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Top Insolvency Cases and Highlights from 2017

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Top Insolvency Cases and Highlights from 2017 With the passing of another year, McCarthy Tétrault's National Bankruptcy & Restructuring Group takes a look at the trends, leading cases and other insolvency highlights from 2017. This publication puts at your fingertips a summary of the year's biggest insolvency cases and developments from across the country and highlights some of the most talked-about cases and issues from 2017, including deemed trusts, the monitor's role in oppression actions, equitable subordination and more. This report was authored by Heather L. Meredith and Adrienne Ho.

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1. Trends: Fewer CCAA Filings and Retail Insolvencies in the News

According to the OSB,[1] in the one year period ending September 30, 2017, only twenty-one *Companies' Creditors Arrangement Act* ("CCAA")[2] proceedings were filed, compared to forty filings in the one year period ending September 30, 2016. Eleven of these proceedings were filed in Ontario, which is relatively consistent with the year prior. Alberta saw the biggest drop in CCAA filings, with only three filings in this period, compared to fourteen in the twelve months leading up to September 30, 2016. CCAA filings continue to be largely in the construction, retail trade, and real estate industries (3 filings each), with a significant decline in mining and oil and gas filings. Retail insolvencies dominated the news in 2017 with the Sears CCAA and liquidation voted the Canadian Press business news story of 2017[3] and the Toys R Us filing also making headlines, together with much speculation about the future of bricks and mortar retail stores.

2. Stelco Completes Successful Restructuring: Equitable Subordination Appeal Does Not Proceed to SCC

In March 2017, the Supreme Court of Canada ("SCC") granted leave to appeal the Ontario Court of Appeal's decision[4] in Stelco that the doctrine of "equitable subordination" (a form of equitable relief to subordinate the claims of a creditor who has engaged in inequitable conduct) is not available in CCAA proceedings. The Court of Appeal ruled that there was no authority in the CCAA, either express or implied, to apply the doctrine of equitable subordination. The Court of Appeal also indicated that the broad jurisdiction under section 11 of the CCAA was not available to invoke the doctrine since the appellant did not identify how equitable subordination would further the remedial purpose of the CCAA. Finally, the Court noted that there was no provision in the CCAA similar to section 183 of the *Bankruptcy and Insolvency Act* ("BIA")[5] (investing the bankruptcy court with such jurisdiction at law and in equity as will enable it to exercise its bankruptcy jurisdiction), leaving the door open to different treatment in BIA and CCAA proceedings.

While insolvency professionals awaited Supreme Court guidance on the issue, in June 2017, Stelco successfully implemented a complex restructuring that compromised more than $2 billion in debt, restructured significant pension and benefit obligations, and implemented creative solutions that included monetizing land holdings, addressing environmental matters and implementing new

[1] Innovation, Science and Economic Development Canada: Office of the Superintendent of Bankruptcy Canada, *CCAA Statistics in Canada: Third Quarter of 2017* (Government of Canada, 2017), available at https://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwapj/CCAA-statistics-EN-Q3-2017.pdf/$file/CCAA-statistics-EN-Q3-2017.pdf.

[2] R.S.C., 1985, c. C-36.

[3] CBC News, "Sears Canada demise named Canadian Press business story of 2017," (Dec. 18, 2017), http://www.cbc.ca/news/business/sears-canadian-press-business-story-year-1.4454115, last accessed Feb. 3, 2018.

[4] *U.S. Steel Canada Inc. (Re),* 2016 ONCA 662, leave to appeal to SCC granted, 2017 CarswellOnt 3573.

[5] R.S.C., 1985, c. B-3.

collective agreements. As a result of the successful restructuring (which later saw Stelco completing a $200 million IPO in November 2017), the appellants withdrew the appeal, leaving the Ontario Court of Appeal's decision in Stelco as the latest appellate court view on the issue of equitable subordination.

3. Monitor as Complainant in Oppression Actions

Two Ontario court decisions in 2017 considered whether a monitor could act as a complainant in an oppression action. The two courts reached opposite results on the facts of those cases.

In *Ernst & Young Inc. v. Essar Global Fund Limited* ("*Essar*"),[6] the Ontario Court of Appeal upheld the decision authorizing the monitor to bring an oppression action. The Court observed that a monitor generally plays a neutral role though it frequently takes positions (indeed is required by statute to do so), typically in support of a restructuring purpose. The Court noted that it will be a rare occasion that a monitor will be authorized to be a complainant; however, the CCAA does not preclude the making of such an order, and in this case it was appropriate given that, among other things, the oppression action served to remove an insurmountable obstacle to the restructuring (since the transaction at issue gave one company the ability to veto a change of control of the debtor's business) and the Monitor could efficiently advance an oppression claim on behalf of stakeholders who were not organized as a group but who were all affected by the alleged oppressive conduct.

