report"), and the Manitoba Gaming Control Commission's *Municipal VLT Plebiscite Review* (Winnipeg: The Commission, 1998). Both reports recommended that municipal plebiscites be held to determine local opinion on the issue of VLTs.

22 The pith and substance of the VLT Act falls within a provincial head of legislative authority. As Stevenson J. wrote for this Court in *Furtney*, *supra*, at p. 103, gaming is a matter that falls within the "double aspect" doctrine. Accordingly, gaming can be subject to legislation by both the federal and provincial governments:

> In my view, the regulation of gaming activities has a clear provincial aspect under s. 92 of the *Constitution Act, 1867* subject to Parliamentary paramountcy in the case of a clash between federal and provincial legislation. . . . Altogether apart from features of gaming which attract criminal prohibition, lottery activities are subject to the legislative authority of the province under various heads of s. 92, including, I suggest, property and civil rights (13), licensing (9), and maintenance of charitable institutions (7) (specifically recognized by the *Code* provisions). Provincial licensing and regulation of gaming activities is not *per se* legislation in relation to criminal law.

Without foreclosing discussion on other potential heads of jurisdiction, it is sufficient for this appeal to find that the VLT Act was, *prima facie*, validly enacted under ss. 92(13) and 92(16). Section 16(1) deals specifically with the siteholder agreements, which are contractual in nature and thereby fall under property and civil rights. On a broader level, the municipal plebiscites empower each community to determine whether VLTs will be permitted, thereby invoking matters of a local nature.

23 The VLT Act is not, as the appellants have submitted, a colourable attempt to legislate criminal law. The Act does not possess the relevant characteristics outlined by Rand J. in *Reference re Validity of s. 5(a) of Dairy Industry Act (Canada), (Margarine Case)* (1948), [1949] S.C.R. 1 (S.C.C.), at p. 50, and affirmed by the Privy Council in (1950), [1951] A.C. 179 (Canada P.C.), at p. 196, and, more recently, in *Reference re Firearms Act (Canada)*, [2000] 1 S.C.R. 783, 2000 SCC 31 (S.C.C.), at para. 27. These are (1) a prohibition, (2) coupled with a penalty, and (3) a criminal law purpose. The respondents conceded that the VLT Act contains a prohibition, namely, s. 3(1) prohibits the operation of VLTs in municipalities that have banned them as the result of a binding plebiscite. Nevertheless, this alone is insufficient to establish that the VLT Act is, in pith and substance, criminal law. The Act does not create penal consequences, and was not enacted for a criminal law purpose.

24 Although s. 3(1) prohibits the operation of VLTs in relevant municipalities, it does not create a provincial offence. Nor does it impose a penalty for operating VLTs in those municipalities. If VLT operators were to be charged with any offence, it would be under the gaming provisions in the *Criminal Code*, which prohibit gambling *except* in accordance

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with lottery schemes conducted and managed by the provinces. The effect of s. 3(1) of the VLT Act is simply to remove the exception and give full effect to the existing federal offences.

25 However, even if the VLT Act did create a provincial offence or impose a fine, that would not necessarily make it an attempt to legislate criminal law. Section 92(15) of the *Constitution Act, 1867* allows the provincial legislatures to impose fines or other punishments as a means of enforcing valid provincial law, and the provinces have enacted countless punishable offences within their legislative spheres. Motor vehicle offences are the classic example, and they have been declared constitutionally valid in, *inter alia*, *O'Grady v. Sparling*, [1960] S.C.R. 804 (S.C.C.) (careless driving), and *Ross v. Ontario (Registrar of Motor Vehicles)* (1973), [1975] 1 S.C.R. 5 (S.C.C.) (provincial licence suspension upon conviction for *Criminal Code* impaired driving offence). The mere presence of a prohibition and a penalty does not invalidate an otherwise acceptable use of provincial legislative power.

26 The appellants submitted that the VLT Act contains penal consequences because it terminates all siteholder agreements in municipalities that have voted to prohibit VLTs in accordance with the Act. Relying on this Court's decision in *Johnson v. Alberta (Attorney General)*, [1954] S.C.R. 127 (S.C.C.), they argued that the provisions of the VLT Act result in the forfeiture of VLTs, which can be characterized as a penalty. However, the termination of siteholder agreements cannot be characterized as a forfeiture within the meaning of the criminal law. At all times during a siteholder agreement, the MLC maintains ownership of the VLTs. The siteholder (in this case, the appellants) has no property interest in the machines. Therefore, when the agreement is terminated and the VLTs are removed from the siteholder's establishment, the siteholder is not required to forfeit any property. The siteholder has merely lost the opportunity to earn a percentage of the revenue that the VLTs generate.

27 That is sufficient to distinguish the present appeal from *Johnson*, *supra*, which properly identified the alleged penalty as a forfeiture. In that case, the impugned legislation specifically denied property rights in slot machines. Where the machines were being operated contrary to the legislation, the Act allowed police to confiscate those machines even if, except for the legislation, they would have been considered the property of the offender. In short, a violation of the legislation struck down in *Johnson* resulted in a loss of property. In the present case, however, the VLT Act merely allows the MLC to reclaim its own VLTs. This cannot be considered a forfeiture.

28 The conclusion that the VLT Act does not impose penal consequences makes it unnecessary to determine whether it was enacted for a criminal law purpose. Nevertheless, certain submissions made during the course of proceedings warrant a brief response. The appellants argued that the VLT Act was enacted for purposes of public morality, and that it was, therefore, an attempt to legislate criminal law. This submission is flawed on several bases. First, the trial judge found no evidence indicating that this law was enacted to regulate public morality. The province has authority to regulate gaming, and this includes provisions regulating where gaming may be conducted. Just as the province can regulate when and where alcohol may be legally consumed, so can it regulate when and where individuals can legally operate VLTs. It does not follow that, in doing so, the province is somehow regulating public morality.

29 Second, the province and individual municipalities may have any number of reasons for restricting gaming to certain locations. Some may concern the local economy, and others may be purely aesthetic or cultural. There is no basis on which to assume that the dominant purpose for prohibiting VLTs in certain locations is to regulate public morality. Indeed, the fact that the VLT Act does not affect VLTs located at racetracks or other "premises dedicated to gaming activity" suggests that the government was not attempting to condemn VLTs on any moral basis. See *Gaming Control Act*, S.M. 1996, c. 74, s. 1. Rather, it supports the interpretation that the VLT Act was designed merely to limit more "incidental" contact with VLTs - in taverns, for example - in municipalities that wish to do so.

30 Third, the presence of moral considerations does not *per se* render a law *ultra vires* the provincial legislature. In giving Parliament exclusive jurisdiction over criminal law, the *Constitution Act, 1867* did not intend to remove all morality from provincial legislation. In many instances, it will be impossible for the provincial legislature to disentangle moral considerations from other issues. For example, in the present case, it is difficult to ignore the various social costs associated with gambling and VLTs. As the Desjardins Report, *supra*, examined in detail, government-run gambling

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can have adverse social consequences, including addiction, crime, bankruptcy, and reductions in charitable gaming. The provincial government can legitimately consider these social costs when deciding how to regulate gaming in the province. The fact that some of these considerations have a moral aspect does not invalidate an otherwise legitimate provincial law.

31 The dominant purpose of the VLT Act is to regulate gaming in the province. Any moral aspects of the VLT Act fall within the doctrine of "incidental effects," recently affirmed by this Court in *Kitkatla Band*, *supra*, at para. 54, and *Global Securities Corp. v. British Columbia (Securities Commission)*, [2000] 1 S.C.R. 494, 2000 SCC 21 (S.C.C.), at para. 23. Where a law is in pith and substance related to the provincial legislative sphere, it will not be struck down merely because it has incidental effects on a federal head of power. For instance, in *Rio Hotel Ltd. v. New Brunswick (Liquor Licensing Board)*, [1987] 2 S.C.R. 59 (S.C.C.), it was held that a provincial law restricting nude entertainment at licensed taverns was valid. It is reasonable to assume that such a law would have had some incidental effects on public morality. Yet the Court found that the law was validly enacted because in pith and substance it dealt with licensing, local matters, and property and civil rights.

32 In the present appeal, the provincial government passed a law that was within a provincial head of legislative authority. Although there is a possibility that local morality may affect which municipalities choose to ban VLTs through binding plebiscites, the dominant purpose of the VLT Act is not to express moral disapproval of VLTs. In as much as there is a moral aspect to the VLT Act, this effect is incidental to the overall regulatory scheme and does not infringe on Parliament's exclusive authority to legislate criminal law.

33 In making this determination, I am mindful of the presumption of constitutionality recognized in *Reference re Farm Products Marketing Act (Ontario)*, [1957] S.C.R. 198 (S.C.C.), at p. 255, *McNeil v. Nova Scotia (Board of Censors)*, [1978] 2 S.C.R. 662 (S.C.C.), at pp. 687-688, *Re Firearms Act*, *supra*, at para. 25. When faced with two plausible characterizations of a law, we should normally choose that which supports the law's constitutional validity.

34 The Attorney General of Canada's intervention in support of the provincial government creates a situation of attempted federal-provincial cooperation. The governments, in the absence of jurisdiction, cannot by simple agreement lend legitimacy to a claim that the VLT Act is *intra vires*. However, given that both federal and provincial governments guard their legislative powers carefully, when they do agree to shared jurisdiction, that fact should be given careful consideration by the courts: *O.P.S.E.U. v. Ontario (Attorney General)*, [1987] 2 S.C.R. 2 (S.C.C.), at pp. 19-20, *Kitkatla Band*, *supra*, at paras. 72-73.

35 This principle is further bolstered in the present case by the explicit interaction of the *Criminal Code* and provincial gaming legislation. Section 207(1)(a) of the *Criminal Code* specifically creates an exception to the gaming and betting offences where a lottery scheme has been established by a province. It was first enacted in 1969 for the purpose of decriminalizing lotteries and allowing each province to determine whether it wished to establish a lottery scheme. Where no such scheme exists, the *Criminal Code* offences still apply. Parliament has intentionally designed a structure for gaming offences that affirms the double aspect of gaming and promotes federal-provincial cooperation in this area. Section 207(1)(a) removes the possibility of operational conflict and, with it, any question of paramountcy.

36 I conclude that the VLT Act in its entirety, and s. 16 in particular, are *intra vires* the provincial legislature. The Act's purposes are to regulate gaming in the province and to allow for local input on the issue of VLTs, both of which fall under the powers enumerated in s. 92 of the *Constitution Act, 1867*. It is not an attempt to legislate criminal law, as it has neither penal consequences nor a criminal law purpose. Finally, the issues of interjurisdictional immunity and paramountcy do not arise in this case, and they need not be discussed beyond what has already been stated.

C. The Claim of Improper Delegation

37 Before turning to the various *Charter* claims, a brief comment is warranted on the argument raised by the intervening group of Alberta merchants. They challenged the entire VLT Act on the ground that it constitutes an improper abdication of the legislature's law-making powers and usurps the authority of the Lieutenant Governor. These interveners submit

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that, by allowing municipalities to hold binding plebiscites, the provincial government has given them the power to make and repeal law. This, they argue, violates the provincial legislature's exclusive authority to make laws for the province.

38 This submission fails, as the interveners' argument rests on an incorrect characterization of the impugned legislation. The VLT Act does not, in any way, empower municipal voters to enact legislation. The Act has been wholly drafted, debated and enacted by the provincial legislature, and has been given Royal Assent by the Lieutenant Governor. It sets out how the municipal plebiscites will take place and what their effects will be in the relevant municipalities. The only role played by municipal electors is in initiating and voting in a plebiscite. The results of the plebiscite determine whether the prohibition in s. 3 of the VLT Act will apply in the municipality. In other words, the application of the statutory VLT prohibition is conditional upon there being a certain plebiscite result. Consequently, the VLT Act falls within the category of "conditional legislation" which was upheld by the Privy Council in *Russell v. R.* (1882), (1881-82) L.R. 7 App. Cas. 829 (Canada P.C.), at p. 835:

> . . . the Act does not delegate any legislative powers whatever. It contains within itself the whole legislation on the matters with which it deals. The provision that certain parts of the Act shall come into operation only on the petition of a majority of electors does not confer on these persons power to legislate. Parliament itself enacts the condition and everything which is to follow upon the condition being fulfilled. Conditional legislation of this kind is in many cases convenient, and is certainly not unusual, and the power so to legislate cannot be denied to the Parliament of Canada, when the subject of legislation is within its competency.

39 Through the VLT Act, the Manitoba Government has employed a statutory instrument to bind itself to respect local opinion. Nowhere does the Act, in purpose or effect, give municipal voters the power to legislate. This case is distinguishable from the *Reference re Initiative and Referendum Act (Manitoba)* (1916), 27 Man. R. 1 (Man. C.A.), upon which the interveners based their argument. There, the impugned legislation allowed voters to submit laws for approval by ballot and, if approved, the proposed law would be deemed an Act of the provincial legislature. Here, there has been no attempt to bypass the Legislative Assembly or to usurp its law-making function. The Act merely allows municipalities to decide on the applicability of the Act to their communities.

40 Finally, I would add that the interveners' argument would severely restrict Parliament and the provincial legislatures from enacting "local option" legislation, which was upheld over a century ago by the Privy Council in *Russell*, *supra*, with respect to the *Canada Temperance Act*. That decision was affirmed by the Privy Council in *Reference re Canada Temperance Act*, [1946] A.C. 193 (Ontario P.C.), and there is no need to question its continued validity as authority on this issue.

