Gambling From the Bottom Rung of the Priority Ladder: CCAA Restructuring, Shareholder Equity and the *Stelco* Case

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Shauna Towriss
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GAMBLING FROM THE BOTTOM RUNG: CCAA RESTRUCTURING, SHAREHOLDER EQUITY AND THE *STELCO* CASE

> *Because of this country's relatively small population…Canadian industry is and probably will continue to be very much dependant on world markets and consequently vulnerable to world depressions. If there should be such a depression it will become particularly important that an adequate reorganization procedure should be in existence so that the Canadian economy will not be permanently injured by discontinuance of its industries, so that whatever going concern value the insolvent companies have will not be lost through dismemberment and sale of their assets, so that their employees will not be thrown out of work, and so that large numbers of investors will not be deprived of their claims and their opportunity to share in the fruits of the future activities of the corporations. While we hope that this dismal prospect will not materialize, it is nevertheless a possibility which must be recognized. But whether it does or not, the growing importance of large companies in Canada will make it important that adequate provision be made for reorganization of insolvent corporations.*
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> ~Stanley E. Edwards, Canadian Bar Review article, 1947[1]

INTRODUCTION

Although written 60 years ago, Edwards' comments are, for the most part, still apt today. Modern Canadian companies operate within and depend upon a complex and interdependent global commercial world that is highly competitive and is characterized by continuously evolving and fluctuating market and customer demands. In addition, after a number of significant high profile corporate governance scandals over the last decade in North America, the commercial world in which Canadian companies operate their businesses now involves increased government and public scrutiny of corporate behaviour. All of these factors combine with increased globalization and global competitiveness to create an environment where, as companies work to operate successfully under these dynamic conditions, insolvency (temporary or otherwise) will unfortunately be the inevitable consequence for many. Indeed, in the last decade, a significant number of iconic Canadian enterprises, including Woodward's, Eaton's, Canadian Airlines and Air Canada have found themselves teetering on the precipice of

[1] Stanley E. Edwards, "Reorganizations Under the *Companies' Creditors Arrangement Act*" (1947) 25 Canadian Bar Rev. 587 [Edwards, "Reorganizations"].

insolvency for any of a number of different reasons.[2] However, having availed themselves of the renownedly flexible and evidently debtor-friendly[3] *Companies' Creditors Arrangement Act*,[4] most such companies have managed to come away from the brink as restructured, "new, better corporation[s]" ready to go forward as viable and profitable businesses.[5]

The surprisingly threadbare provisions of the *CCAA* are the primary method by which large insolvent Canadian corporations choose to restructure their affairs when they experience significant and business-threatening financial distress. The *CCAA* is a short statute comprised of less than 25 sections and was enacted during the Depression. It is applicable exclusively to the commercial insolvency of debtor corporations carrying more than $5 million in debt, and although financially troubled debtor corporations technically may choose to proceed under either the *CCAA* or the proposal provisions of the *Bankruptcy and Insolvency Act*;[6] the *BIA* is best suited for small- to medium-sized insolvent corporations while the *CCAA* is most effective for large and complex restructurings.[7]

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[2] See for example, Kevin P. McElcheran, *Commercial Insolvency in Canada* (Markham, Ont: LexisNexis Butterworths, 2005) [McElcheran, *Commercial Insolvency*] where McElchern says at page 1, "The insolvency of a business enterprise may be the result of many different external factors that do not affect the essential viability of the underlying business. In some cases, temporary adverse factors result in the inability of the business enterprise to meet its obligations generally as they come due. However, it is [also] important to recognize that insolvency may be an ailment affecting the owner of the business. It may not be terminal to the business itself."

[3] For a brief discussion of this perspective, see Joyce Hampton, "Do the courts favour debtors in insolvency cases?" (1996) 15 The Lawyers Weekly 35 where the author quotes Michael Barrack of the Toronto office of McCarthy Tétrault as saying that "…there is a process underway that can give rise to the perception of debtor-friendliness. If judges perceive their role of judicial success being to promote a restructuring and they are unsuccessful if a liquidation occurs, such judicial attitudes can cause a subtle, or non-subtle, skewing in favour of those parties who favour a restructure. It doesn't occur in every case with every judge but it's a subtlety at the margin that causes the problem."

[4] R.S.C. 1985, c. C-36 [the "*CCAA*"].