In *Urbancorp Cumberland 2 GP Inc., (Re)*,[7] Myers J. declined to grant the Monitor's motion for directions as to whether certain payments made to creditors were oppressive. He agreed that monitors may be empowered to bring legal proceedings in appropriate circumstances (though he noted the Monitor had not been empowered to do so in this case, and was critical of the attempt to structure the motion as one for directions and to rely on statements in a Monitor's report that were not incorporated into an order). He reasoned that, while the court has broad discretion to empower the Monitor to take steps to facilitate the restructuring or to advance the goals of the CCAA, there was no evidence in this liquidating CCAA that the Monitor bringing proceedings in place of creditors could be said to facilitate the restructuring. He specifically noted that, unlike *Essar* where the claim addressed a roadblock to the restructuring affecting all parties, this claim simply pit current creditors against creditors paid out earlier and as such was really an inter-creditor proceeding. The Monitor was ordered to pay $40,000 in costs.

Both cases acknowledge that a monitor may be empowered to bring an oppression action in exceptional circumstances. In determining whether such circumstances exist, the test developed by the Court of Appeal in *Essar* (considering whether there is a *prima facie* case for oppression, whether the proposed action has a restructuring purpose/materially advances or removes an impediment to a restructuring and whether any other stakeholder is better placed to be a complainant) will likely guide courts in future cases.

[6] 2017 ONCA 1014.

[7] 2017 ONSC 7649.

4. Quebec Court Treats Pension Deemed Trusts the Same in Liquidating CCAAs as in BIA

In September 2017, the Quebec Superior Court in the Wabush Mines CCAA proceedings issued a detailed decision[8] holding that the deemed trusts created under the federal *Pension Benefits Standards Act, 1985*[9] and provincial pensions acts in Newfoundland and Labrador and Quebec do not apply in the context of a liquidating CCAA. The Court held that only employee contributions and normal cost payments are protected in a liquidating CCAA to the extent provided for by sections 6(6) and 36(7) of the CCAA, consistent with the priorities in a BIA distribution.

Building on comments from the SCC in *Century Services Inc. v. Canada (Attorney General)*,[10] the Court noted that the scheme of distribution under the BIA should apply in a liquidating CCAA unless there is a contradiction between the two. With respect to the deemed trusts at issue, the Court held that the provincial deemed trust created under Newfoundland and Labrador law was inoperable as a matter of federal paramountcy (the CCAA does not expressly invalidate deemed trusts in favour of parties other than the Crown; however, it would frustrate Parliament's purpose by protecting amounts in addition to the specific protections in 6(6) and 36(7) of the CCAA) and the federal deemed trust was similarly ineffective since the CCAA, which protects only normal payments and employee contributions, was more specific and enacted after the federal pension act. Leave to appeal this decision to the Court of Appeal has been granted[11] so this may not be the final word on pension deemed trusts in liquidating CCAAs.

5. Priority of Source Deduction Deemed Trust v. Court-Ordered Charges Still in Flux

In 2017, courts in Nova Scotia and Alberta issued seemingly inconsistent decisions as to whether a deemed trust for unremitted source deductions under the *Income Tax Act* ("*ITA*")[12] has priority over a DIP charge. As explained in a post on our Restructuring Roundup Blog,[13] 1) in *Rosedale Farms Limited, Hassett Holdings Inc., Resurgam Resources (Re)*,[14] the Supreme Court of Nova Scotia held that the *ITA* deemed trust takes priority over all security interests, including a DIP charge in a BIA proposal (noting that while property may be sold by the debtor free from the trust, this does not mean that charges could supercede the trust); and, 2) in *Canada North Group Inc. (Companies' Creditors Arrangement Act)* ("*Canada North*"),[15] the Alberta Court of Queen's Bench held that the DIP charge had priority over the *ITA* deemed trust in CCAA proceedings (noting that

[8] *Arrangement relatif à Bloom Lake,* 2017 QCCS 4057.

[9] R.S.C., 1985, c. 32.

[10] 2010 SCC 60.

[11] *Syndicat des métallos, section locale 6254 c. FTI Consulting Canada Inc.*, 2017 QCCA 1676.

[12] R.S.C., 1985, c. 1 (5th Supp).