D. The Claim under s. 2(b) of the Charter

41 According to the appellants, the effect of the "deemed vote" in s. 16 of the VLT Act was to deny them the right to vote in a plebiscite under the Act and, therefore, to violate their freedom of expression in s. 2(b) of the *Charter*. There is no question since this Court's decision in *Haig v. R.*, [1993] 2 S.C.R. 995 (S.C.C.), that casting a vote is a form of expression that is protected under s. 2(b). The question in this case is whether s. 16 of the VLT Act actually violates this freedom. I conclude that it does not.

42 While *Haig* held that voting is a protected form of expression, it also concluded that there is no constitutional right to vote in a referendum. See L'Heureux-Dubé J., at pp. 1040-1041:

> A referendum is a creation of legislation. Independent of the legislation giving genesis to a referendum, there is no right of participation. The right to vote in a referendum is a right accorded by statute, and the statute governs the terms and conditions of participation. . . . In my view, though a referendum is undoubtedly a platform for expression, s. 2(b) of the *Charter* does not impose upon a government, whether provincial or federal, any positive obligation to consult its citizens through the particular mechanism of a referendum. Nor does it confer upon all citizens the right to express their opinions in a referendum. A government is under no constitutional obligation to

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> extend this platform of expression to *anyone*, let alone to *everyone*. A referendum as a platform of expression is, in my view, a matter of legislative policy and not of constitutional law. [emphasis in original]

A municipal plebiscite, like a referendum, is a creation of legislation. In the present case, any right to vote in a plebiscite must be found within the language of the VLT Act. It alone defines the terms and qualifications for voting. Accordingly, the appellants cannot complain that the VLT Act, itself, denied them the right to vote in a VLT plebiscite.

43 A *caveat* was added in *Haig* that, once the government decides to extend referendum voting rights, it must do so in a fashion that is consistent with other sections of the *Charter*. However, as the appellants submitted that they had been denied referendum voting rights on a discriminatory basis, their claim should be assessed under s. 15(1), of which more will be said below.

44 Finally, it is worth noting that the VLT Act does not prevent the residents of Winkler from voting in future plebiscites on the issue of VLTs. They have not been disenfranchised from VLT plebiscites. Like all other residents of Manitoba, they are free to initiate a plebiscite under the Act to either reinstate or remove VLTs from their municipality.

E. The Claim under s. 7 of the Charter

45 The appellants also submitted that s. 16 of the VLT Act violates their right under s. 7 of the *Charter* to pursue a lawful occupation. Additionally, they submitted that it restricts their freedom of movement by preventing them from pursuing their chosen profession in a certain location, namely, the Town of Winkler. However, as a brief review of this Court's *Charter* jurisprudence makes clear, the rights asserted by the appellants do not fall within the meaning of s. 7. The right to life, liberty and security of the person encompasses fundamental life choices, not pure economic interests. As La Forest J. explained in *Godbout c. Longueuil (Ville)*, [1997] 3 S.C.R. 844 (S.C.C.), at para. 66:

> . . . the autonomy protected by the s. 7 right to liberty encompasses only those matters that can properly be characterized as fundamentally or inherently personal such that, by their very nature, they implicate basic choices going to the core of what it means to enjoy individual dignity and independence.

More recently, *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, 2000 SCC 44 (S.C.C.), concluded that the stigma suffered by Mr. Blencoe while awaiting trial of a human rights complaint against him, which hindered him from pursuing his chosen profession as a politician, did not implicate the rights under s. 7. See Bastarache J., at para. 86:

> The prejudice to the respondent in this case . . . is essentially confined to his personal hardship. He is not "employable" as a politician, he and his family have moved residences twice, his financial resources are depleted, and he has suffered physically and psychologically. However, the state has not interfered with the respondent and his family's ability to make essential life choices. To accept that the prejudice suffered by the respondent in this case amounts to state interference with his security of the person would be to stretch the meaning of this right.

46 In the present case, the appellants' alleged right to operate VLTs at their place of business cannot be characterized as a fundamental life choice. It is purely an economic interest. The ability to generate business revenue by one's chosen means is not a right that is protected under s. 7 of the *Charter*.

F. The Claim under s. 15(1) of the Charter

47 The appellants argued that their rights under s. 15(1) of the *Charter* were violated by s. 16 of the VLT Act. This claim should be analyzed in accordance with the three-pronged test summarized by Iacobucci J. in *Law*, *supra*, at para. 88:

> (A) whether a law imposes differential treatment between the claimant and others, in purpose or effect;
>
> (B) whether one or more enumerated or analogous grounds of discrimination are the basis for the differential treatment; and

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> (C) whether the law in question has a purpose or effect that is discriminatory within the meaning of the equality guarantee.

The appellants submitted that part (A) of the test was met because s. 16 of the VLT Act distinguished between residents of Winkler and all other residents of Manitoba. They further argued that this distinction was based on the analogous ground of residence, and was discriminatory because it denied them the opportunity to vote in a binding plebiscite on the issue of VLTs.

48 There is no merit in this ground of appeal. First, although s. 16 of the VLT Act clearly makes a distinction between Winkler and other municipalities, it is implausible that residence in Winkler constitutes an analogous ground of discrimination. Residence was rejected as an analogous ground in both *Haig*, *supra*, and *R. v. Turpin*, [1989] 1 S.C.R. 1296 (S.C.C.). Further, the majority in *Corbiere v. Canada (Minister of Indian & Northern Affairs)*, [1999] 2 S.C.R. 203 (S.C.C.), clearly stated that the analogous ground recognized in that case was "Aboriginality-residence," and that "no new water is charted, in the sense of finding residence, in the generalized abstract, to be an analogous ground" (para. 15). In rejecting the claimant's s. 15 argument in *Haig*, the majority explained, at p. 1044, why residence is an unlikely analogous ground:

> It would require a serious stretch of the imagination to find that *persons moving to Quebec less than six months before a referendum date* are analogous to persons suffering discrimination on the basis of race, religion or gender. People moving to Quebec less than six months before a referendum date do not suffer from stereotyping, or social prejudice. Though its members were unable to cast a ballot in the Quebec referendum, the group is not one which has suffered historical disadvantage, or political prejudice. Nor does the group appear to be "discrete and insular". Membership in the group is highly fluid, with people constantly flowing in or out once they meet Quebec's residency requirements. [emphasis in original]

Although the Court in *Haig* left it open for residence to be established as an analogous ground in the appropriate case, I share the trial judge's view here that this is not such a case. Nothing suggests that Winkler residents are historically disadvantaged or that they suffer from any sort of prejudice.

49 However, putting the appellants' case at its best and assuming that they could establish a distinction based on an analogous ground, the legislation does not discriminate against them in any substantive sense. It is not necessary to proceed through all the contextual factors listed by Iacobucci J. in *Law*, *supra*, because it is clear that the VLT Act directly corresponds to the circumstances of Winkler residents. The Town of Winkler was singled out in s. 16 of the VLT Act because it was the *only municipality* to have held a plebiscite on the issue of VLTs. The very purpose of that section was to respect the will of Winkler residents, as expressed in their 1998 plebiscite. Viewed in the context of that plebiscite, I am not convinced that any reasonable resident of Winkler would feel that he or she has been marginalized, devalued or ignored as a member of Canadian society (see *Law*, *supra*, at para. 53). There is no harm to dignity and no violation of s. 15(1).

50 It was noted above in the s. 2(b) claim that s. 15(1) might be implicated where the opportunity to vote in a plebiscite is extended to some and withheld from others based on a prohibited ground of discrimination. This would be the case if a law prohibited members of a certain race or religion from voting in a plebiscite. However, that is not the case in this appeal. First, as previously noted, the distinction in s. 16 of the VLT Act is not based on an analogous ground. Second, the distinction does not affect the qualification and ability of Winkler residents to vote in a VLT plebiscite under the Act. They are free to initiate a plebiscite should they wish to reinstate VLTs in their community. Consequently, although s. 16 makes a distinction for Winkler residents, that distinction has nothing to do with the alleged right to vote.

VII. Conclusion and Disposition

51 These reasons support the October 31, 2002, dismissal of this appeal. The respondents are entitled to costs, and the stated constitutional questions are answered as follows:

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(1) Is *The Gaming Control Local Option (VLT) Act*, S.M. 1999, c. 44, in its entirety *ultra vires* the Legislature of the Province of Manitoba as it relates to a subject matter which is within the exclusive jurisdiction of the Parliament of Canada under s. 91(27) of the *Constitution Act, 1867*?

Answer: No.

(2) Is s. 16(1) of *The Gaming Control Local Option (VLT) Act*, S.M. 1999, c. 44, *ultra vires* the Legislature of the Province of Manitoba as it relates to a subject matter which is within the exclusive jurisdiction of the Parliament of Canada under s. 91(27) of the *Constitution Act, 1867*?

Answer: No.

(3) Is s. 16 of *The Gaming Control Local Option (VLT) Act* inconsistent with s. 2(b) of the *Canadian Charter of Rights and Freedoms*?

Answer: No.

(4) If the answer to question 3 is in the affirmative, is s. 16 of *The Gaming Control Local Option (VLT) Act* nevertheless justified by s. 1 of the *Canadian Charter of Rights and Freedoms*?

Answer: It is unnecessary to answer this question.

(5) Is s. 16 of *The Gaming Control Local Option (VLT) Act* inconsistent with s. 7 of the *Canadian Charter of Rights and Freedoms*?

Answer: No.

(6) If the answer to question 5 is in the affirmative, is s. 16 of *The Gaming Control Local Option (VLT) Act* nevertheless justified by s. 1 of the *Canadian Charter of Rights and Freedoms*?

Answer: It is unnecessary to answer this question.

(7) Is s. 16 of *The Gaming Control Local Option (VLT) Act* inconsistent with s. 15(1) of the *Canadian Charter of Rights and Freedoms*?

Answer: No.

(8) If the answer to question 7 is in the affirmative, is s. 16 of *The Gaming Control Local Option (VLT) Act* nevertheless justified by s. 1 of the *Canadian Charter of Rights and Freedoms*?

Answer: It is unnecessary to answer this question.

Appeal dismissed.

Pourvoi rejeté.

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Rescue!

The Companies' Creditors Arrangement Act

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Includes text of *Companies' Creditors Arrangement Act*.

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Justice Sewell was of the view that the case raised squarely the appropriateness of permitting "vulture funds" to participate in insolvency restructurings, finding that there was no compelling argument that the activities of vulture funds are undesirable; and it is the role of Parliament to address what limits, if any, should be placed on the activities of such funds. Here, the terms of the plan were significantly improved after it became apparent that the fund had a substantial position in the claims. The Court recognized that creditors are entitled to vote their claims in what they, as creditors, perceive to be their own economic interests, so long as their actions are not unlawful or do not result in a substantial injustice.[96] Moreover, in this case, the liquidation analysis prepared by the monitor did not lead to the conclusion that creditors would be worse off under liquidation.[97] In the result, the application to disallow the fund's vote was dismissed and the application to approve the plan was thus also dismissed.[98]

V. CONSOLIDATION OF PROCEEDINGS

The court has authority to authorize consolidation of proceedings. The caselaw has developed a set of criteria that the court will apply in considering the appropriateness of consolidating two or more proceedings. Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

For example, in *Re PSINet Ltd.*, the Court allowed consolidation of proceedings for four companies that were intertwined and essentially operated as one business.[99] The Court found that the filing of a consolidated plan avoided complex issues regarding the allocation of the proceeds realized from the sale of the assets, and that although consolidation by its nature would benefit some creditors and prejudice others, the prejudice had been ameliorated by concessions made by the parent corporation, which was also the major creditor.[100] Other cases of consolidated proceedings, such as Philip Services, Canadian Airlines, Airline Canada and Stelco, all proceeded without issues in respect of consolidation.

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96 *Ibid.* at para. 40.

97 *Ibid.* at para. 51.

98 *Ibid.* at para. 52.

99 *Re PSINet Ltd.* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]). The Court observed that the record keeping of the companies was deficient.

100 See M. Rotsztain and N. De Cicco, "Substantive Consolidation in *CCAA* Restructurings: A Critical Analysis", in J. Sarra, ed., *Annual Review of Insolvency Law, 2004* (Carswell, 2005) 331-354.

Where applicant crown corporations, business corporations, pension funds, and financial institutions together held more than $21 billion of the approximately $32 billion of asset-backed commercial paper (ABCP) at issue, the Court allowed a consolidated process to commence.[101] Each series of ABCP was issued pursuant to a trust indenture or supplemental trust indenture.[102] The trustees of each of the conduits had insufficient liquidity to make payments that were due and payable on their maturing ABCP. Each remained unable to meet its liabilities, and accordingly, each entity was insolvent.[103] Each trust indenture appointed an indenture trustee; however, the indenture trustee had no economic interest and under the circumstances, it was neither practical nor realistic to expect the indenture trustees to put forward a restructuring plan.[104] The applicants sought to put forward and obtain approval of the restructuring plan they had developed in their own right as holders of ABCP and as the real creditors of the respondents.[105] The Court concluded that the *CCAA* process allowed for meaningful efficiencies by restructuring all of the affected ABCP simultaneously, while also providing stakeholders with more certainty that the plan would be implemented. In addition, the Court observed that the *CCAA* provided a process to obtain comprehensive releases, which was a condition of participation by certain key parties.[106] The Court held that the application for a consolidated plan complied with the requirements of the *CCAA*; the relief sought in the circumstances was available under the *CCAA* and was consistent with the purpose of the statute; and the classification of creditors set out in the plan for voting and distribution purposes was appropriate.[107] Campbell J. was satisfied that under the unique circumstances of the case, the practical restructuring of the ABCP claims could only be implemented on a global basis. If there were separate proceedings, each individual plan would of necessity have been conditional on the approval of all the other plans.[108]

The Court in *Re Kerr Interior Systems Ltd.* held that a consolidation of debtors for the purposes of a plan of arrangement pursuant to the *CCAA* may be sanctioned where the consolidated plan avoids complex and potentially litigious issues, the companies are intertwined in their business operations, there has been compliance with statutory requirements and court orders, and the plan is fair and reasonable.[109] The Court held that while consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general

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[101] *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 CarswellOnt 2652 (Ont. S.C.J. [Commercial List]), affirmed 2008 CarswellOnt 4811 (Ont. C.A.), leave to appeal refused 2008 CarswellOnt 5432, 2008 CarswellOnt 5433 (S.C.C.).