[5] See *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 (Ont. Ct. (Gen. Div.)) (aff'd (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.)), in which Farley J., at p. 171, was dealing with the oppression remedy and stated that in determining a plan of operation for the corporation, the directors and officers should act to make the corporation a "better corporation" and if they do, the shareholders will benefit. See also *Stelco Inc. (Re)* (2005) 7 C.B.R. (5th) 310 at para. 4 (Ont. Sup. Ct. J), rev'd on other grounds (2005) 9 C.B.R. (5th) 135 (Ont.C.A.).

[6] R.S.C. 1985, c. B-3 [the "*BIA*"].

[7] As Caplan and Gollob, *infra* note 24, state at pages 8-9, "[g]enerally, the proposal procedure under the *BIA* is less costly and takes less time to complete than a proceeding under the *CCAA*. The rules and deadlines for *BIA* proposals are more rigid and the courts have less discretion than under the *CCAA*, which has very few procedural requirements. The *CCAA* is more commonly used for large corporate restructurings primarily due to [its] greater flexibility…The lack of rules under the *CCAA* allows for the exercise of considerable judicial discretion, especially with respect to the stay of proceedings. In contrast, the scope of the stay of proceedings under the *BIA* is prescribed by the statute. While the expense, duration and discretionary element of *CCAA* proceedings can be disadvantageous to secured creditors, *CCAA* proceedings may be attractive when there is a need for a more extensive stay of proceedings."

The fact that a large number of significant Canadian enterprises have been able to escape the spectre of insolvency and successfully emerge from their respective *CCAA* proceedings speaks to the lasting value and effectiveness of that statute. Indeed, with the frequency that the *CCAA* is employed today, it is difficult to believe that it was only occasionally used and lay practically dormant for the first 50 years following its enactment.[8] The *CCAA* provides companies with the option to save an essentially viable enterprise through the mechanisms of compromise, reorganization and restructuring, thus avoiding bankruptcy and liquidation of the corporate assets. This highlights the policy focus of Canada's insolvency regime as being rehabilitative as opposed to retributive of debtor corporations.[9] Indeed, as McElcheran states, the provisions of the *CCAA* and the *BIA* belie a "legislative preference for reorganization and compromise of creditor claims against insolvent business debtors over the closure and liquidation of their assets."[10]

One of the above-referenced 'iconic' and long-standing Canadian companies that recently availed itself of the advantageous provisions of the *CCAA* to avoid bankruptcy and complete a restructuring and reorganization of its business is the Hamilton, Ontario based steelmaker, Stelco Inc. ("Stelco"). The Stelco *CCAA* restructuring took more than two years to complete; and coming as it did almost directly on the heels of the equally high-profile Air Canada case, it garnered significant and widespread media attention. This media attention brought the Stelco restructuring out of the boardrooms of law firms and the halls of legal academia and into the living rooms of regular Canadians via the evening news or the daily newspapers, with the result that regular Canadians may have become, if only for a short time, at least peripherally aware of the existence of commercial insolvency events. This in itself is noteworthy considering that a little over 20 years ago Canadian corporate lawyers themselves were largely unfamiliar with the *CCAA* and its potential.[11]

Aside from its media notoriety, the Stelco *CCAA* restructuring was and is important on a number of other fronts, not the least of which is the size and complexity of the

[8] Janis P. Sarra, *Creditor Rights and The Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003) at 16 [Sarra, *Creditor Rights*].
[9] *Ibid* at 12.
[10] McElcheran, *Commercial Insolvency*, *supra* note 2 at 9.
[11] Christopher Moore, *McCarthy Tétrault: Building Canada's Premier Law Firm 1855-2005*. (Vancouver: Douglas McIntyre Ltd., 2005) at 174 [Moore, *McCarthy Tétrault*].

reorganization, the length of time it took to develop the ultimately successful plan of compromise and arrangement and the numerous precedents and clarifications of the law that the case established. Against this background and bearing this in mind, this paper will examine the Stelco restructuring as it relates to a few significant areas of insolvency law. In particular, the below discussion will focus on the controversy that arose regarding the value of the shares of Stelco during the court-ordered stay period and the ultimate treatment that the pre-existing shareholders received in the final plan of compromise and arrangement.[12] As will be seen below, focusing on this aspect of the Stelco restructuring will lead to a dynamic discussion drawing together a number of different and complementary threads of corporate and insolvency law.