[13] Walker W. MacLeod and Audrey Bouffard-Nesbitt, "Alberta Court of Queen's Bench Reiterates Court's Discretion to Grant an Interim Financing Charge "Super-Priority" Status in the Face of a Deemed Trust Under the Income Tax Act," (Sept. 27, 2017), McCarthy Tétrault Blog: Restructuring Roundup, https://www.restructuringroundup.com/2017/09/alberta-court-of-queens-bench-reiterates-courts-discretion-to-grant-an-interim-financing-charge-super-priority-status-in-the-face-of-a-deemed-trust-under-the-income/.

[14] 2017 NSSC 160.

[15] 2017 ABQB 550.

the deemed trust was unlike a proprietary interest, reviewing the importance of super-priority charges to restructurings, and concluding that the intent of Parliament was to grant priority to the relevant deemed trusts over all security interests other than the "super-priority" charges ordered by the CCAA court as necessary for the restructuring). Leave to appeal the decision in *Canada North* was granted[16] late last year.

6. Strengthening GST/HST Deemed Trust as Against Secured Creditors

In July 2017, the Federal Court of Appeal issued its decision in *Canada v. Callidus Capital Corporation*,[17] which is widely seen as strengthening the deemed trust for GST/HST. As summarized in our Restructuring Roundup Blog,[18] the Court (with one dissent) held that, while the deemed trust is rendered ineffective with respect to property of the tax debtor at the time of bankruptcy, the CRA could still enforce the deemed trust for GST/HST as against a secured creditor who received proceeds from the sale of a debtor's assets prior to bankruptcy. The decision has caused lenders to consider whether an early bankruptcy filing is preferable rather than forbearing and taking the risk that payments made to them will be clawed back by the CRA. Leave to appeal this decision to the SCC has been filed.[19]

7. CCAA Representation Orders can Benefit a Range of Stakeholders

In January 2017, the Quebec Court of Appeal considered the scope of representation orders in CCAA proceedings. The Court of Appeal in *Groupe Hexagone*[20] heard an application for leave to appeal the order appointing representatives for a group of about 140 unpaid subcontractors. The fees of the representatives and their counsel were to be paid by the debtors and secured by a charge against the debtors' assets. The petitioners did not dispute the application of the *Canwest Publishing Inc.*[21] factors for granting a representation order but argued that this group of subcontractors did not meet the test since there was no evidence of vulnerability or limited resources, among other things.

The Court of Appeal dismissed the application for leave, observing that vulnerability could not be reduced to impecuniosity and that CCAA representation orders are not limited to "widows and orphans" but can in fact benefit stakeholders in a range of circumstances. The Court further held that it was not inappropriate to consider that subcontractors' claims are vulnerable on the basis of

[16] *Canada v Canada North Group Inc.,* 2017 ABCA 363.

[17] 2017 FCA 162.

[18] Walker W. MacLeod and Lan Nguyen, "Crown priority under section 222(3) of the Excise Tax Act," (Oct. 31, 2017), McCarthy Tétrault Blog: Restructuring Roundup, https://www.restructuringroundup.com/2017/10/crown-priority-under-section-2223-of-the-excise-tax-act/.

[19] *Callidus Capital Corp. v. R.* [Application/Notice of Appeal], 2017 CarswellNat 5573.

[20] *Bridging Finance Inc. c. Béton Brunet 2001 inc.,* 2017 QCCA 138.

[21] 2010 ONSC 1328.

the cost of individual participation, as opposed to the financial circumstances of each, and that vulnerability is only one of a series of factors to be weighed. This decision emphasizes that the appointment of a representative in a CCAA proceeding is a discretionary decision, which can be used to ensure effective participation of various stakeholders (beyond employees and retirees) where appropriate.

8. Redwater Appeal heard by the Supreme Court of Canada

In April 2017, the Alberta Court of Appeal upheld the lower court ruling in *Redwater Energy Corporation (Re)* ("*Redwater*").[22] Later in the year, leave to appeal to the SCC was granted. The appeal was heard on February 15, 2018 and judgment was reserved. The *Redwater* decision is important for insolvency cases in the oil and gas industry in Alberta as it considered whether the bankruptcy trustee of an oil and gas company could disclaim the company's interest in "orphan" wells while selling valuable wells to maximize recovery to creditors – a step opposed to by the provincial energy regulator. The Court of Appeal confirmed that a court officer appointed under federal legislation may pick and choose the realizable property in an estate in order to maximize the recovery available for creditors without undue interference from a provincial regulator. This continues to be a very significant issue in insolvency cases in the oil patch and we await a final determination by the country's highest court with interest.