[102] *Ibid.* at para. 8.

[103] *Ibid.* at para. 12.

[104] *Ibid.* at para. 8.

[105] *Ibid.* at para. 9.

[106] *Ibid.* at para. 14.

[107] *Ibid.* at para. 41.

[108] *Ibid.* at para. 39.

[109] *Re Kerr Interior Systems Ltd.*, 2008 CarswellAlta 661 (Alta. Q.B.), reversed 2009 CarswellAlta 942 (Alta. C.A.).

effect.[110] Given the intertwined nature of the business of the two debtors, the fact that they were owned by the same party, that one supplied products solely for the other, and their cross-guarantees, consolidation was appropriate.[111]

In determining whether consolidation was appropriate, the New Brunswick Court of Queen's Bench in *Re Atlantic Yarns Inc.* considered the following factors: difficulty in segregating assets; presence of consolidated financial statements; profitability of consolidation at a single location; commingling of assets and business functions; unity of interests in ownership; existence of inter-corporate loan guarantees; and transfer of assets without observance of corporate formalities.[112] In the circumstances, the Court held that consolidation was fair and reasonable.[113]

VI. COURT APPROVAL OF THE PLAN

The court has authority to approve a plan of compromise or arrangement once creditors have voted in favour of the plan in the requisite amounts. The court holds a sanctioning hearing at which it will examine three criteria: whether there has been strict compliance with all the statutory requirements; whether all materials filed and procedures carried out were authorized by the *CCAA*; and whether the plan is fair and reasonable.[114]

1. Compliance with the Statutory Requirements

In terms of the statutory requirements, the debtor corporation must have proven that it is insolvent within the meaning of the legislation. The court will also assess the appropriateness of the classes; and confirm that the meetings were held and votes conducted in compliance with the statutory scheme and that the plan was approved by the requisite double majority.[115]

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[110] *Ibid.* at para. 100.

[111] *Ibid.* at para. 101.

[112] *Re Atlantic Yarns Inc.*, 2008 CarswellNB 195 (N.B.Q.B.) at para. 34.

[113] *Ibid.* at para. 36.

[114] *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C.S.C.); *Re Dairy Corp. of Canada Ltd.*, [1934] O.R. 436 (Ont. S.C.); *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.); *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.) at p. 182, affirmed (1989), (*sub nom.* Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada) 73 C.B.R. (N.S.) 195, 34 B.C.L.R. (2d) 122 (B.C.C.A.); *Re BlueStar Battery Systems International Corp.* (2000), 25 C.B.R. (4th) 216 (Ont. S.C.J. [Commercial List]).

[115] *Re Canadian Airlines Corp.* (2000), 20 C.B.R. (4th) 1 (Alta. Q.B.), leave to appeal refused (2000), 84 Alta. L.R. (3d) 52, [2000] A.J. No. 1028 (Alta. C.A. [In Chambers]), affirmed 2000 CarswellAlta 1556 (Alta. C.A.), leave to appeal refused 2001 CarswellAlta 888, 2001 CarswellAlta 889, [2001] S.C.C.A. No. 60 (S.C.C.).

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2002 CarswellOnt 1261
Ontario Superior Court of Justice [Commercial List]

PSINet Ltd., Re

2002 CarswellOnt 1261, [2002] O.J. No. 1156, 113 A.C.W.S. (3d) 760, 33 C.B.R. (4th) 284

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

In the Matter of a Plan of Compromise or Arrangement of PSINet Limited, PSINet Realty Canada Limited, PSINetworks Canada Limited and Toronto Hosting Centre Limited, Applicants

Farley J.

Heard: March 14, 2002
Judgment: March 14, 2002
Docket: 01-CL-4155

Counsel: *Lyndon A.J. Barnes*, *Monica Creery*, for Applicants
Geoffrey B. Morawetz, for the Monitor, PricewaterhouseCoopers Inc.
Peter H. Griffin, for PSINet Inc.
Edmond F.B. Lamek, for 360Networks Services Ltd.

Subject: Corporate and Commercial; Insolvency

MOTION by corporations to sanction consolidated plan of arrangement or compromise.

***Farley J.*:**

1 This motion was for the sanctioning of the consolidated plan of arrangement or compromise of the four Canadian applicants under the *Companies' Creditors Arrangement Act* ("CCAA"). The consolidated plan was approved by the creditors of the applicants at meetings held February 28, 2002. Since that time and as permitted by the consolidated plan there have been ongoing negotiations concerning various aspects of the plan. It is a tribute to the expertise and experience of the parties involved and their counsel that they have been able to negotiate resolutions of the various points in issue with the result that this sanction motion is unopposed. I also think it commendable that the Monitor so amply demonstrated the objectivity and neutrality which is the hallmark of a court-appointed officer.

2 I am advised that while the applicants initially considered an unconsolidated plan which had the support of PSINet Inc. ("Inc."), their parent and major creditor, it was considered that the consolidated route was the way to go. The consolidated plan avoids the complex and likely litigious issues surrounding the allocation of the proceeds from the sale of substantially all of the assets of the applicants to Telus Corporation. The consolidated plan also reflected the intertwined nature of the applicants and their business operations, which businesses in essence operated as a single business and with only one of the applicants having employees. I have previously alluded to the incomplete and deficient record keeping of the applicants. While shooting oneself in the foot should not be endorsed, this is another factor favouring consolidation and the elimination of expensive allocation (amongst the four Canadian applicants) litigation.

3 I note that the consolidated plan also provides that Inc. valued its charge against the assets of PSINet Limited ("Ltd.") one of the applicants to $55 million. The Monitor, PricewaterhouseCoopers Inc. found this to be a reasonable amount and within the range of values which might reasonably be anticipated. Again however I would repeat my observation about incomplete and deficient record keeping.

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4 At the February 28th meeting of creditors, a single class of creditors, namely the unsecured creditors, voted on the consolidated plan as it then existed. Secured creditors were not affected by the plan, but were of course characterized as unsecured creditors to the extent that their claim exceeded the expected deficiency in the deemed realization of their security. 92.7% of the creditors voting, representing 98.8% in value of the claims, voted in favour of the plan. Had the votes of Inc. and other creditors affiliated with the applicants been ignored, then 92.5% of the class, representing 87.2% in value voted in favour of the plan.

5 Since the vote, 360Network Services Ltd. (and other affiliates) ("360Networks") have reached agreement with the applicants and Inc. to resolve a motion brought by 360Networks in respect of its concerns regarding the consolidation of the estates of the applicants in the plan of arrangement.

6 Similarly Inc. has made certain concessions as to the plan with an eye to making good on the condition imposed on it to make a material (albeit modest) adjustment so as to compensate the other creditors for the "frustration cost" associated with Inc.'s late blooming discovery of its security vis-à-vis Ltd. and its motion to reperfect this security.

7 The three part test for sanctioning a plan is laid out in *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.); *Sammi Atlas Inc., Re*, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]):

> (a) There must be strict compliance with all statutory requirements and adherence to the previous orders of the court;
>
> (b) All material filed and procedures carried out are to be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA or other orders of the court; and
>
> (c) The plan must be fair and reasonable.

8 It appears to me that parts (a) and (b) have been accomplished, now that Inc. has made the further concessions. The creditors have had sufficient time and information to make a reasoned decision. They have voted in favour of the consolidated plan by a significant margin over the statutory requirement, even where one eliminates the related vote of Inc. and its affiliates. In reviewing the fairness and reasonableness of a plan, the court does not require perfection. As discussed in *Sammi* at p. 173:

> 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... One must look to 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...

9 There is a heavy onus on parties seeking to upset a plan that the required majority have supported: See *Sammi* at p. 174 citing *Central Guaranty Trustco Ltd., Re*, 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List])

10 The fairness and reasonableness of a plan are shaped by the unique circumstances of each case, within the context of the CCAA. In *Canadian Airlines Corp., Re*, [2000] 10 W.W.R. 269 (Alta. Q.B.), leave to appeal refused [2000] 10 W.W.R. 314 (Alta. C.A. [In Chambers]) Paperny J. at p. 294 considered factors such as the composition of the unsecured vote, what creditors would receive on liquidation or bankruptcy as opposed to the plan, alternatives available (to the plan and bankruptcy) and the public interest. I have already discussed the first element; the third and fourth do not appear germane here. As to the second, it is clear that the creditors generally are receiving more than in a bankruptcy and to the extent that Inc. is impacted, it has consented to such impact.

11 In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C. S.C.), affirmed (B.C.C.A.),

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supra, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect. Here as well the concessions of Inc. have ameliorated that prejudice. Further I am of the view if consolidation is appropriate (and not proceeded with by any applicant for tactical reasons of minimizing valid objections), then it could be inappropriate to segregate the creditors into classes by corporation which would not naturally flow with the result that one or more is given a veto, absent very unusual circumstances (and not present here). I would also note that *Associated Freezers of Canada Inc., Re*, 36 C.B.R. (3d) 227 (Ont. Bktcy.) and *J.P. Capital Corp., Re*, 31 C.B.R. (3d) 102 (Ont. Bktcy.) which referred to prejudice to one creditor were not CCAA cases, but rather *Bankruptcy and Insolvency Act* cases; secondly *Associated Freezers* merely kept the door open for the objecting party to reconsider its position given the short notice and provided that if on reflection it wished to come back to make its submissions, it was entitled to do so for a period of time.

12 In the end result (and with no creditors objecting), I approve and sanction the consolidated plan as amended. Order to issue accordingly as per my fiat.

Motion granted.

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

Lehndorff General Partner Ltd., Re

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

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

Farley J.

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

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

Subject: Corporate and Commercial; Insolvency

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

***Farley J.*:**

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

(a) short service of the notice of application;

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

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

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

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

(f) certain other ancillary relief.

2 The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issues under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermögensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the *Limited Partnership Act* , R.S.O. 1990, c. L.16 ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the *Partnership Act* , R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of intercorporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

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

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

(b) The restructuring of existing project financing commitments.

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

(d) Elimination or reduction of certain overhead.

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

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

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

(h) Consolidation of entities in the Group; and

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

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

4 "Instant" debentures are now well recognized and respected by the courts: see *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44 (N.B. Q.B.) , at pp. 55-56, varied on reconsideration (1988), 68 C.B.R. (N.S.) 170 (N.B. Q.B.) , reversed on different grounds (1988), 69 C.B.R. (N.S.) 161 (N.B. C.A.) , at pp. 165-166; *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) at pp. 250-251; *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (sub nom. *Ultracare Management Inc. v. Gammon*) (1990), 1 O.R. (3d) 321 (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

5 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659 at p. 661, 16 C.B.R. 1, [1934] 4 D.L.R. 75 ; *Meridian Developments Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215 (Alta. Q.B.) at pp. 219-220; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R.

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(2d) 361 (Q.B.) , at pp. 12-13 (C.B.R.); *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.) , at pp. 310-311, affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.) .; *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra, at p. 307 (O.R.); *Fine's Flowers v. Fine's Flowers (Creditors of)* (1992), 7 O.R. (3d) 193 (Gen. Div.) , at p. 199 and "Reorganizations Under The Companies' Creditors Arrangement Act", Stanley E. Edwards (1947) 25 Can. Bar Rev. 587 at p. 592.

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

7 One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the *Bankruptcy Act* , R.S.C. 1985, c. B-3, before the amendments effective November 30, 1992 to transform it into the *Bankruptcy and Insolvency Act* ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an application under the BIA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 318 and *Re Associated Investors of Canada Ltd.* (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) at pp. 245, reversed on other grounds at (1988), 71 C.B.R. (N.S.) 71 (Alta. C.A.) . It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See *Re Associated Investors of Canada Ltd.* , supra, at p. 318; *Re Amirault Fish Co.*, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) at pp. 187-188 (C.B.R.).

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

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

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act* , whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,

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(*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;

(*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and

(*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

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

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

11 The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see *Gaz Métropolitain v. Wynden Canada Inc.* (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) at pp. 290-291 and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 311-312 (B.C. C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (C.A. Que.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

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

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

12 It was submitted by the applicants that the power to grant a stay of proceedings may also extend to a stay of proceedings against non-applicants who are not companies and accordingly do not come within the express provisions of the CCAA. In support thereof they cited a CCAA order which was granted staying proceedings against individuals who guaranteed the obligations of a debtor-applicant which was a qualifying company under the terms of the CCAA: see *Re Slavik* , unreported, [1992] B.C.J. No. 341 [now reported at 12 C.B.R. (3d) 157 (B.C. S.C.)]. However in the *Slavik*

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situation the individual guarantors were officers and shareholders of two companies which had sought and obtained CCAA protection. Vickers J. in that case indicated that the facts of that case included the following unexplained and unamplified fact [at p. 159]:

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

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

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

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

14 I am not persuaded that the words of s. 11 which are quite specific as relating as to a *company* can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in *Campeau v. Olympia & York Developments Ltd.* unreported, [1992] O.J. No. 1946 [now reported at 14 C.B.R. (3d) 303 (Ont. Gen. Div.)] at pp. 4-7 [at pp. 308-310 C.B.R.].