To set the stage, Part I of this paper discusses the historical foundations and purposive premises underpinning the *CCAA*. Part II sets up the essential challenge that exists in *CCAA* restructurings with respect to dealing with existing shareholder equity and discusses how the courts have generally approached the issue. Part III discusses the Supreme Court of Canada's noteworthy 2005 decision in *Peoples Department Stores Inc. (Trustee of) v. Wise*, *infra*, and explains the current law in Canada with respect to directors' statutory duties in an insolvency situation. Finally, Part IV will focus an analytical lens on the Stelco *CCAA* workout, synthesizing the above topics and discussion in an examination of the unique features of the Stelco restructuring, with particular emphasis on the issue of dealing with existing shareholder equity.

PART I: HISTORICAL FOUNDATIONS AND PREMISES OF THE *CCAA*

Legislative Background

Richard H. McLaren discusses the legislative and historical underpinnings of the *CCAA*, noting that the first comprehensive Canadian legislation in the area of bankruptcy and reorganization was brought into force in 1919;[13] and the origins and influence of this early

[12] (2006), 17 C.B.R. (5th) 78 [*Stelco: Sanction Order*].

[13] *Bankruptcy Act*, S.C. 1919, C-36 [the "*Bankruptcy Act*"]. See §1.50 in Richard H. McLaren, *Canadian Commercial Reorganization: Preventing Bankruptcy*, looseleaf (Aurora, Ont.: Canadian Law Book Inc., 2002) [McLaren, *Canadian Commercial Reorganization*].

legislation was, of course, the bankruptcy laws of the United Kingdom.[14] McLaren explains that as the first legislative enactment in this area of the law, the Canadian *Bankruptcy Act* of 1919 "brought relief to insolvent companies" who were seeking reorganization because it "permitted a limited company to make a proposal to creditors before a receiving order was filed or an assignment was made…[and] reorganization of the debtor could therefore be carried out without bankruptcy taking place."[15] This welcome and helpful state of affairs was short-lived, however, because in 1923, the *Bankruptcy Act* was amended by the *Bankruptcy Act Amendment Act, 1923*[16] to require debtors to actually be bankrupt before they were permitted to make a proposal to their creditors.[17] This turn of events was unpopular with many corporate debtors, and it is certainly not difficult to conceive of how challenging it would be to reorganize and rehabilitate a bankrupt company as opposed to one that was insolvent. McLaren states that after the enactment of these restrictive amendments in 1923, "the insolvency of a company signaled a slippery slope of events that would often result in dissolution…[so], the need arose for the introduction of legislation which would allow companies to make arrangements or compromises with creditors before bankruptcy."[18]

Based on this set of circumstances and with the desire to combat this inevitable 'slippery slope of events', the Canadian Parliament enacted the original *CCAA* in the aftermath of the notorious stock market crash of 1929 and during the throes of the Great Depression.[19] Because of the desperate economic times, many companies were defaulting on large public debts and the strictures of the then-existing legislation offered them no ability to preemptively reorganize to maximize going concern value by effecting compromises with their creditors rather than resigning themselves to the inevitability of bankruptcy and liquidation. Speaking to these pressing and urgent issues during the introduction of the initial *CCAA* bill for first reading in the House of Commons, the Honourable C. Cahan, then Secretary of State, delivered the following oft-quoted remarks:

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[14] *Ibid.*
[15] McLaren, *Canadian Commercial Reorganization*, *supra* note 2 at §1.2150.
[16] S.C. 1923, c.31.
[17] McLaren, *Canadian Commercial Reorganization supra* note 2 at §1.2200.
[18] *Ibid.* §1.12250
[19] *Ibid.* §1.12300. See also John D. Honsberger and Vern W. DaRae, *Debt Restructuring: Principles and Practice*, looseleaf (Aurora, Ont.: Canada Law Book Inc., 2006) at §9:02 [Honsberger and DaRae, "*Debt Restructuring*"].