9. Right to Set Off or Compensation Between Pre- and Post-Filing Claims

2017 also saw the *Arrangement relatif à Métaux Kitco inc.* ("*Kitco*")[23] decision from the Quebec Court of Appeal, which found that set off (or "compensation" in Quebec) was not allowed between post-filing claims and pre-filing debts in a CCAA proceeding. While it has been widely accepted that pre-filing claims cannot be set-off against post-filing claims in a bankruptcy, the Ontario Court had held in the 2003 *Air Canada (Re)*[24] decision that there was no loss of mutuality and legal set-off could be asserted between pre- and post-filing debts in a CCAA proceeding (although the court did stay enforcement of such rights in that case). A similar result was reached in British Columbia in *North American Tungsten Corporation Ltd. (Re)*[25] (where leave to appeal was denied)[26] in 2015.

[22] 2016 ABQB 278, aff'd *Orphan Well Association v Grant Thornton Limited,* 2017 ABCA 124, leave to appeal to SCC granted, 2017 CarswellAlta 2352. See also Sean Collins et al., "Court of Appeal upholds Redwater decision," (Apr. 25, 2017), McCarthy Tétrault Blog: Restructuring Roundup, https://www.restructuringroundup.com/2017/04/court-of-appeal-upholds-redwater-decision/.

[23] 2017 QCCA 268.

[24] 2003 CanLII 64234 (ON SC).

[25] 2015 BCSC 1382.

[26] *North American Tungsten Corporation Ltd. v. Global Tungsten and Powders Corp.,* 2015 BCCA 390.

The Court in *Kitco* did not follow *Air Canada*. It referred to a 2003 Ontario Court of Appeal decision[27] in the BIA proposal context as well as to literature that was critical of the *Air Canada* decision for, among other things, creating an incentive for a creditor to procure goods or services from the debtor company post-filing and to withhold payment in order to recover pre-filing debt. Given the differing case law in Ontario and British Columbia, criticisms of the *Air Canada* case in the literature and moves to align bankruptcy and CCAA proceedings, where possible, it will be interesting to see how *Kitco* will be interpreted in future cases on this issue even outside of Quebec.

10. Repeal of *Bulk Sales Act* and Potential for Further Legislative Reform in Ontario

As discussed in our Canadian M&A Perspectives Blog,[28] Ontario's *Bulk Sales Act,* originally enacted to protect unpaid trade creditors from "bulk sales", was repealed in March 2017. The act became less relevant as other supplier rights developed, including PPSA security, oppression remedies and 30 day goods under the *BIA*. Repeal of the act was recommended by a business law advisory panel[29] to support greater market certainty and confidence in market transactions. The panel also recommended the repeal of the *Assignments and Preferences Act*[30] and the *Fraudulent Conveyances Act*[31] in Ontario, to be replaced by the Uniform Law Conference of Canada's *Reviewable Transactions Act*,[32] for the same reasons and to support consistency with the BIA. It will be interesting to see whether those acts are also repealed although we do not expect that to occur this year.

11. High Test to Impose Constructive Trust for Debtor Misconduct in Bankruptcy

In May 2017, the Pemberton Music Festival was cancelled and the hosts made assignments in bankruptcy. The ticket seller then claimed that the ticket sale proceeds received by the debtors were subject to a constructive trust. The B.C. Court, however, found no basis to impose a constructive trust based on unjust enrichment or to remedy misconduct, highlighting that the test for imposing a constructive trust in a bankruptcy is high since it violates the basic policy of *pari passu* distribution of assets.[33]

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[27] *Jones (Re)*, 2003 CanLII 21196 (ON CA).

[28] Ian Mak et al, "Ontario's Bulk Sales Act has been repealed," (Mar. 24, 2017), McCarthy Tétrault Blog: Canadian M&A Perspectives Blog, http://www.canadianmergersacquisitions.com/2017/03/24/ontarios-bulk-sales-act-has-been-repealed/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=inter-article-link.

[29] Business Law Agenda: Priority Findings & Recommendations Report (June 2015), available at http://www.ontariocanada.com/registry/showAttachment.do?postingId=18942&attachmentId=33251, last accessed Feb. 3, 2018.

[30] R.S.O. 1990, c. A.33.

[31] R.S.O. 1990, c. F.29.

[32] Uniform Law Conference of Canada, *Uniform Reviewable Transactions Act,* available at http://www.ulcc.ca/images/stories/2012_pdfs_eng/2012ulcc0035.pdf, last accessed Feb. 3, 2018.