The Power to Stay

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

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

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

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

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

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

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

Gibbs J.A. continued with this comment:

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

(emphasis added)

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

I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra (a "Mississauga Derailment" case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

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

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

Goodman J. (as he then was) in *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in *Edmeades v. Thames Board Mills Ltd.*, [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in *Edmeades* was approved by Lord Justice Davies in *Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis)*, [1972] 1 All E.R. 430, *(*sub nom. *Lane v. Willis; Lane v. Beach)* [1972] 1 W.L.R. 326 (C.A.) .

. . . . .

In *Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 , appeal allowed by consent without costs *(*sub nom. *Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.)* 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.) , Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:

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> The principles which must govern in these matters are clearly stated in the case of *Empire Universal Films Ltd. et al. v. Rank et al.*, [1947] O.R. 775 at p. 779, as follows [quoting *St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al.*, [1936] 1 K.B. 382 at p. 398]:
>
> > (1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.

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

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

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

19 It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See *Lindley on Partnership* , 15th ed. (London: Sweet & Maxwell,

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1984), at pp. 33-35; *Seven Mile Dam Contractors v. R.* (1979), 13 B.C.L.R. 137 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad A. Milne, (1985) 23 Alta. L. Rev. 345, at pp. 350-351. Milne in that article made the following observations:

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

20 It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, "The Control Test of Investor Liability in Limited Partnerships" (1983) 21 Alta. L. Rev. 303; E. Apps, "Limited Partnerships and the 'Control' Prohibition: Assessing the Liability of Limited Partners" (1991) 70 Can. Bar Rev. 611; R. Flannigan, "Limited Partner Liability: A Response" (1992) 71 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner — the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: *Control Test* , (1992), supra, at pp. 524-525. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-à-vis any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

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

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

Application allowed.

Footnotes

* As amended by the court.

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2008 NBBR 144, 2008 NBQB 144
New Brunswick Court of Queen's Bench

Atlantic Yarns Inc., Re

2008 CarswellNB 195, 2008 NBBR 144, 2008 NBQB 144, 169 A.C.W.S. (3d) 20, 333 N.B.R. (2d) 143, 42 C.B.R. (5th) 107, 855 A.P.R. 143

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

And IN THE MATTER OF ATLANTIC YARNS INC., a body corporate and ATLANTIC FINE YARNS INC., a body corporate

RE: GE CANADA FINANCE HOLDING COMPANY MOTION

P.S. Glennie J.

Heard: April 1, 2008
Judgment: April 1, 2008
Written reasons: April 11, 2008
Docket: S/M/92/07

Counsel: Orestes Pasparakis, M. Robert Jette Q.C. for GE Canada Finance Holding Company
Joshua J.B. McElman, Rodney E. Larsen for Atlantic Yarns Inc., Atlantic Fine Yarns Inc.
James H. Grout, Sara Wilson for Integrated Private Debt Fund Inc., First Treasury Financial Inc.
John B.D. Logan for Province of New Brunswick
William C. Kean for Paul Reinhart Inc., Staple Cotton Co-operative

Subject: Insolvency

MOTION by secured creditor challenging voting procedures set out in relation to proposed plan of compromise and arrangement filed by debtors under *Companies' Creditors Arrangement Act*.

***P.S. Glennie J.*:**

1 Atlantic Yarns Inc. ("AY") and Atlantic Fine Yarns Inc. ("AFY") obtained relief pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c-36, as amended (the "CCAA") by order of this Court dated October 26, 2007 (the "Initial Order").

2 On December 18, 2007, this Court issued a Claims Procedure Order (the "Claims Procedure Order") and on February 20, 2008 it issued a Creditors Meeting Order (the "Meeting Order").

3 Subsequent to the issuance of the Meeting Order the parties determined whether there could be a global resolution of all outstanding issues. When no resolution could be realized, one of the secured creditors of AY and AFY (collectively "the Companies"), GE Canada Finance Holding Company ("GE"), brought this motion to address the manner in which voting on the proposed Plan of Arrangement is to be conducted. On April 1, 2008 I denied GE's motion with reasons to follow. These are those reasons.

4 GE's submission is that the voting procedures set out in the Meeting Order are improper in that they violate the express provisions of both the Initial Order and the Claims Procedure Order; in that the procedures are manifestly unfair

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and unreasonable; and in that they appear to be designed to silence GE's objections by gerrymandering the voting and diluting GE's voting rights.

5 In particular, GE asserts that there should be no consolidation of the creditors of the Companies for voting purposes. GE says each of AY and AFY should hold separate meetings with their creditors. As well, GE argues that the current treatment of the secured creditor class is flawed. It says that either GE ought to be in a separate class or the secured claims ought to be valued and voted in accordance with their value.

6 The Companies filed a consolidated plan of compromise and arrangement (the "proposed Plan") with this Court on February 19, 2008. The proposed Plan includes two classes of creditors for the purposes of voting on the proposed Plan: a Secured Class (all creditors of each of the Companies holding any security regardless of the value of their security) and an Unsecured Class (all unsecured creditors of each of the Companies).

7 The Court Appointed Monitor of the Companies, Pricewaterhouse Coopers Inc., delivered a report to the Companies' creditors dated February 21, 2008 which report contains the following:

> **The Plan**
>
> The Applicants have filed a Joint Plan of Arrangement the key Financial Elements of which are:
>
> • Unsecured creditors will received up to 90% of their claim over a relatively short period of time; and
>
> • Secured Creditors will be afforded payments in respect of their claims based on an amount that in all cases exceeds the liquidation value of the assets held as security.
>
> **Alternatives to the Plan**
>
> These Companies operate in northern New Brunswick, and the filing of this Plan was in response to a notice from a secured creditor of its intention to appoint a Receiver. It is a virtual certainty that if this plan is not approved, the secured creditor will appoint a receiver and will liquidate the assets subject to its charges by a sale, possibly under Court supervision.
>
> There is a little likelihood that any other party will purchase these assets to operate in situ.
>
> **Liquidation Ananlysis**
>
> The Monitor has considered and reviewed a series of different liquidation analysis, and there is one common theme — the unsecured creditors will receive nothing under any realization plan.
>
> Counsel to the Companies and the Monitor have reviewed the security held by the various secured creditors and concluded that the various security interests are duly registered, filed and recorded, and accordingly create valid and enforceable security against the Applicants.
>
> As can be seen from the Plan terms and conditions, the Secured Creditors holding first charges on the assets of the Companies are being asked to take write downs in their positions. Each of these Secured Creditors has prepared their own analysis which has generally been shared with the Monitor and in the event of a liquidation the Monitor believes that each of such secured creditors will receive a shortfall greater than the alternative provided for in the Plan.
>
> Accordingly, there would be nothing available for distribution to the Unsecured Creditors.
>
> The Secured Creditors will likely wish to consider a sale on a going concern basis. It is the opinion of the Monitor that such a sale is unlikely (except perhaps back to the existing owner) and regardless, the value of the assets that will be realized will be close to the liquidation values.

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Consequences of Rejecting the Plan

As noted above, if the Plan is rejected by the Creditors or the Court, the assets will be liquidated and:

• Approximately 400 direct jobs will be lost in a largely export oriented business located in a high unemployment area of Canada;

• Approximately 600 indirect jobs will be lost in Canada, with great impact on the remote communities of Atholville and Pokemouche, New Brunswick;

• The Unsecured Creditors will receive nothing on their claims, which in some cases will result in further hardship and business closures.

Monitor's Recommendation

It is the recommendation of the Monitor that ALL affected creditors should approve the Plan.

As a result, creditors are encouraged to send in positive voting ballots and/or proxies as soon as possible.

8 GE argues that from the start of these CCAA proceedings the Initial Order directed that each of the AY and AFY convene separate creditors' meetings. Paragraph 24 of the Initial Order provides as follows:

Each Applicant shall, subject to the direction of this Court, summon and convene meetings between each Applicant and its secured and unsecured creditors under the Plan to consider and approve the Plan (collectively, the "Meetings").

9 GE says the Claims Procedure Order directed the valuation of secured claims and required all secured claims to be valued in accordance with the realizable value of the property subject to security. Paragraph 9 of the Claims Procedure Order provides:

9. THIS COURT ORDERS that any Person who wishes to assert a Claim against the Applicants, other than an Excluded Claim, must file a properly completed Proof of Claim, together with all supporting documentation, including copies of any security documentation and a valuation of such Creditor's security if a Secured Claim is being asserted, with the Monitor by 5:00 p.m. on January 15, 2008 (defined herein as the Claims Bar Date). The Applicants will be allowed to review the Proofs of Claim and Monitor will provide copies to the Applicants of any Proofs of Claim that they may request from time to time.

10 The Claims Procedure Order defines 'Secured Claims' as follows:

...any Claim or portion thereof, other than the Excluded Claim, which is secured by a validly attached and existing security interest...which was duly and properly registered or perfected in accordance with applicable legislation at the Filing date or in accordance with the Initial Order, to the extent of the realizable value of the property of the Applicants subject to such security having regard to, among other things, the priority of such security.

11 The Proof of Claim form approved in the Claims Procedure Order required creditors to submit an estimate of the value of their security with their claim, and the approved Notice of Disallowance/Revision indicates that secured claims are to be recognized:

to the extent of the value of the assets encumbered by such security and subject to any prior encumbrances or security interests.

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12 On January 22, 2008, the Monitor accepted GE's claim and valuation regarding AFY but delivered a Notice of Disallowance in respect of part of GE's claim against AY. The Notice of Disallowance reserved the Monitor's right to value GE's security in respect of this claim if an agreement could not be reached.

13 On January 31, 2008, for the first time, GE challenged the Companies' CCAA process and sought an alternative course to the Companies' restructuring efforts. GE sought a parallel sales process for the Companies, either on a turn key or piecemeal basis. GE was also critical of the Companies and their failures to meet certain deadlines previously promised by them under the CCAA process. As a consequence, GE withdrew its support of the Companies' CCAA process.

14 As mentioned, on February 19, 2008 AY and AFY filed a consolidated plan of compromise and arrangement with this Court. The proposed Plan is on a joint and consolidated basis for the purpose of voting on the proposed Plan and receiving distributions under the proposed Plan. The proposed Plan consolidated the Creditors of AY and AFY and allowed all secured claims to be recognized in accordance with their face amount, not their actual value.

15 GE asserts that the Companies' attempt to fundamentally change the Court's mandated process "came on the heels of GE's opposition the Companies' plans."

16 Subsequent to the issuance of the Initial Order and the Claims Procedure Order, the Meeting Order was issued by this Court on February 20, 2008 and provides that only two classes of creditors for voting on the proposed Plan: a secured class of all creditors of both Companies and an unsecured class of all unsecured creditors of both Companies; that secured creditors be permitted to vote the face amount of their claim, regardless of the value of their claims; and that GE be classified with all of the other secured creditors.

17 GE asserts that the effect of the Meeting Order is to consolidate all of the Creditors and permit them to vote the face amount of their claims which GE asserts "serves to swamp GE's vote."

18 GE has a first charge over the equipment of each of AY and AFY. It obtained an expert valuation report early on in the CCAA process and has provided that valuation to the Companies and the Monitor. Based on the valuation GE says it would recover the full amount of its claims plus accrued interest and costs in an orderly liquidation of the equipment.

19 GE says its position is very different form the other creditors being compromised under the proposed Plan. GE has security over the Companies' equipment which ought to cover its claims. GE asserts that no other creditor has the same relationship with the Companies or their assets.

20 Thus, the CCAA process in this case essentially involves two differing interests. On the one hand there are stakeholders, including the Province of New Brunswick, which collectively appear to have lost tens of millions of dollars, as well as the hundreds of employees who currently have no employment. These stakeholders have already suffered a loss. On the other hand, there is GE, which had sufficient security at the time of filing to cover its claims.

21 In spite of its unique interest, GE asserts that the Companies have placed GE in a class of creditors where there is no commonality of interest. GE argues that the Companies have gerrymandered the process to try to prevent GE from properly exercising its voting rights.

22 It is obvious that GE wants to be able to vote down, or veto, the Companies' proposed consolidated Plan of Arrangement on its own. It wants the right to jettison the proposed Plan. No other stakeholder supports GE's position.

23 The Court appointed Monitor says the proposed Plan of Arrangement and the process which is now in place for the creditors' meeting and the voting process are fair and equitable. In this regard, the Monitor has confirmed that even if this Court were to order two separate creditors meetings with an unconsolidated vote, GE would not be able to veto the proposed consolidated Plan of Arrangement on its own. It should also be noted that GE does not object to the actual proposed Plan of AY and AFY being made on a consolidated basis. It is the voting process that it has a problem with. GE asserts that by consolidating the votes of the Companies' creditors, an "enormous" prejudice to GE is created. However,

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the Court appointed Monitor has confirmed that there is no prejudice resulting in this regard because GE could not vote down the proposed Plan on its own even if there were two separate meetings and creditors' votes were not consolidated.

24 It is clear that GE no longer supports the Companies and wants to immediately enforce its security and get paid out now rather than waiting until later.

25 As mentioned, the Monitor has confirmed that the voting process as it is now structured for the April 2nd meeting of creditors is equitable. The Monitor is of the opinion that the proposed Plan is fair to all parties.