> …[t]here is no mode or method under our laws whereby the creditors of a company may be brought into court and permitted by amicable agreement between themselves to arrange for a settlement or compromise of the debts of the company in such a way as to permit the company effectively to continue its business by its reorganization…At the present time, some legal method of making arrangements and compromises between creditors and companies is perhaps more necessary because of the prevailing commercial and industrial depression and it was thought by the government that we should adopt some method whereby compromises might be carried into effect under the supervision of the court without utterly destroying the company or its organization, without loss of goodwill and without forcing the improvident sales of its assets.[20]

Thus, the year 1933 saw the enactment of the *CCAA* – a short, seemingly innocuous statute that has played a significant role in Canadian corporate law since the 1980s. One would be forgiven for not comprehending, or perhaps not even believing, that this skeletal piece of legislation could play such a role; and indeed, it is also very unlikely that the legislators who enacted the *CCAA* foresaw such a prominent role in the statute's future.[21] Its drafting influence and model was the English *Companies Act, 1929* and as Honsberger and DaRae note, much of the key language and relevant portions of the two statutes "are almost identical".[22] Interestingly, according to these authors, "[t]he principal and only difference between the *CCAA* and its English drafting model is that the *CCAA* does not provide for an arrangement to be made between a company and its shareholders."[23] The ramifications of this aspect of the *CCAA* will be explored further in Part II below.

The *CCAA* has been variously described as "the most important Canadian statute in the reorganization of large corporate debtors",[24] "a vitally important part of [Canadian] corporate law"[25], "the tool of choice for companies undergoing financial restructuring",[26] and "a formidable tool for debtors".[27] The resurgence in the successful use of the statute since its

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[20] Honsberger and DaRae, *Debt Restructuring*, *supra* note 19 at §9:02.
[21] S.C. 1933, c.36.
[22] Honsberger and DaRae, *Debt Restructuring*, *supra* note 19 at §9:03.
[23] *Ibid.* Note in particular the author's comparison of subsections (1) and (2) of section 206 of the *English Companies Act, 1929* with sections 4,5, and 6 of the *CCAA*.
[24] Jeffrey B. Gollob & Lisa Kerbel Caplan, "Overview of Insolvency Proceedings in Canada" (2000) 12 Comm. Insol. R. 39 at 14-15 [Gollob & Caplan, "Overview"].
[25] Sarra, *Creditor Rights*, *supra* note 8 at 27.
[26] Douglas S. Nishimura, "The Companies' Creditors Arrangement Act and the Petroleum Industry: The Blue Range Resource Corporation Proceedings" (2001) 39 Alberta L. Rev. 35 at 36.
[27] Gollob & Caplan, "Overview", *supra* note 24 at 15.

enactment has contributed to the creation of these superlative descriptions. Moreover, its deceptive brevity as well as the role the courts have played in its dynamic application and evolution has also contributed to the *CCAA*'s favourable reputation. LoPucki and Triantis state that "[t]he *CCAA* has few statutory provisions worth noting, but [has] a rapidly growing body of case law",[28] and this is certainly true. The ability and willingness of the Canadian courts to "'flesh out' the bare bones"[29] of the provisions in the *CCAA* is well documented and has been equally praised and criticized by lawyers, academics and other commentators and participants in the restructuring processes.

Despite the laudable and important purposes and foundations behind its enactment, the *CCAA*, as noted above, essentially collected cobwebs until the next serious economic downtown during the late 1980s and early 1990s when the advisors to highly leveraged firms 'too big to fail' sought methods by which such corporations could avoid bankruptcy.[30] In pursuit of some equivalent to the US Chapter 11 process, companies and their creative corporate counsel 'rediscovered' the inherently flexible bare-bones provisions of the *CCAA*. Professor Janis Sarra explains the reinvigorated interest in, and increased reliance upon, the short but powerful *CCAA* as follows:

> [t]he *CCAA* essentially fell into disuse for half a century [following its enactment], and notwithstanding its existence, Canada's insolvency system historically favoured liquidation. Only in the past fifteen years has there been a shift towards a regime that encourages restructuring. The renewed interest in the *CCAA* was likely driven by the need to find alternatives to premature liquidation. With the growth of debt financing, failures from leveraged buyouts and fluctuating products markets, and competition for capital in an increasingly global market, the size and impact of firm failure was unprecedented.[31]

These conclusions as to the effect of the recession on large Canadian companies are echoed by Honsberger and DaRae who state that, "the depression of the early 1980s caused many large corporations to become insolvent and forced them to negotiate with their creditors