[33] *Pemberton Music Festival Limited Partnership (Re),* 2017 BCSC 2398.

The Court noted the constructive trust to remedy misconduct is only available in bankruptcy proceedings in extraordinary cases where finding otherwise would result in a commercial immorality since it disrupts the usual scheme of distribution of the BIA. The applicants contended there was misconduct by the debtors in authorizing the sale of tickets when they must have known there was substantial uncertainty as to whether the festival would proceed. However, the Court held that the evidence fell short of establishing bad faith or other misconduct on the part of the debtors that would be sufficient to impost a constructive trust.

12. Importance of Vesting Orders for Providing Certainty in CCAA Transactions

2017 also saw another decision in the Wabush Mines proceedings emphasizing the importance of vesting orders to provide certainty in CCAA transactions. In 2016, the Quebec Superior Court had held that a vesting order could provide for the sale of certain properties owned by the debtor free and clear of any unpaid municipal taxes. Leave to appeal to this decision was denied in early 2017.[34] At the end of 2017, the same court again commented on the scope of vesting orders.[35]

The CCAA debtor, Wabush Mines, sold its assets to a buyer pursuant to a sale and vesting order. Prior to the sale, Wabush Mines had been required, pursuant to Quebec legislation, to put in place a pay equity program to determine whether a pay discrepancy existed between jobs traditionally held by men and those traditionally held by women and, if so, to correct it by salary adjustments retroactive to 2001. Wabush Mines did not finish the program prior to the CCAA filing (meaning the liability for salary adjustments was unclear). Following the sale, the Pay Equity Commission ("Commission") sought to re-open the file as against the new owner of the assets. No proof of claim was filed by or in connection with the Commission in the Claims Process and the Commission had not contested the vesting order.

The CCAA court did not explicitly consider whether the claim for retroactive salary adjustments was a "claim" pursuant to the Claims Process Order, although the Monitor argued it was a "claim" and that no proof of claim was filed in respect of those claims prior to the claims bar date. Rather, the Court focused on the very broad language of the vesting order and commented that it is fundamental to the CCAA process that the purchaser be able to buy the debtor's assets without fear of being sued for the debtor's debts and that any uncertainty about this affects the purchase price to the detriment of all creditors (since it is difficult to pay the best price when also being forced to write a "blank cheque" for indeterminate debts of the debtor). The purpose of a vesting order is to eliminate this uncertainty. The Court held that the order vested the assets in the buyer free and clear of all obligations of the seller, including any salary adjustments for the period prior to the purchase. The Court did not comment on whether the buyer was a successor employer (a fact that would have to be determined by the relevant administrative tribunal) but held that the tribunal could determine if the buyer had any obligations with respect to the pay equity program other than obligations for pre-purchase salary adjustments.

[34] *Bloom Lake, g.p.l. (Arrangement relatif à)*, 2016 QCCS 5620, leave to appeal refused, 2017 QCCA 15.
[35] 2017 QCCS 5573.

13. Nortel Settlement and Distribution

Finally, in January 2017, Nortel's restructuring plan for the Canadian debtors was sanctioned in both Canada and the United States and was implemented in May 2017, more than eight years after it had filed for CCAA protection. According to the Monitor:[36]

- The Canadian estate received its allocation entitlement of approximately $4.156 billion, expense reimbursement of $35 million and the release of further sale proceeds of approximately $237 million, among other amounts;

- Distributions began in July 2017 and the initial distribution to unsecured creditors with claims in Canadian dollars was just over 45 cents on the dollar; and

- As of November 2017, the Canadian estate had distributed approximately $4 billion to over 15,100 unsecured creditors and approximately $63 million of priority payments, among other distributions.

[36] One Hundred and Forty Third Report of the Monitor Dated November 21, 2017 in *Nortel Networks Corporation (Re),* Court File No. 09-CL-7950, available at Ernst &Young Inc. Restructuring Document Centre, http://documentcentre.eycan.com/eycm_library/Project%20Copperhead/English/Monitor's%20Reports/143%20Monitor%20Record%20Nov%2021%2017.pdf, last accessed Feb. 3, 2018.

About McCarthy Tétrault's Bankruptcy & Restructuring Group

McCarthy Tétrault has one of the leading bankruptcy & restructuring groups in Canada, with extensive experience in all areas of the practice. We regularly represent debtors as well as major financial institutions and other capital providers, large corporate creditors and court-appointed monitors, receivers and trustees.

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