26 According to its Fourth Report dated March 27, 2008, the Monitor says it is not aware of any creditor, other than GE, which would be voting against the proposed Plan.

27 GE's position is dealt with in the proposed Plan of Arrangement in paragraph 4.3(b) as follows:

> **b) GE Canada Finance Holding Company**
>
> GE shall receive 100% of the amount of its Proven Distribution Claim excluding any Claim for costs, penalties, accelerated payments or increased interest rates resulting from any default of either of the Atlantic Yarn Companies occurring prior to the Plan Implementation Date as follows:
>
> > (i) All accrued interest not paid as of the Plan Implementation Date shall be paid within 30 days of the Sanction order;
> >
> > (ii) Interest shall accrue at the non-default rate and be paid monthly in arrears;
> >
> > (iii) Principle repayment shall be deferred until and commence on January 31, 2009 and continue in 48 equal monthly installments until paid in full; and
> >
> > (iv) The Proven Distribution Claims of GE shall be secured by the existing Charges held by GE subject to the February DIP Order.

28 The Monitor says that the Province of New Brunswick revisions which have been made to the proposed Plan improve the position of GE by virtue of increasing cash flow and deferring cash expenditures until after GE is repaid.

Consolidation of Creditors

29 GE wants separate creditors meetings for each of the Companies and that there not be a consolidation of the Companies' creditors for the purpose of voting on the proposed Plan.

30 AY and AFY are affiliated debtor companies within the meaning of section 3 of the CCAA.

31 Although the Companies are distinct legal entities, they are intertwined in that they are both wholly owned subsidiaries of Sunflag Canada Inc.; there is a commingling of business functions between the Companies in that the marketing divisions, upper employee management, finance management and most suppliers for the Companies are the same, and the employees of both Companies are represented by the same union. As well, AY has guaranteed certain indebtedness of AFY.

32 In addition, for the purposes of its security, GE treated the Companies as intertwined or linked by virtue of cross default provisions contained in the security held by GE from each of the Companies.

33 In *Rescue! The Companies' Creditors Arrangement Act*, by Dr. Janis Sarra, Carswell 2007, the author writes at page 242:

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The court will allow a consolidated plan of arrangement or compromise to be filed for two or more related companies in appropriate circumstances. For example, in *PSINet Ltd.* the Court allowed consolidation of proceedings for four companies that were intertwined and essentially operated as one business. The Court found the filing of a consolidated plan avoided complex issues regarding the allocation of the proceeds realized from the sale of the assets, and that although consolidation by its nature would benefit some creditors and prejudice others, the prejudice had been ameliorated by concessions made by the parent corporation, which was also the major creditor. Other cases of consolidated proceedings such as *Philip Services Canadian Airlines, Air Canada and Stelco*, all proceeded without issues in respect of consolidation.

Generally, the courts will determine whether to consolidate proceedings by assessing whether the benefits will outweigh the prejudice to particular creditors if the proceedings are consolidated. In particular, the court will examine whether the assets and liabilities are so intertwined that it is difficult to separate them for purposes of dealing with different entities. The court will also consider whether consolidation is fair and reasonable in the circumstances of the case.

34 In *Northland Properties Ltd., Re*, [1988] B.C.J. No. 1210 (B.C. S.C.) Justice Trainor writes:

In *Baker and Getty Financial Services Inc.*, U.S. Bankruptcy Court, N.D. Ohio (1987) 78 B.R. 139, the court said:

> The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition.

The Court then went on to list seven factors which had been developed to assist in the balancing of interests. Those factors are:

1. difficulty in segregating assets;
2. presence of consolidated financial statements;
3. profitability of consolidation at a single location;
4. commingling of assets and business functions;
5. unity of interests in ownership;
6. existence of intercorporate loan guarantees; and
7. transfer of assets without observance of corporate formalities.

35 In *PSINET Ltd., Re* (2002), 33 C.B.R. (4th) 284 (Ont. S.C.J. [Commercial List]) Justice Farley noted that consolidation of creditors may be appropriate in certain cases where, for example, the nature of the businesses was intertwined, the businesses were operated as a single business or where the allocation of value and claims between the businesses would be burdensome. He discusses consolidation at paragraph 11 as follows:

> In the circumstances of this case, the filing of a consolidated plan is appropriate given the intertwining elements discussed above. See *Northland Properties Ltd., Re*, 69 C.B.R. (N.S.) 266 (B.C. S.C.), affirmed (B.C.C.A.), *supra*, at p. 202; *Lehndorff General Partner Ltd., Re*, 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p.31. While consolidation by its very nature will benefit some creditors and prejudice others, it is appropriate to look at the overall general effect. Here as well the concessions of Inc. have ameliorated that prejudice. Further I am of the view if consolidation is appropriate (and not proceeded with by any applicant for tactical reasons of minimizing valid objections), then it could be inappropriate to segregate the creditors into classes by corporation which would not

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naturally flow with the result that one or more is given a veto absent very unusual circumstances (and not present here).

36 In my opinion the nature of the businesses of AY and AFY were intertwined and, looking at the overall general effect, consolidation is fair and reasonable in the circumstances of this case.

Voting Value of Assets Secured versus Voting Value of Claim

37 GE wants the claims of secured creditors to be allowed only to the extent of the realizable value of the property of the Companies subject to the security underlying the claim and that any portion of a claim in excess of the underlying security should be listed as an unsecured claim.

38 Section 12 of the CCAA provides as follows:

> 12.(1) For the purposes of this Act, "claim" means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act*.
>
> (2) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor shall be determined as follows:
>
> > (a) the amount of an unsecured claim shall be the amount
> >
> > > (i) in the case of a company in the course of being wound up under the *Windings-up and Restructuring Act*, proof of which has been made in accordance with that Act,
> > >
> > > (ii) 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*, proof of which has been made in accordance with that Act, or
> > >
> > > (iii) in the case of any other company, proof of which might be made under the *Bankruptcy and Insolvency Act*, but if the amount so provable is not admitted by the company, the amount shall be determined by the court on summary application by the company or by the creditor; and
> >
> > (b) the amount of a secured claim shall be the amount, proof of which might be made in respect thereof under the *Bankruptcy and Insolvency Act* if the claim were unsecured, but the amount if not admitted by the company shall, in the case of a company subject to pending proceedings under the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act*, be established by proof in the same manner as an unsecured claim under the *Winding-up and Restructuring Act* or *Bankruptcy and Insolvency Act*, as the case may be, and in the case of any other company the amount shall be determined by the court on summary application by the company or the creditor.
>
> (3) Notwithstanding subsection (2), the company may admit the amount of a claim for voting purposes under reserve of the right to contest liability on the claim for other purposes, and nothing in this Act, the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act* prevents a secured creditor from voting at a meeting of secured creditors or any class of them in respect of the total amount of a claim as admitted.

39 In my view, the amount of a secured claim is the amount admitted by the company governed by the CCAA after receiving a proof of the claim. This was the legislative intent. Nowhere in section 12, or anywhere else in the CCAA, is the limit of the value of a secured creditor's claim to be the realizable value of the assets secured. Where a company governed by the CCAA has developed a plan for its reorganization, the value of a claim should be determined in accordance with paragraph 12(2)(b). The CCAA does not establish a requirement or a procedure for valuing claims. The CCAA is broad and flexible so that Courts can apply the legislation with the overall purpose of restructuring in the context of the facts for any given company.

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40 The value of a secured creditor's claim is the amount outstanding. In my opinion, to require a valuation based on realizable value for voting ignores the value of the security in reorganization and the legislative intent of the CCAA.

41 I am of the view that the relief sought by GE in this regard is an attempt to maneuver for a better voting position amoung the Companies' secured creditors. It is attempting to fortify its bargaining position in order to negotiate with the Companies for a better deal pursuant to the proposed Plan.

42 If GE's request in this regard is granted and the claims of the Companies' secured creditors are limited to the realizable value of their security, GE would be able to trump the interests of other stakeholders who would benefit from a plan of arrangement or continuation of the Companies' business. The Quebec Superior Court in *Boutiques San Francisco Inc., Re* (2004), 5 C.B.R. (5th) 174 (C.S. Que.), notes as follows:

> Surely, maintaining the status quo involves balancing the interests of all affected parties and avoiding advantages to some of the others. Under the CCAA, the restructuring process and general interest of all creditors should always be preferred over the particular interests of individual ones.

43 In *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), the Court notes:

> The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. **It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning amoung the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed.** The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. **The court's primary concerns under the CCAA must be for the debtor and all of the creditors:** *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* (1990), 4 C.B.R. (3d) 311 at pp 315-318. [Emphasis Added]

44 In my opinion, GE is clearly an aggressive creditor maneuvering for positioning in order to get itself into a position to veto the proposed Plan.

45 I am satisfied that the purpose of the proposed Plan is to provide a fair recovery to the creditors of AY and AFY and to successfully restructure the Companies as a going concern. The Monitor has confirmed that the Companies have acted in good faith.

46 The Monitor says it was never its intention that the Proof of Claim forms were being completed by creditors of the Companies for voting purposes. Counsel for GE says what the Monitor had "in its minds eye" is irrelevant.

47 Counsel for GE goes on to say that he does not understand how there could be any misunderstanding with respect to the purpose of the Order being to determine the value of creditors claim for the purpose of voting. At the hearing of this Motion counsel for GE asked: "*If a creditor was under a misunderstanding whose lookout was it? Is it somebody who reads the reasonable words and relies on them, GE, or is it somebody whose interpretation seems to be contrary to the words of this document?*"

48 Counsel for Integrated Private Debt Fund Inc. and First Treasury Financial Inc. counters by saying that GE's interpretation is inconsistent with the wording of the Order and inconsistent with CCAA practice.

49 In my opinion, given the overall purpose and intent of the CCAA, the relief sought by GE with this Motion is not fair and reasonable. It is an attempt by GE to obtain a better voting position and to trump the rights of other secured

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creditors, none of which support GE's Motion. No other secured creditor supports the voting scheme sought by GE. The purpose of the proposed Plan is to provide a fair recovery to the creditors of AY and AFY and to successfully restructure the Companies as a going concern.

50 In the result, GE's request that the claims of the Companies' secured creditors be allowed only to the extent of the realizable value of the property of the Companies subject to the security underlying the claim, and that any portion of a claim in excess of the value of the underlying security be listed as and unsecured claim, is denied.

Classification of Creditors

51 GE also wants to be put in a separate class of creditors by itself for the purposes of voting on the proposed Plan.

52 Madam Justice Paperny of the Alberta Court of Queen's Bench set out the starting point for determining the classification of creditors under the CCAA in *Canadian Airlines Corp., Re*, [2000] A.J. No. 1693 (Alta. Q.B.) at paragraph 14 where she writes:

> The starting point in determining classification is the statue under which the parties operating and from which the court obtains its jurisdiction. The primary purpose of the C.C.A.A. is to facilitate the re-organization of insolvent companies, and this goal must be given proper consideration at every stage of the C.C.A.A. process, including classification of claims. See for example, *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta Q.B.).

53 Classification of creditors must be based on a commonality of interest and is a fact driven determination that is unique to the particular circumstances of every case. In *Canadian Airlines Corp., Re*, *supra*, Justice Paperny writes at paragraphs 16-18:

> 16 A frequently cited description of the method of classification of creditors for the purposes or voting on a plan, under the C.C.A.A., is *Sovereign Life Assurance Co. v. Dodd* (1891) [1892] 2 Q.B. 573, (Eng. C.A.).
>
> 17 At page 583 (Q.B.), Bowen L.J. writes:
>
>> The word 'class' is vague and to find out what is meant by it, we must look at the scope of the section which is a section enabling, the court to order a meeting of a class of creditors to be called. It seems plain that we must give such a meaning to the term 'class' as will prevent the section, being so worked as to result in confiscation and injustice, and that it must be confined to those persons, whose rights are not so dissimilar as to make it impossible for them to consult together with the view to their common interest.
>
> This test has been described as the "commonality of interest" test. All counsel agree that this is the test to apply to classification of claims under the C.C.A.A. However, there is a dispute on the types of interests that are to be considered in determining commonality.
>
> 18 Generally, the cases hold that classification is a fact-driven determination unique to the circumstances of every case upon which the court should be loathe to impose rules for universal application, particularly in light of the flexible, and remedial jurisdiction involved: see, for example, *Re Fairview Industries Ltd.* (1991) 11 C.B.R. (3d) 71 (N.S.T.D.)

54 Justice Blair writing for the Ontario Court of Appeal in *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.) discussed the principles to be considered by the courts with respect to the question of commonality of interest as follows:

> 22 These views have been applied in the CCAA context. But what comprises those "not so dissimilar" rights and what are the components of the "common interest" have been the subject of debate and evolution over time. It is clear that classification is a fact-driven exercise, dependent upon the circumstances of each particular case. Moreover,

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given the nature of the CCAA process and the underlying flexibility of that process — a flexibility which is its genius — there can be no fixed rules that must apply in all cases.

23 In *Re Canadian Airlines Corp.* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), Paperny J. nonetheless extracted a number of principles to be considered by the courts in dealing with the commonality of interest test. At para. 31 she said:

> In summary, the cases establish the following principles applicable to assessing commonality of interest:
>
> 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
>
> 2. The interests to be considered are the legal interest that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as liquidation.
>
> 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if possible.
>
> 4. In placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
>
> 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
>
> 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.

