
CCAA PROTECTION

Liquidating Under the CCAA: an Overview of Recent Developments in Cliffs Over Maple Bay and Pope & Talbot

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American lawyers find it unnerving that the Canadian restructuring scheme seems so uncertain due to the brevity of the *Companies' Creditors Arrangement Act* ("CCAA").¹ Whereas Chapter 11 of the U.S. Bankruptcy Code seems to have a specified rule and test for any situation, judicial discretion and inherent jurisdiction are the watchwords under the CCAA.

Canadian judges and lawyers appreciate the flexibility that is available from skeletal legislation that imposes few hard and fast rules. However, the situation we now face due to the British Columbia Court of Appeal's decision in *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*² highlights the negative side of the scope of judicial discretion in play under the CCAA. The primary purpose of this article is to provide a brief overview of the impact of this case on liquidating plans under the CCAA, and to discuss some other areas of uncertainty that have been created by this decision.

Liquidating Under CCAA Protection

There has been little controversy that sales of assets to allow for a downsizing of the debtor's operations can take place before the restructuring plan is presented to the creditors. However, the issue becomes less clear when a

full liquidation and shutdown of operations is contemplated.

There has been controversy over whether it is a proper use of the CCAA to obtain protection from creditors to allow for an orderly liquidation of the debtor company where there seems to be no purchaser who intends to continue operating the business. The recent decisions referred to in this article suggest that the ongoing evolution of the CCAA may well result in limits being imposed on the circumstances in which such a liquidation can take place within CCAA proceedings.

Purposes of the CCAA

There are many decisions in which the purpose of the CCAA is discussed. *The 2008 Annotated Bankruptcy and Insolvency Act*³ lists no less than 10 purposes. The cases often indicate that the purpose of the CCAA is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to allow the company to deal with financial difficulties. Some, but not all, of those decisions indicate that the compromise or arrangement is presented to allow the company to remain in operation or in business.

The Ontario courts have found no difficulty with using the CCAA to facilitate a liquidation. In *Re Olympia & York Developments Ltd.*,⁴ Farley J. indicated the CCAA could also involve a liquidation scenario. In *Re Lehndorff General Partner Ltd.*,⁵ Farley J. indicated that the CCAA could involve a winding up or liquidation, provided it was proposed in the best interests of the creditors generally.

In *Re Canadian Red Cross Society*,⁶ Blair J., then of the Ontario General Division (now of the Court of Appeal), indicated it was common in CCAA restructurings for the court to approve a sale and disposition of assets during the CCAA process and before the Plan is formally tendered and voted upon.

³ Lloyd W. Houlden, Geoffrey B. Morawetz and Janis P. Sarra, *The 2008 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Carswell, 2007).

⁴ (1995), 34 C.B.R. (3d) 93 (Ont. Gen. Div.) [*"Olympia & York"*].

⁵ (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.) [*"Lehndorff"*].

⁶ (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.).

¹ R.S. 1985, c. C-36.

² (2008), 296 D.L.R. (4th) 577 (B.C. C.A.) [*"Cliffs"*].

However, he stated that the circumstances must be “appropriate” and the orders must be made within the framework and in the spirit of the CCAA.

An Alberta Court has decided to the contrary. In *Re Fracmaster*,⁷ the Alberta Court of Queen’s Bench refused to approve a plan involving a liquidation that provided no recovery for unsecured creditors. There were several applications before the Court. The company applied to extend the stay for 60 days to allow the creditors to meet and vote on its plan. There was an application to approve a sale of all the company’s assets, which the secured creditors were contractually bound to support. Alternatively, they sought to lift the stay, appoint a receiver and allow the secured lenders to realize on their security. The secured creditors indicated they would vote against the plan being put forth by the debtor.

Madam Justice Paperny distinguished both *Olympia & York* and *Lehndorff*, and expressed concern over the fact that there was no value in the company greater than the amount owed to secured creditors – there was nothing at all available for the unsecureds.

She indicated it would be pointless to order meetings of the creditors since the secured creditors would clearly vote them down. She also refused to approve the asset sale under the CCAA. She indicated the purpose behind such an order was to facilitate a sale for the benefit of the secured lenders. She indicated a sale could be accomplished without distorting the spirit of the CCAA.

Madam Justice Paperny indicated that notwithstanding the Court’s broad powers under the CCAA, the plan before her and the CCAA itself specifically required the approval of the secured lenders. Since that approval would not be forthcoming, she ordered the stay to be lifted and appointed a receiver to liquidate.

The Root Question

Re Fracmaster alludes to the troubling question associated with liquidating CCAAs. Why should the debtor retain control over the liquidation process when the only parties who hold a real stake in the outcome are the

secured creditors? Surely the true stakeholders, generally the secured creditors, should have greater control or influence over the process than they currently have under the CCAA.