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[28] Lynn M. LoPucki & George G. Triantis, "A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies" (1994) 35 Harv. Int'l L.J. 267 at 278 [LoPucki & Triantis, "A Systems Approach"].
[29] *Re Westar Mining Ltd.*, 14 C.B.R. (3d) 88 (B.C.S.C.) at 93. See also *Stelco Inc. (Re)* (2005), 9 C.B.R. (5th) 135 (C.A.) at para. 32 and Honsberger and DaRae, *Debt Restructuring*, at 9:02.
[30] Moore, *McCarthy Tétrault*, *supra* note 11 at 174.
[31] Sarra, *Creditor Rights*, *supra* note 8 at 16.

and they found the *CCAA* useful in doing so."[32] In addition, McLaren explains that the ability to stay the claims of secured creditors under the *CCAA* was an enormous boon for large companies on the brink of insolvency, because in the late 1980s and early 1990s, the *Bankruptcy Act* in existence at the time contained no provisions to permit the stay of secured creditors' claims.[33] Of course, this is no longer a consideration when choosing between the two statutes because the *BIA* was amended in 1992 to permit companies to make compromises with secured creditors,[34] but it is nevertheless interesting to note in considering the *CCAA*'s rapid climb in popularity as the preferred restructuring tool of corporate debtors. Gollob and Caplan detail the following four factors which also affected the decision of large insolvent companies to resort to the *CCAA* beginning in the late 1980s:

> (i) As a result of the generally liberal judicial approach to interpretation of the *CCAA* and the almost complete absence of statutory rules of procedure, proceedings under the *CCAA* offer significantly more flexibility to a debtor company than proceedings under the *BIA*.
>
> (ii) There is no statutory time limit prescribed by the *CCAA* for the stay of proceedings, although the initial stay cannot exceed 30 days. There is no limit on the length of an extension...
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> (iii) A court under the *CCAA* has the discretion to make certain third parties, who are not creditors of the debtor, subject to the stay of proceedings. However, the *CCAA* prohibits orders staying proceedings against a debtor company's guarantors or obligors under letters of credit. Even with this constraint, there is more flexibility with respect to a stay than under the *BIA*.
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> (iv) If a debtor's unsecured creditors reject a proposal under the *BIA* or the court refuses to approve it, the debtor will be automatically adjudged bankrupt. Rejection of a plan of compromise or arrangement under the *CCAA* dopes not have this effect although, as a practical matter, a bankruptcy will frequently result.[35]

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[32] Honsberger and DaRae, *Debt Restructuring, supra* note 19 at § 9:01.
[33] McLaren, *Canadian Commercial Reorganization*, *supra* note 2 at §1.2600.
[34] *Bankruptcy Amendment Act*, S.C. 1992, c.27.
[35] Gollob & Caplan, "Overview", *supra* note 24 at 15-16.

The Purposes of the CCAA According to the Case Law

Burnyeat J. of the B.C. Supreme Court, writing when he was still a partner at Davis & Company LLP in Vancouver, B.C.,[36] stated that prior to the renewed interest in the *CCAA* in the 1980s and 1990s, most case law seemed to assume that the limitations and possibilities of the *CCAA*, as well as the reasons underlying its enactment, were best explained by Duff C.J. in *In the Matter of a Reference Concerning the Constitutional Validity of the Companies' Creditors Arrangement Act*.[37] In that case, Duff C.J. stated at page 661 that,

> …the aim of the *Act* is to deal with the existing condition of insolvency, in itself, to enable arrangements to be made, in view of the insolvent condition of the company, under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy.

And at page 662, he further explained that,

> [t]he ultimate purpose would appear to be to enable the Court to sanction a compromise which, although binding upon a class of creditors only, would be beneficial to the general body of creditors as well as to the shareholders.

These comments by Duff C.J. have been quoted often, and they summarize the goals and purposes of the *CCAA* clearly and succinctly. Many other cases have similarly discussed the historic and continuing purposes shaping and underpinning the *CCAA*; for example, in *Chef Ready Foods Ltd. v. Hong Kong Bank of Canada*,[38] Gibbs J.A., summarized the focus of the *CCAA* and explained the general outline of the procedures thereunder in the following brief paragraph at page 88:

> The purpose of the *CCAA* is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. It is available to any company incorporated in Canada with assets or business or business activities in Canada that is not a bank, a railway company, a telegraphy company, an insurance company, a trust company or a loan company. When a company has recourse to the *CCAA* the court is called upon to

[36] Grant Burnyeat, "Recent Developments Under the *CCAA*" in *Workouts: Rescuing Value—The Dynamics of a Business Recovery* (Toronto: The Canadian Institute, 1990).
[37] [1934] S.C.R. 659 [*CCAA Reference*].
[38] (1990), 51 B.C.L.R. (2d) 84 (B.C.C.A.) [*Chef Ready Foods*].