55 In my opinion, the proposed classification of creditors as set forth in the proposed Plan should not be amended. GE should not be placed in its own class of creditors. I am of the view that the Companies' secured creditors, including GE, should remain together in the proposed secured creditor class. All of the Companies' secured creditors have commonality of interests when viewed in light of both the non-fragmentation approach and the object of the CCAA, which is to facilitate reorganizations in a way that is fair and reasonable, and for the benefit of all stakeholders. The secured creditors have similar interests in relation to the Companies, which include: the nature of the debt owed to the secured creditors by the Companies, that is money advanced as a loan; the type of security held by the secured creditors, that is priority in the Companies' assets and property; the secured creditors all generally have the same enforcement remedies under their security; the secured creditors are all sophisticated lenders who are in the business and aware of the gains and possible risk, and the secured creditors have all dealt with the Companies over an extended period of time.

56 Moreover, the Companies' secured creditors' rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interests. There are inter-creditor agreements that were clearly negotiated among the majority of secured creditors. There is no evidence that the secured creditors will be unable to consult together with a view to their common interests under the proposed Plan, or that they will be unable to assess their legal entitlement as creditors after the proposed Plan.

57 GE is the only secured creditor which opposes the proposed classification scheme. However, Counsel for the Companies argues that under the proposed Plan GE stands to recover the most of any secured creditor. Under the proposed Plan GE will receive almost the entire amount due to it. The Monitor is of the view that GE is being treated fairly and will not be prejudiced as a result of the proposed classification.

58 It must be remembered that the relief GE seeks, namely that it be placed in its own class, stems from its disapproval of the proposed Plan and its apparent goal to position itself to veto power in order to defeat the proposed Plan.

59 In my view, the classification GE seeks would result in a fragmented approach that could jeopardize and likely defeat the proposed Plan. It would empower GE with the ability to veto the proposed Plan so that it may immediately

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liquidate its security, to the detriment of all stakeholders of the Companies. As Justice Blair, writing for the Ontario Court of Appeal in *Stelco Inc., Re*, supra, explained:

> Finally, to hold the classification and voting process hostage to the vagaries of a potentially infinite variety of disputes as between already disgruntled creditors who have been caught in the maelstrom of a CCAA restructuring, runs the risk of hobbling that process unduly. It could lead to the very type of fragmentation and multiplicity of discrete classes or subclasses of classes that judges and legal writers have warned might well defeat the purpose of the Act: see Stanley Edwards "Reorganizations under the Companies Creditors Arrangement Act"; Ronald N. Robertson Q.C., "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association — Ontario Continuing Legal Education; Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd., supra, at para 27; Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada, supra; Sklar-Peppler, supra; Re Woodwards Ltd., supra.
>
> In the end, it is important to remember that classification of creditors, like most other things pertaining to the CCAA, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny J. noted in Re Canadian Airlines, the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans.

60 In my view, the proposed classification in this case as drafted by the Companies and the Monitor, namely a division between secured and unsecured creditors, is both fair and reasonable. It is the most appropriate classification scheme based on commonality of interest and the non-fragmentation approach. Moreover, the proposed scheme is in accordance with the underlying purpose of the CCAA, namely the successful reorganization of companies.

61 In *Federal Gypsum Co., Re*, [2007] N.S.J. No. 559 (N.S. S.C.) Justice McAdam writes at paragraph 21:

> The flexibility afforded the Court, in respect to CCAA applications, is to ensure that Plans of Arrangement and compromise are fair and reasonable as well as designed to facilitate debtor reorganization. Justice Romaine, in *Ontario v. Canadian Airlines Corporation*, [2001] A.J. No. 1457, 2001 ABQB 983, at paras. 36-38 stated:
>
>> [36] The aim of minimizing prejudice to creditors embodied in the CCAA is a reflection of the cardinal principle of insolvency law: that relative entitlements created before insolvency are preserved: *R. v. Goode*, *Principles of Corporate Insolvency Law*, 2nd ed. (London: Sweet & Maxwell, 1997) at 54. While the CCAA may qualify this principle, it does so only when it is consistent with the purpose of facilitating debtor reorganization and ongoing survival, and in the spirit of what is fair and reasonable.
>>
>> [37] Paperny J. (as she then was) also discussed the purpose of the CCAA in *Re Canadian Airlines Corp.* (2000), 265 A.R. 201 (Q.B.), aff'd [2000] A.J. No. 1028 leave refused 2001 S.C.C.A No. 60. At para. 95, she stated that the purpose of the CCAA is to facilitate the reorganization of debtor companies for the benefit of a broad range of constituents.
>>
>> [38] Paperny J. also noted in para. 95 that, in dealing with applications under the CCAA, the court has a wide discretion to ensure the objectives of the CCAA are met. At para. 94, she identified guidance for the exercise of the discretion in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) at p. 9 as follows:
>>
>>> Fairness' and 'reasonableness' are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers

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> given to the judiciary by the legislation which makes its exercise in equity — and 'reasonableness' is what lends to objectivity to the process.

62 A plan under the CCAA can be more generous to some creditors but still be fair to all creditors. Where a particular creditor has invested considerable money in the debtor to keep the debtor afloat, that creditor is entitled to special treatment in the plan, provided that the overall plan is fair to all creditors: *Uniforêt inc., Re* (2003), 43 C.B.R. (4th) 254 (C.S. Que.).

63 The classification of classes of secured creditors must take into account variations tailored to the situations of various creditors within a particular class. Equality of treatment, as opposed to equitable treatment, is not a necessary, nor even a desirable goal: *Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.); *Minds Eye Entertainment Ltd. v. Royal Bank*, 2004 CarswellSask 192 (Sask. C.A.).

64 It is clear that the objective of GE in this case is to defeat the proposed Plan and in order to have the ability to do so it wants to gain veto power. Allowing GE's motion would, in my opinion, doom the proposed Plan because GE wants to be in a position to veto it and have it fail.

65 Counsel for GE suggested at the hearing of this Motion that if the relief sought by GE is granted, "*the Companies are going to have to rethink and in the next couple of days they're either going to come to a deal that's going to work, and if it's a viable company they'll be able to do it, or they're not, and it just was never meant to be*." In other words, if GE's motion is granted, its negotiating power would be fortified.

66 In *San Francisco Gifts Ltd., Re*, [2004] A.J. No. 1062 (Alta. Q.B.), Madam Justice Topoloniski writes at paragraphs 11 and 12:

> The commonality of interest test has evolved over time and now involves application of the following guidelines that are neatly summarized by Paperny J. (as she then was) in Resurgence *Asset Management LLS v. Canadian Airlines Corp.* ("Canadian Airlines"):
>
> > 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
> >
> > 2. The interests to be considered are the legal interest that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as liquidation.
> >
> > 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if possible.
> >
> > 4. In placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
> >
> > 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
> >
> > 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.

67 Justice Topoloniski goes on to write:

> To this pithy list, I would add the following considerations:
>
> > (i) Since the CCAA is to be given a liberal and flexible interpretation classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application.

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(ii) In determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of a plan.

68 I agree with Madam Justice Topoloniski's analysis including her additional considerations. In the case at bar, the Monitor in its Report dated March 27, 2008 states that on balance the proposed Plan is fair to all parties subject to the proposed Plan. The March 27, 2008 Monitor's Report states as follows with respect to the major benefit of a successful restructuring:

The major benefit of a successful restructuring will be significant, including:

(a) The continuing employment of approximately 400 direct employees with high paying jobs in New Brunswick and Ontario;

(b) The continuing employment of a further approximately 600 indirect jobs as a result of a high export content of the sales of the Companies;

(c) The payment of a significant portion of the outstanding unsecured debt of the Companies owed to its suppliers; and

(d) The future expenditure of significant amounts other than payroll in Canada and New Brunswick, which expenditures and payroll are of significance to the economy of the areas around the mills and the Province of New Brunswick.

69 With respect to the practical effect of a failure of the proposed Plan, the Monitor has stated "*the unsecured creditors will receive nothing on their claims which in some cases will result in further hardship and business closures*."

70 In my opinion, a reclassification of the Companies' creditors for the purposes of voting on the proposed Plan so that GE is in a separate class of creditors could potentially jeopardize a viable plan of arrangement. Bearing in mind that the object of the CCAA to facilitate reorganizations, if possible, I am attracted to the additional consideration referenced by Madam Justice Topoloniski in *San Francisco Gifts Ltd., Re*, supra, namely that in determining commonality of interests, the Court should also consider factors such as a plan's treatment of creditors, the business situation of the creditors and the practical effect on them of a failure of the plan. In my view, the practical effect in this case of a failure of the proposed Plan on the Companies' creditors, other than GE, would be significantly negative and adverse.

71 In my opinion, for these reasons, GE ought not to be placed in a separate class of creditors and accordingly this request is denied.

Disposition

72 For these reasons, the motion of GE is denied.

Motion dismissed.

End of Document

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2016 ONSC 6030
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corp., Re

2016 CarswellOnt 15064, 2016 ONSC 6030, 271 A.C.W.S. (3d) 86, 40 C.B.R. (6th) 211

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

IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION and NORTEL NETWORKS TECHNOLOGY CORPORATION

Newbould J.

Heard: September 22, 2016
Judgment: September 26, 2016
Docket: 09-CL-7950

Counsel: Mark Zigler, James Harnum, for former Nortel employees in Calgary
Lyndon Barnes, Alexander Cobb, Adam Hirsh, for former directors and officers of NNC and NNL
Jason Wadden, Christopher G. Armstrong, for Monitor

Subject: Corporate and Commercial; Insolvency; Public; Employment

MOTION by employees for order imposing personal liability on former directors of employer for unpaid severance payments.

***Newbould J.*:**

1 One hundred and fifteen former employees who worked in Nortel's Western Innovation Centre in Calgary bring a motion to impose personal liability on the former directors of Nortel Networks Limited ("NNL") and Nortel Networks Corporation ("NNC") for unpaid amounts under section 119 of the *Canada Business Corporations Act*, which imposes personal liability on directors of a corporation to employees of the corporation for debts not exceeding six months wages for services performed for the corporation.

2 In May 2008, Nortel announced that it would be shutting down the Western Innovation Centre, with final closure to occur in June 2009. The closure of the Calgary operations was part of a strategy to consolidate Nortel's research and development in lower-cost centers such as Ottawa and China. A plan was put into place to transfer the knowledge and infrastructure in Calgary to other parts of Nortel's global business. It was in the interests of Nortel that the Calgary employees stay on while the transition was taking place.

3 In connection with the announcement, Nortel advised the claimants that their employment at future dates would be terminated as a result of the closure. Statements were made by management at the time of the announcement and later regarding the severance pay that would be paid upon termination of an employee's employment so long as the employee did not voluntarily resign before being terminated.

4 The essential argument of the claimants is that the promise of a severance payment at the time it was made amounted to a promise of payment to the claimants for staying with Nortel, akin to a retention payment for continuing to perform services for Nortel, and that the severance payment obligation was to be a payment "for services performed for Nortel"

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within the meaning of section 119 of the CBCA. As the severance payments were not made as a result of Nortel filing for CCAA protection on January 14, 2009, it is claimed that the directors of NNC and NNL are liable under section 119.

5 The directors raise three defences, being (i) severance payments are not covered by section 119 as they are to compensate for a loss of a job and not for services performed while employed; (ii) the directors exercised due diligence and thus have a defence under section 123(4) of the CBCA; and (iii) the claimants were employed by Nortel Networks Technology Corporation ("NNTC") and the directors against whom the claims are made were not directors of that corporation.

Liability under section 119 of the CBCA

6 Section 119 of the CBCA provides:

> 119 (1) Directors of a corporation are jointly and severally, or solidarily, liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.

7 A number of leading cases have held that amounts owing as damages for pay in lieu of notice, or amounts owing as termination or severance pay under a statute or contract, do not constitute "debts ... for services performed for the corporation."

8 In *Crabtree (Succession de) c. Barrette*, [1993] 1 S.C.R. 1027 (S.C.C.) which dealt with pay in lieu of notice and a claim against the directors of a failed corporation under section 114(1) of the CBCA, now section 119(1), the Supreme Court of Canada held that such pay is not for services performed for the corporation but rather damages arising from the non-performance of a contractual obligation to give sufficient notice. L'Heureux-Dubé J. for the Court said:

> The term "debts" cannot be dissociated from the context in which it is used. According to the language used by Parliament, the debts must result from "services performed for the corporation". An amount payable in lieu of notice does not flow from services performed for the corporation, but [page1049] rather from the damage arising from non-performance of a contractual obligation to give sufficient notice. The wrongful breach of the employment relationship by the employer is the cause and basis for the amounts awarded by the Superior Court as pay in lieu of notice. It is primarily for this reason that the Ontario Court of Appeal has excluded this type of compensation from the scope of s. 114(1) C.B.C.A. (see *Mesheau v. Campbell*, supra, at p. 157, and *Mills-Hughes v. Raynor (1988), 47 D.L.R. (4th) 381*, at pp. 386-87). In the absence of additional legislative indicia, the performance of services by the employee remains the cornerstone of the directors' personal liability for debts assumed by the corporation. On the pretext of a broad interpretation, this Court cannot add to the text of the provision words which it does not contain. Taking account of the context in which s. 114(1) C.B.C.A. was enacted and the nature of the specific liability which departs from what the law ordinarily prescribes, it seems to me that only one conclusion logically follows.