Pope & Talbot

In a decision dated July 18, 2008 in *Re Pope & Talbot Ltd.*,⁸ Chief Justice Brenner alluded to this question when considering whether it is within the discretion of the judge supervising a CCAA case to stay a creditor from relying upon a post-filing breach of a contract in order to terminate the contract. He indicated that he was mindful that he was dealing with a liquidating CCAA. He did not mention the fact that it seems unlikely that any plan will ever be presented in *Pope & Talbot* since the situation is so abysmal that only the DIP lenders have a remaining stake in the outcome.

The Chief Justice referred to the conflicting authorities and the unsettled state of the law, and then mentioned the discussion of the issue in Professor Janis Sarra’s book, *Rescue! The Companies Creditors Arrangement Act*.⁹ He seemed to endorse Professor Sarra’s conclusion that as long as the liquidation results in an enhanced result as compared to a bankruptcy for the creditors whose claims still have value, the plan could still be approved as fair and reasonable.

While acknowledging the conflicting Alberta case law, the Chief Justice went on without further discussion to conclude that the Court had the discretion to decide the issue before him despite the fact that it was a liquidating CCAA. It is implicit in that conclusion that in British Columbia, liquidation can take place under CCAA protection.

Cliffs Over Maple Bay

The Facts

The debtor was a land development company who was carrying out a phased development of a 300 acre site on Vancouver Island. Their plan was essentially to build a golf course, install the services, then sell residential lots surrounding the golf course.

⁷ (1999) 11 C.B.R. (4th) 204 (Alta. Q.B.).

⁸ Docket No. SO77839.

⁹ (Toronto: Thomson Carswell, 2007).

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The first phase was 95% complete with the remaining four phases less far along. The developer had run into delays and budget overruns. Ongoing construction was virtually halted. The main two mortgages had matured and the developer had not been able to arrange refinancing.

The problems came to a head when the anticipated source for the water to irrigate the golf course proved to be problematic. The developer notified the lenders of this problem and they quickly issued notice of intention to enforce their security.

The value of the development was estimated to be as follows:

- with no source of water: \$10 million;
- with water: \$28 million; and
- as a going concern at completion: \$50 million.

The aggregate balance owing on the two most significant mortgages registered against the development was approximately \$28,800,000. The company also had unsecured liabilities in the aggregate amount of approximately \$7,340,000.

The company was granted an initial protective stay order under the CCAA. It later applied for and was granted an extension of the stay and authority for a DIP loan to pursue an alternative source for water and lot sales.

The holders of the largest mortgages appealed that decision and argued that they should be free to foreclose. They argued that the CCAA should not apply to companies whose sole business is a single land development or to companies whose business is essentially dormant.

The Decision

Justice Tysoe indicated that the CCAA clearly applied to the debtor, but said the real question is whether a stay should have been granted under section 11 of the CCAA in this case. He indicated the ability of the Court to grant a stay under section 11 is not a free-standing remedy available to any debtor wishing to undertake a restructuring. Section 11 is ancillary to the fundamental purpose of the CCAA and a stay freezing creditors' rights should only be granted in furtherance of the CCAA's fundamental purpose.

Justice Tysoe then referred to the CCAA and decisions of the B.C. Court of Appeal cited in *Re United Used Auto & Truck Parts Ltd.*¹⁰ in which the fundamental purpose of the CCAA was discussed. The title of the CCAA indicates that it is:

An Act to facilitate compromises and arrangements between companies and their creditors.

It is noteworthy that in both of the decisions he cited in *United Used Auto*, the quoted passages go beyond the purpose stated in the title of the CCAA to indicate that the end goal is to allow the company to remain in operation and continue its business for the future benefit of both the company and its creditors.

The Court indicated that a stay should not be granted or continued if the debtor company does not intend to propose a compromise or arrangement to its creditors. Justice Tysoe indicated that he agreed with decisions approving the use of the CCAA to effect a sale, winding up or liquidation. However, he queried but did not decide whether the Court should grant a stay to permit a liquidation if it was not part of the arrangement approved by the creditors and sanctioned by the Court. He also queried whether the Court should grant a stay to permit a sale or liquidation without requiring a creditor vote if the company will simply propose that the net proceeds from the sale be distributed to its creditors.

He also questioned, again without deciding, whether the Court should continue the stay to allow the debtor to fulfil a critical prerequisite to its plan without requiring a vote by the creditors. He noted that some prerequisites may be so fundamental that they should be regarded as part of the overall plan.

Earlier in his decision, Justice Tysoe had indicated that the nature and state of the debtor's business are simply factors to be taken into account when considering under section 11(6) whether to grant a stay. Later in the decision he indicated that, although the CCAA can apply to companies whose sole business is a single land development, it may be that, in view of the nature of its business and financing arrangements, such companies would have difficulty proposing an

¹⁰ (2000), 16 C.B.R. (4th) 141 (B.C. C.A.).

arrangement that was more advantageous than the remedies available to its creditors. He noted that secured creditors may feel that they will be in a better position by exercising their remedies than by letting the developer remain in control while attempting to orchestrate a rescue through DIP or other financing.