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

Echoing the above discussion regarding the economic impetus behind the enactment of the *CCAA*, Gibbs J.A. remarked further on at page 91 that,

> The *CCAA* was enacted by Parliament in 1933 when the nation and the world were in the grip of an economic depression, when a company became insolvent liquidation followed because that was the consequence of the only insolvency legislation which then existed—the *Bankruptcy Act* and the *Winding-Up Act*. Almost inevitably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the *CCAA* to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

These comments, in addition to highlighting the grave economic circumstances in place at the time the *CCAA* came into force, also emphasize that there are a wide variety of interests at stake in any given corporate insolvency that stand to benefit when firm failure of a viable company is avoided. Gibbs J.A., among other judges who have discussed the purposes and foundations of the *CCAA,* also cited the following passage written by Stanley E. Edwards in the 1947 article, "Reorganizations Under the Companies' Creditors Arrangement Act":

> It is important in applying the *CCAA* to keep in mind its purpose and several fundamental principles which may serve to accomplish that purpose. Its object, as one Ontario Judge has cited in a number of cases, is to keep a company going despite insolvency. Hon. C.H. Cahan when he introduced the bill in the House of Commons indicated that it was designed to permit a corporation, through reorganization, to continue its business, and thereby to prevent its organization being disrupted and its goodwill lost. It may be that the main value of assets of a company is derived from their being fitted together into one system and that individually they are worth little. The trade connections associated with the system and held by the management may also be valuable. In the case of a large company it is probable that no buyer can be found who would be able and willing to buy the enterprise as a whole and pay its

> going concern value. The alternative to reorganization then is often a sale of the property piecemeal for an amount that would yield little satisfaction to the creditors and none at all to the shareholders.[39]

Thus, judging from the comments of Gibbs J.A. and the comments he quotes by Edwards, the impetus for restructuring is clear: there are many interests that stand to suffer in a bankruptcy of an otherwise viable corporation and where restructuring is not undertaken, recovery for these stakeholders will be minimal. To this end, Edwards also goes on to highlight the fact that "reorganization may give to those who have a financial stake in the company an opportunity to salvage its intangible assets",[40] and in *Chef Ready Foods*, Gibbs J.A. further quotes and concurs with another passage from Edwards' article:

> [t]here are a number of conditions and tendencies in this country which underline the importance of this statute. There has been over the last few years a rapid and continuous growth of industry, primarily manufacturing. The tendency here, as in other expanding private enterprise countries, is for the average size of corporations to increase faster than the number of them, and for much of the new wealth to be concentrated in the hands of existing companies or their successors. The results of permitting dissolutions of companies without giving the parties an adequate opportunity to reorganize them would therefore likely be more serious in the future than they have been in the past.[41]

It is clear, then, based on the foregoing discussion, what it is that the *CCAA* was and is intended to facilitate and accomplish. However, is the *CCAA* to be used to facilitate reorganizations in all circumstances and at all costs? As will be seen below in the discussion regarding Stelco, some stakeholders would surely argue that this is exactly how the *CCAA* has been used by debtor corporations. However, Farley J. addressed this issue in *Inducon Development Corp. (Re)*,[42] where he described the *CCAA* as "an elderly statute…[that]…is designed to be remedial."[43] He cautioned that "it is not however designed to be preventative" and explained that resort to its provisions "should not be the last gasp of a dying company" but rather that the *CCAA* "should be

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[39] *Supra*, note 39 at page 91, citing Edwards, "Reorganizations", *supra* note 1 at 592, citations omitted.
[40] Edwards, "Reorganizations", *supra* note 1 at 592.
[41] Edwards, "Reorganizations", *supra* note 1 at 590.
[42] (1991), 8 C.B.R. (3d) 306 (Ont. Gen. Div.)
[43] *Ibid.* at para. 12.

implemented, if it is to be implemented, at a stage prior to the death throe."[44] Thus, the *CCAA* is not and will not be a panacea to save the day in every insolvency situation.

In terms of the procedural and mechanical aspects of the *CCAA*, in *Campeau v. Olympia & York Developments Ltd.*,[45] Blair J. stated that,

> By its formal title, the *CCAA* 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.