9 In *Mills-Hughes v. Raynor* (1988), 63 O.R. (2d) 343 (Ont. C.A.), referred to by L'Heureux-Dubé J. in *Crabtree*, a claim against directors under then section 114(1) of the CBCA for severance pay or termination pay under contracts of employment or the *Employment Standards Act* were dismissed. Blair J.A. for the Court said:

> **16** The appellants maintain that the termination and severance payments payable under the statute are debts due to employees for services performed for the corporation for which the directors are liable under s. 114(1) of the Act. The respondents argue that they are not debts for services performed, but rather are claims arising from the termination of employment which are only measured by years of service. Both principle and authority compel the acceptance of the respondents' position.
>
> **17** In *Armstrong v. Coopers & Lybrand Ltd.*, *supra*, Carruthers J. rejected the claims of another group of former Admiral employees for termination and severance pay made against Coopers who, as described above, had taken

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possession of Admiral's assets as agent for the banks. This court affirmed his judgment that Coopers was not legally liable for this claim and Houlden J.A. said at p. 131 O.R., p. 192 D.L.R., p. 260 C.B.R. (N.S.):

> We agree with the trial judge that these claims do not, in the circumstances of this case, constitute "wages, salaries or other remuneration owing in respect of the period of three months next preceding the making of such order or assignment" under s. 178(6) of the Bank Act.

His reasons apply equally to this case where, in my view, it cannot be said that claims for termination and severance pay are in any sense "debts ... for services performed" under s. 114 of the Act. Rather, they constitute a statutory benefit arising from the termination of employment which is payable in lieu of damages for such termination. Montgomery J. was correct in considering his decision to be analogous to this court's decision in *Mesheau v. Campbell* (1982), 39 O.R. (2d) 702, 141 D.L.R. (3d) 155, where Weatherston J.A. held that a discharged employee of a company could not collect an unsatisfied judgment for damages for wrongful dismissal from directors under s. 114(1) of the Act.

10 Similarly, in *Brown v. Shearer* (1995), 33 C.B.R. (3d) 314 (Man. C.A.), a claim against directors under section 119(1) of the CBCA for severance pay was dismissed. Huband J.A. for the Court said:

> **10** I agree entirely with the conclusion of Kennedy J. that the claim for severance pay is not a claim for a debt in respect of "services performed." It is unlike salary or vacation pay which relate to work performed over a period of time. The severance pay is in the nature of a payment which MSI was entitled to make at any time to relieve itself of the burden of the employment contract. The amount payable would be precisely the same if MSI had terminated the plaintiff Brown's employment, without cause, on the day after it had begun, or on the day before his contract was about to expire. The amount was unrelated to the quality or duration of his service to the company.
>
> **11** The disposition of this aspect of the claim is consistent with the decision of the Supreme Court of Canada in *Barrette v. Crabtree Estate*, [1993] 1 S.C.R. 1027, in which a claim for damages in lieu of notice, as compensation for wrongful dismissal, was not considered as a debt for the performance of services for the corporation.

11 The claimants say that while the word severance was used in describing what would be paid to those employees who were going to be terminated, in essence Nortel was anxious to keep them on during the transition and the payments were intended as an inducement to keep them there without resigning before they were to be terminated. Thus the payments were really intended to be a form of retention payments for continuing to work, and thus they were "for services performed for the corporation" within the meaning of section 119. What was said to the Calgary employees must therefore be considered.

12 In his affidavit, Mr. Darryl Pitchko was at the relevant time the Acting Director of R&D at the Westwinds Innovation Centre. He said that he was told by senior managers at Nortel in Ottawa that Nortel would be using the offer of severance as an incentive for the employees to stay in their positions. Mr. Hanrieder, a former manager in Calgary, said much the same, saying it was discussed informally with various members of management of Nortel that the promise of severance was used to retain employees during the transition period. These statements of course are not evidence of what was told to the employees, and it is what was said to the employees that is relied on by the claimants as being promises made to them.

13 What the employees were told is in an agreed statement of facts and includes:

> 4. In May 2008, Nortel announced that it would be shutting down the WIC, with final closure to occur in June of 2009 (the "Transition Period"). In connection with such announcement, Nortel advised the Calgary Employees that the employment of many of them would be terminated as a result of the closure of the WIC.

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5. In or around May 2008, a general information presentation was given to senior managers at WIC by Harold Graham, Vice-President of CDMA R&D, with respect to CDMA R&D for Q2 2008. That presentation, a copy of which is attached as Exhibit A, contained a slide regarding the WIC closure with the following information:

• Last week, we announced the next steps in the implementation of the Calgary specialty site transition.

• The changes have significant implications to Calgary employees.

• Carrier Networks R&D is re-forming in Calgary to what we expect to be the end steady state, a research oriented base station design team.

• An R&D team of 20 - 30 engineers is being established to work on next generation technologies for 4G BTS's.

• R&D design implementation and sustaining roles currently performed in Calgary related to BTW Software, BTS Hardware, BTS Global Product Support, Release Management, and BTS Systems/Architecture will be transitioned to Beijing, Guangzhou, or Ottawa by June 30th 2009.

• Work from home will be an option for a small number of Systems/Architecture and Project Management functions.

• Each employee will be given the opportunity to request re-location. A limited number of positions have been identified for relocation (?20%).

• All employees are being asked to support knowledge transfer during the transition between now and June 30th 2009.

• We are committed to providing a fair compensation package to each employee to secure current projects and facilitate the transition of skills and accountabilities.

7. In or around May and June 2008, several information sessions were conducted by the Human Resources Department of the WIC and senior WIC managers to provide the Calgary Employees with information regarding the WIC closure and their roles dur ing the Transition Period.

8. During these sessions, the Calgary Employees were advised that Nortel would pay severance on termination of their employment in accordance with Nortel's past practices. It was also stated that these payments would only be made if the relevant employee worked until his or her stop work date as determined by Nortel; if a Calgary Employee wanted to leave earlier than his or her stop work date, it would be considered a resignation, and no severance would be paid. It was also indicated that the Calgary Employees who would not be offered relocation or a continuing role would be provided with a termination package two to three months prior to their stop work date.

9. These information sessions included the presentation of several PowerPoint presentations, an example of which is attached as Exhibit B. These PowerPoint presentations stated the following:

• *Severance Plan: Purpose/Goal*

• ?*Severance determination is in accordance with our past practice and is based on common law, taking into account general market conditions, age and service of the employee*

• *There are no intentions to make any changes to our severance program in the current round of workforce restructuring recently announced by Mike Z.*

• *All past practices will be adhered to including a 60 day non-working notice period and the provision of outplacement support*

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• *All employees are being asked to support knowledge transfer during the transition between now and June 30th 2009*.

• *We are committed to providing a fair compensation package to each employee to secure current projects and facilitate the transition of skills and accountabilities*.

12. At the time the WIC closure was announced, Nortel stated to the Calgary Employees that it did not intend to modify its current severance practices, which it stated was to provide the following benefits to Canadian employees whose employment was terminated as a result of a restructuring decision:

• a period of 60 days non-working notice;

• complete benefits plan through this 60 day period;

• a lump sum severance amount calculated by reference to an employee's individual circumstances (e.g. age, length of service with Nortel, seniority) and past practice in a particular region or market; and

• access to outplacement transition service.

14 There is no evidence that the information about severance given by Nortel was ever described to any of the Calgary employees as a payment or bonus for performing work.

15 Forty-five key employees did receive retention bonuses termed "Project Completion Bonuses". Mr. Pitchko said these were given to address risks with employees they needed to retain for the transition where their severance payouts might not be enough to incent them to remain. Forty-five employees were given these payments under an agreement which contained in part:

Your skills have been identified as a key part of this organizational transition, and Nortel wishes to retain them through the period of this project....

Recognizing the importance of completing the Calgary R&D transition project, as well as the challenges associated with maintaining focus on your assigned roles during this time, Nortel is offering a special project completion bonus in a lump sum amount equa l to [percentage amount] % of your annual base salary...

• ...you must remain continuously and actively employed...

16 The persons who were given this completion bonus were paid after the CCAA filing under a KERP plan approved by the Court in the CCAA proceedings. They now claim against the directors for the severance payments said to have been promised to them along with the other employees on the basis that the severance payments were also considered to be for the purpose of retaining them.

17 In the period from May 2008 through December 2008, at least 48 of the Calgary employees who were being terminated met with their managers to discuss the termination of their employment and were subsequently sent letters from Nortel confirming the particulars pertaining to the termination of the their employment, including their stop-work date and entitlements upon the termination of their employment (the "Pre-Filing Termination Letters").

18 Employees who were not notified of their termination until after the CCAA filing were not provided with a Pre-Filing Termination Letter but there is no evidence or suggestion that had they been notified of their termination before the CCAA filing that they would not have received the same letter. That is, all employees who would be entitled to payment for severance would have been entitled to severance as described in the Pre-Filing Termination Letters. However, in light of the CCAA filing in January of 2009, employees who later received their termination notice were not offered any severance pay.

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19 Each Pre-Filing Termination Letter advised the Calgary employee of his or her termination date and stop work date, and that upon such date they would commence a 60 day non-working notice period until their termination date. Each letter contained a promise to pay a lump sum severance payment (or in some cases bi-weekly payments) in the following terms:

> Conditional upon: (i) your compliance with all terms and conditions of this letter; and (ii) your not obtaining employment with the Corporation, prior to the termination date that would enable you to continue your employment with the Corporation, the Corporation shall, on or immediately following the termination date, pay you a lump sum of $[dollar amount]. This payment ("the termination payment") in addition to the provided period of paid notice is intended to recognize your past service with the Corporation and to compensate you in all respects for the loss of employment. It is inclusive of any severance and/or termination payment to which you may be entitled as a consequence of the termination of your employment under applicable employment standards legislation. (Underling added).
>
> If you recommence employment with the Corporation after the termination date but prior to [a date], you agree that you will return to the Corporation the portion of the termination payment equivalent to your gross weekly/daily salary with the Corporation multiplied by the number of weeks/days during which you were employed with the Corporation prior to [the date].

20 The Calgary employees say that the nature of what the payment was for is contained in the Pre-Filing Termination Letters that 48 of the employees received and signed before the CCAA filing and that it confirms that the payment is in part for past services provided to Nortel. I do not agree. The letter stated the opposite. I have referred to the provision above, but for ease of reference the relevant part is:

> This payment ("the termination payment") in addition to the provided period of paid notice is intended to recognize your past service with the Corporation and to compensate you in all respects for the loss of employment.
>
> (Underling added)

21 The past service was recognized in that the amount to be paid, as stated in the information provided to the Calgary employees, was a lump sum severance amount calculated by reference to an employee's individual circumstances (e.g. age, length of service with Nortel, seniority) and past practice in a particular region or market. The amount to be paid was to compensate for the loss of employment.

22 Some of the employees who signed a Pre-Filing Termination Letter had a termination date later than what turned out to be the CCAA filing date of January 14, 2014. They were therefore not paid the amount set out in their Pre-Filing Termination Letter. They filed a claim in the CCAA proceeding for the amount set out in their Pre-Filing Termination Letter but, unlike the other employees who had not received a Pre-Filing Termination Letter, they did not claim any other severance pay in the CCAA claims process, which presumably they might have if they thought that the payment in the Pre-Filing Termination Letter was a retention payment. They must have assumed that the amount in their Pre-Filing Termination Letter was for severance in an amount that they agreed to. The directors contend that this action after the letter was agreed to is evidence that the signers thought the payment agreed to was for severance. I think the contention is valid.

23 The directors also contend that if the payment had intended to be some form of retention bonus, it would not have made sense to require it to be paid back if the employee after his or her termination date recommenced employment with Nortel. A retention bonus is paid on top of a salary. Just because the employee later recommenced working for Nortel and earned a salary would be no reason to return a retention bonus. The fact that it had to be repaid is an indication that it was not payment for services with Nortel. I think this contention is also valid.

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24 In my view of the evidence, while Nortel was anxious to keep the employees in Calgary at the Western Innovation Centre during the transition and its motivation to tell the employees that they would be paid severance if they stayed until terminated may have been driven by that, that did not change the nature of what the employees were entitled to. It was severance pay to be paid in accordance with Nortel's past practices and not some new payment to compensate employees for continuing to work at Nortel until their termination date.

25 I find that the severance payments promised to the Calgary employees were not to be for services performed for Nortel and therefore are not covered by section 119 of the CBCA.

Due diligence defence

26 The directors rely on a due diligence defence in the event that the payments to be made for severance fall under section 119 of the CBCA.

27 Section 123(4) of the CBCA contains a due diligence defence, as follows:

> 123 (4) A director is not liable under section 118 or 119, and has complied with his or her duties under subsection 122(2), if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on
>
> > (a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or
> >
> > (b) a report of a person whose profession lends credibility to a statement made by the professional person.

28 In this case, it is claimed by the directors that they relied on legal advice provided to them by Osler as external counsel regarding their legal duties. According to Mr. Manley, one of the directors, the directors were advised by Osler and internal counsel that obligations for termination or severance pay were not a source of personal liability. As well, as Nortel's financial condition worsened in the latter half of 2008, the Nortel board insisted on knowing that Nortel's employee obligations were being fulfilled, as they were well aware of the risk of personal liability if such amounts were unpaid. At the October 2, 2008 board meeting, Nortel's treasurer confirmed to the board that statutory payments, including wages, would continue to be paid. "Statutory payments" referred to obligations for which the Nortel directors were potentially personally liable pursuant to various statutory provisions. I accept Mr. Manley's evidence.

29 Apart from legal advice, Ernst & Young were retained as restructuring advisors by Nortel. Ernst & Young reported to the Nortel boards that it had identified no exceptions in which employee wage and related obligations were not remitted on or before the date on which they were due, including in respect of any such obligations to employees in Alberta. Mr. Manley stated in his affidavit, which I accept, that it was repeatedly confirmed to the Nortel directors that Nortel was current on its statutory obligations, the nature of which was based on advice received from Nortel's internal and external counsel and from Osler, the independent counsel appointed by the boards of NNC and NNL.