Justice Tysoe indicated that the failure of the chambers judge to consider the fundamental purpose of the CCAA infected both his decision to extend the stay and his exercise of discretion in authorizing the DIP financing. He allowed the appeal and set aside the order that the stay should be extended and the DIP approval order, because the company was not proposing an arrangement or compromise with its creditors.

Judicial Reaction to the Cliffs Decision

While the potential effects of this decision are quite significant, to date it has had little effect beyond creating uncertainty among some insolvency lawyers.

In *Re Hayes Forest Services Ltd.*,¹¹ Justice Burnyeat was asked to consider whether the debtor's non-disclosure warranted setting aside the stay. The principal non-disclosure related to ongoing arbitrations under two contracts which might have a significant impact on Hayes' financial ability to continue its operations and present a plan to its creditors.

Justice Burnyeat indicated that, in accordance with the principles set out in the *Cliffs* decision, he was satisfied that Hayes had shown an intention to put a plan before its creditors and that the financing was in place to allow sufficient time to bring forward its plan.

Implications of Cliffs

It is submitted that *Cliffs* is binding authority to the effect that a stay can only be granted in furtherance of the CCAA's fundamental purpose, which is to facilitate the presentation of a restructuring plan or arrangement to the company's creditors. Materials in support of every Initial Application and every application for an extension must therefore satisfy the court that the company intends to file a plan and hold a creditors meeting.

Earlier Scrutiny of the Plan

While the *Cliffs* case does not actually decide the question, it suggests that judges hearing CCAA cases, particularly cases involving single purpose real estate development companies, are entitled to expect debtor's counsel to file materials indicating the following:

1. A company whose plan is to liquidate and simply distribute the net proceeds of sale to its creditors should indicate that it will seek creditor approval before carrying out its liquidation.
2. Where the plan to liquidate is known at the time of the Initial Application, or becomes inevitable at any later extension application, the company should disclose why, in the context of the nature of the company's business and financing arrangements, liquidation under the CCAA is more advantageous than allowing secured creditors to exercise their remedies.
3. Where there is a critical prerequisite to the company filing its plan, the company should indicate why it should be entitled to proceed to go forward to fulfil this prerequisite, as opposed to including the prerequisite as part of the plan and obtaining creditor approval. In some cases, the company may have to present a "holding plan" to the creditors to deal with this issue.

All this suggests that CCAA judges may more closely scrutinize the company's restructuring plan at an earlier stage than in the past.

The Court's queries provide potentially fruitful arguments for counsel for creditors seeking to terminate the stay. The queries should be seen as an indication that these are legitimate issues worthy of full argument and consideration by the CCAA court, and eventually by the Court of Appeal.

Greater Leverage for Secured Creditors

CCAA judges may conclude that, for single purpose real estate development companies and possibly other businesses, where liquidation seems inevitable, they should give greater weight to the wishes of the creditors whose interests are truly affected by the liquidation and less weight to the "greater constituency," such as employees, and the community in which the business is located.

¹¹ 2008 BCSC 1256.

Secured Creditors Beware

One other recent decision suggests that secured creditors may be more inclined to oppose the granting of a CCAA stay order or an extension of the stay than in the past. On July 30, 2008 in *Re Pope & Talbot Ltd.*, an application was made before Chief Justice Brenner to approve a sale of the Harmac Pulp mill to Nanaimo Forest Products, a new company in which some of the shares were held by the pulp mill employees. By the time of this application, Pope & Talbot was under CCAA protection but was also in receivership with the receiver conducting the liquidation.

The only creditor with any realistic hope of recovery was the DIP lender, who opposed the receiver accepting the offer. The receiver indicated it was unable to conclude that the offer was appropriate for recommendation to the Court since there appeared to be at least the prospect that an alternative offer might be obtained from a party prepared to pay possibly millions of dollars more than would be recovered under the Nanaimo Forest Products offer.

Chief Justice Brenner acknowledged that the primary duty of the receiver is to get the best possible price for an asset. However, he pointed out that the case remained a continuation of proceedings under the CCAA so the Court must consider the principles underlying the CCAA and the wider interests of stakeholders affected by an insolvency under the CCAA. This included 300 hourly paid employees who work at the pulp mill, the mill's suppliers and the surrounding community. The Chief Justice approved the sale despite evidence that other alternatives existed which would likely produce significantly greater recovery for the DIP lender.

Conclusion

For many years, the pendulum has swung toward dealing with an ever wider set of circumstances under the protection of the broad stay of proceedings available under the CCAA. Recent developments in both *Re Pope & Talbot Ltd.* and *Re Cliffs Over Maple Bay Investments Ltd.* hint that the pendulum may have lost momentum and may be swinging back, toward a more restricted application of the CCAA to cases where the result of the restructuring will be an ongoing business.