30 It is argued that the directors did not follow the legal advice received from Osler. In a Osler memorandum presented to the directors on December 18, 2008 the directors were advised not for the first time that directors were liable for services provided to the corporation under section 119 of the CBCA but that the provision had been held not to include damages for wrongful dismissal, termination or severance. The memorandum then went on to state:

> However, there may be instances in which a corporation has entered into contract with employees or collective agreements with unions that might support a claim for these amounts under the CBCA. We understand that the Company is not a party to any collective agreements and is party to relatively few employment agreements with its senior executives. We recommend Company counsel review those agreements to confirm that they do not impose liability on the Board for damages for wrongful dismissal or termination or severance pay.

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31 On his cross-examination. Mr. Manley said he had no idea if there was ever a review of any obligations that might be created for the directors from employment agreements made with the employees in Calgary at the Western Innovation Centre. He said he was unaware of the Pre-Filing Termination Letters signed by some of those employees and thus unaware of any review of them. He said he would have expected that reviewing agreements in accordance with the quoted provision in the memorandum would have fallen within the mandate of Osler as they had been retained as independent counsel to the board in order to protect the directors from personal liability.

32 This response of Mr. Manley was a reasonable response. The advice in the quoted provision was that company counsel review those agreements, i.e. the relatively few employment agreements with its senior executives. There is no evidence that company counsel did not consider those agreements.

33 Regarding the Pre-Filing Termination Letters, it is inconceivable that Nortel counsel did not review them in the circumstances in which Nortel found itself when the letters were drafted and signed. The language in the letters no doubt came from lawyers. Even if it could be said that the senior executives included the Calgary employees who signed a Pre-Filing Termination Letter, the company counsel's conclusion and advice would have been the same as provided generally to the directors, i.e. that severance payments referred to in the letters were not covered by section 119 of the CBCA.

34 In my view of it, the Nortel directors were entitled to rely upon the legal and restructuring advice they received. They did so in good faith. It was not required of them to second guess the advice given by these leading professional firms. To have done so would likely have been perceived to be not acting prudently. Thus if I had held that the promised severance payments were covered by section 119 of the CCAA, the directors would have had a good due diligence defence.

The employer of the Calgary employees

35 The directors contend that 77 of the claimants were not employed by NNC or NNC, the corporations of which they were directors, but by NNTC. Thus they contend that they could have no liability under section 119 of the CBCA. They base this argument on the fact that these 77 employees received their pay cheques from NNTC and were issued their T4 slips by NNTC. I do not agree.

36 Section 119 does not attempt to define who an employee is. It is a question of fact if an employee claiming under that section is an employee of the corporation whose directors are being claimed against. It is not a matter of statutory interpretation or construing the section narrowly, as contended by counsel for the directors.

37 It is settled law that the true employer must be ascertained on the basis of where effective control over the employee resides. Which particular company in a group may be paying the employee is not determinative of who the employer is. In *Jones v. CAE Industries Ltd.* (1991), 40 C.C.E.L. 236 (Ont. Gen. Div.), a wrongful dismal case adopted and approved in *Downtown Eatery (1993) Ltd. v. Ontario* (2001), 54 O.R. (3d) 161 (Ont. C.A.), Adams J. stated the following:

> The fact that CAE Accurcast "may" have been used as a "payroll" company for a portion of 1987 does not determine the identity of the true employer. The true employer must be ascertained on the basis of where effective control over the employee resides and in this regard control rested with CAE Industries....
>
> I stress again that an employment relationship is not simply a matter of form and technical corporate structure. While CAE Accurcast was the paymaster corporation prior to January 26, 1987, direct control was asserted over Mr. Jones by CAE Industries through Mr. MacKay who was an employee of CAE Industries and not an executive officer of CAE Accurcast.

38 In this case, it is undoubted that the whole NNTC operation was controlled by NNL, the operating subsidiary of NNC. Nortel's Westwinds Innovation Centre was one of Nortel's research and development facilities, primarily conducting R&D related to Nortel's CDMA business (also known as Carrier Networks).

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39 Mr. Darryl Pitchko was employed by Nortel from 1987 to 2009. At the relevant time he was the Acting Director of R&D at the Westwinds Innovation Centre and the most senior Nortel R&D Nortel executive there from April 2008 until his departure from Nortel in June 2009. In his affidavit he said he was paid by NNTC but took directions from NNL. Mr. Handrieder, another employee in the Westwinds Innovation Centre, said the same thing in his affidavit. This is hardly surprising evidence. In the allocation decision involving Nortel, I described the way in which Nortel operated along business lines in a matrix structure, a matter that was not contested, as follows:

> [13] At the time of its insolvency, Nortel had four main product groups (also known as Lines of Business):
>
> > • The "Carrier Networks" segment provided wireless networking solutions that enabled service providers and cable operators to supply mobile voice, data and multimedia communications to individuals and enterprises using mobile phone and other wireless devices. The Carrier Networks business also offered products providing local, toll, long distance and international gateway capabilities to telephone service providers as well as providing support to customers transitioning from one network to another....
>
> [16] The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.
>
> [17] As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada [which included NNTC], NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.

40 There is no question but that NNTC played no role in directing the business of R&D at the Westwinds Innovation Centre in Calgary. Effective control over the employees was directed by NNL people in the R&D division responsible for the R&D for the Carrier Networks line of business. During argument counsel for the directors conceded that. Even at the end the instructions to Mr. Pitchko to wind down the Westwinds Innovation Centre came from the Nortel VP of R&D in Ottawa and HR personnel at Nortel in Ottawa.

41 The boards of NNC and NNL understood that the Calgary employees were Nortel employees over which they had a responsibility. After October 2, 2008 the board of Nortel instituted a practice of having management provide reports confirming that statutory obligations were being paid, which were reviewed at each board meeting. These reports included information regarding NNTC as well as the other subsidiaries of NNL.

42 Thus, had I held that section 119 covered the severance payments said to have been promised to the Calgary employees of the Westwinds Innovation Centre, I would not have dismissed the claims of those who received their pay cheques from NNT on the basis that the employees were not employees of NNL.

Release

43 The Pre-Filing Termination Letters signed by 48 Calgary employees contained a sufficiently broad release of NNC, its subsidiaries and affiliates, and its directors and officers that would cover a claim under section 119 of the CBCA made against the directors. The Monitor but not the directors raise this release as a defence for the directors as well. The release provision was as follows:

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> In consideration of the foregoing, and by accepting these arrangements, you hereby: release and forever discharge the Corporation, its directors, officers, employees, and representatives of and from all manner of actions, causes of actions, suits, debts, accounts, covenants, contracts, claims, including, without limitation, claims under applicable employment standards and human rights legislation, and demands whatsoever which you have had, now have or which your heirs, executors, administrators, or assigns or any of them, hereafter can, shall or may have against the Corporation, its employees and representatives, for or by reasons of any cause, matter or thing whatsoever in connection with your employment with the Corporation, including without limitation the termination of such employment [...]

44 It is argued by the Calgary employees that section 119(1) of the CBCA is a public policy provision that is not capable of being contracted out of. I do not accept the argument. A release of a section 119 CBCA claim as part of a negotiated settlement of amounts to be paid to an employee is not contracting out of the statute. If it were otherwise, no corporation could ever settle a claim such as a claim for pay required under provincial statutes such as the Ontario *Employment Standards Act*.

45 It is argued by the employees that the release is not binding due to a failure of consideration, the release beginning with the words "In consideration of the foregoing...". The Monitor says that the mutual promises in the agreement are sufficient consideration for the agreement including the release to be binding. I do not intend to deal with this as it is not necessary and to do it justice would require far more than has been provided. A complete failure to pay the amount owing under an agreement is not a completely straightforward issue.

Conclusion

46 The claim of the Calgary employees under section 119 of the CBCA is dismissed. This is not a case for costs.

Motion dismissed.

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1971 CarswellOnt 55
Ontario Supreme Court, In Bankruptcy

Mohawk Sports Equipment Ltd., Re

1971 CarswellOnt 55, 15 C.B.R. (N.S.) 63

Re Mohawk Sports Equipment Limited

Houlden J.

Judgment: June 17, 1971

Counsel: *M. A. Eustace*, for applicant.
W. J. Meyer, for financing company.

Subject: Corporate and Commercial; Insolvency

***Houlden J.* (orally):**

1 This is an application for directions pursuant to s. 12(1) of the Bankruptcy Act, R.S.C. 1952, c. 14. The following questions have been proposed to the Court:

> (a) Should Irving Burton, the trustee under the proposal made by Mohawk Sports Equipment Limited, before making any distribution to the preferred and unsecured creditors under the proposal, be required to have deposited in his trust account by Mohawk Sports Equipment Limited moneys sufficient to cover all disputed claims as well as the claims that have been filed and allowed by the trustee and Mohawk Sports Equipment Limited?
>
> (b) If the answer to (a) is no, should the trustee under the proposal made by Mohawk Sports Equipment Limited pay those preferred creditors with valid accepted proven claims and should he pay those unsecured creditors with valid accepted proven claims?

2 The debtor company was incorporated in 1969. In February 1970 it became involved in serious financial difficulties. At that time, the debtor approached a company in the City of Toronto for financial assistance. This company proceeded to advance approximately one quarter of a million dollars to the debtor company over a period of months. No security was received for these advances. In November 1970 a petition in bankruptcy was filed against the debtor company. The financing company decided to assume control of the debtor and, in due course, arranged for a proposal to be filed under the Bankruptcy Act.

3 The proposal offered to unsecured creditors the option of taking stock in the debtor company, or a cash dividend of 10 cents in the dollar. The stock dividend is, of course, being accepted by the financing company. It was anticipated that most of the ordinary creditors would elect to take the cash dividend.

4 What has caused this application is that a number of substantial claims have been filed with the trustee of which the company providing the financial backing had no knowledge, and most of which are disputed by the debtor. There are claims of preferred creditors in dispute amounting to $12,727.98 and disputed claims of unsecured creditors in the amount of $221,441.98. It would require some $36,000 to pay the dividend on these claims if it subsequently turns out that they are all valid claims against the debtor.

5 Under the terms of the proposal, the trustee is required to pay the claims of preferred creditors as set forth in s. 95 of the Bankruptcy Act. These claims must be paid prior to any payment being made to ordinary creditors. In addition,

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the trustee must pay within 45 days after 3rd March 1971 the cash dividend provided for in the proposal for ordinary creditors.

6 Counsel for the financing company has pointed out to the Court that, at the meeting of creditors held to consider the proposal, the question of a guarantee was raised by the creditors. It was made clear to the creditors that funds would be made available to meet the proposal, but no formal guarantee would be given by the financing company. In spite of this, creditors saw fit to accept the proposal and in due course it was approved by the Registrar on 3rd March 1971. Counsel submits that, if the financing company must secure the trustee in respect of the disputed claims, in effect, the financing company is being required to guarantee the proposal.

7 As regards any creditors who have not proved their claims with the trustee before the declaration of a dividend, s. 109 of the Act protects the trustee. Such creditors only have the right to be paid out of any money remaining in the hands of the trustee the dividend or dividends they should have received, before that money is applied to the payment of future dividends. But they are not entitled to disturb the distribution of any dividend declared before their claims were proved. In this case, however, the claims of the nine creditors which are in dispute have been proved with the trustee so s. 109 is of no assistance to the trustee.

8 It is my opinion that, if the trustee were to make a distribution to the ordinary creditors whose claims are not disputed and at a later date certain of the disputed claims were found to be valid, the trustee would be personally liable for the dividends on the claims of those creditors for whom funds were not available. This follows, in my opinion, from s. 107(2) of the Act which provides that, where the validity of any claim has not been determined, the trustee shall retain sufficient funds to provide for payment thereof in the event that the claim is admitted. By virtue of s. 38(1) of the Act, this section is applicable in the case of a proposal.

9 It is of the essence of bankruptcy proceedings that all creditors of the same class should be treated in the same way. If the trustee were to use the funds which he presently has on hand to pay a dividend on the claims of creditors which are not in dispute and then, at a later date, did not have sufficient funds to pay a dividend on the claims of creditors which were disputed and were subsequently found to be valid, the trustee would not be dealing with creditors of the same class on an equal basis.

10 It is interesting to note that the English Bankruptcy Rules specifically provide for this situation. Rule 214 of the English Bankruptcy Rules, 1952 (Williams on Bankruptcy, 18th ed., p. 680) provides:

> 214. (1) Where under a composition or scheme provision is made for the payment of any moneys to the creditors and any claim in respect of which a proof has been lodged is disputed, the court may, if it thinks fit, direct that the amount which would be payable if the claim were established shall be secured in such manner as the court may direct.
>
> (2) On the determination of the dispute, the sum so secured shall be paid as the court may direct.

11 This Rule accords with my view of what the law should be on this matter.

12 In the result, the answer to the first question of the trustee should be that the trustee should have sufficient funds deposited in his trust account to cover all disputed claims, as well as the claims that have been filed and allowed by the trustee and Mohawk Sports Equipment Limited, or should be adequately secured so that the funds will be available to pay the dividends on disputed claims if they are subsequently found to be valid.

13 In view of the answer to Q. (a), I am not required to answer Q. (b) propounded by the trustee.

14 The costs of both parties will be out of the assets of the estate.

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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 ET AL.

Court File No.: 09-CL-7950

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF THE MONITOR AND CANADIAN DEBTORS
(Motion for Plan Sanction and Canadian Escrow Release Order)

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