In addition, and building upon the above-noted idea of 'respite' from creditors, in *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*,[46] Borins J. discussed the policy and objectives of the *CCAA* and highlighted the myriad of interests that hang in the balance when a company becomes insolvent, noting that the *CCAA* proposes a regime for

> the court-supervised re-organization of the applicant company intended to avoid the devastating social and economic effects of a creditor initiated termination of its on-going business operations and enabling the company to carry on its business in a manner in which it is intended to cause the least possible harm to the company, its creditors, its employees and former employees and the communities in which it carries on and carried on its business operations.[47]

This focus on encouraging the common benefit to be derived from fostering a regime where businesses may restructure and move forward on a going concern basis was also discussed in *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada* where McEachern C.J.B.C.,[48] as he then was, stated on behalf of the court that,

> …there can be no doubt about the purpose of the *CCAA*. It is to enable compromises to be made for the common benefit of the creditors and of the company, particularly to keep a company in financial difficulties

[44] *Ibid.* at para. 13.
[45] (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) at para 13.
[46] (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) [*Sklar-Peppler*].
[47] *Ibid.* at para 3.
[48] (1989), 73 C.B.R. (NS) 195 (B.C.C.A.) [*Northland*].

> alive and out of the hands of liquidators. To make the *Act* workable, it is often necessary to permit a requisite majority of each class to bind the minority to the terms of the plan, but the plan must be fair and reasonable.[49]

Finally, in an excellent summation of the various common perspectives discussed in this Part, Newbury J.A. remarked at paragraph 10 of *Quinsam Coal Corp. (Re)* that "the purpose of *CCAA* proceedings is to allow the *best solution* to be brought forward from the viewpoint of the company's creditors and the company itself."[50]

Almost all of the case law discussed above highlights the normative assumption prominent in Canadian insolvency law of favouring the rehabilitation of debtor corporations with a view to preserving going concern value in order to benefit the maximum number of stakeholders. Indeed, as Professor Sarra notes, "[w]hile rehabilitation should not be the exclusive goal of insolvency law, a workout is frequently the course that will best maximize enterprise value and best recognize diverse interests of all those with equity capital, debt, human capital, and other investments in the corporation."[51]

PART II: THE POSITION OF SHAREHOLDER EQUITY IN A CCAA RESTRUCTURING

As discussed above, the focus and objective in *CCAA* restructurings is generally "to restructure the debt claims against, and the ownership interests in, the debtor such that the debtor will emerge from the process with only obligations it can meet."[52] As the basic alternative to the liquidation or sale of the business, proceeding under the *CCAA* provides the debtor corporation with the breathing room necessary to rearrange and restructure its affairs with its secured and unsecured creditors in order to move forward to preserve value and operate on a going concern basis.[53] This seems to be an intuitively obvious, but also highly sensible proposition. Often one of the central but implicit negotiating positions of the parties in *CCAA* proceedings is that liquidation is the basic alternative to negotiating a successful plan or

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[49] *Ibid*. at para. 27.
[50] (2000) 20 C.B.R. (4th) 145 (B.C.C.A.), emphasis added.
[51] Professor Sarra, *Creditors Rights*, *supra* note 8 at 53.
[52] LoPucki & Triantis, "A Systems Approach", *supra* note 28 at 288.
[53] Lydon J. Barnes, Frederick L. Meyers and Andrew M. Diamond "The *CCAA*—Two Initials, Two Steps" (December 1999) 14 N.C.D. Rev. 49. See page 8 where the authors note that "The purpose of the stay in the Initial Order is to permit the debtor breathing space to commence working on a Plan."

compromise or arrangement, [54] and as noted by Edwards above, in a liquidation scenario where the debtor's assets are sold off piecemeal, all claims will not be met and creditors and other stakeholders most often receive far less return on their claims than they would if the business were to restructure and go forward on a going concern basis, even if in a downsized and recapitalized form. Thus, there clearly is a strong incentive, where the economics support it, for stakeholders to negotiate with the debtor to preserve the business. This sentiment is echoed by McElcheran who states that, "[b]ecause insolvency affects all stakeholders of the insolvent business enterprise, Canadian insolvency law focuses less on the creditors' individual legal entitlements and more on the preservations, realization and appropriate distribution of the value inherent in the business enterprise and its assets for the benefit of all its stakeholders."[55] Such a focus is laudable and important given the significant effects that bankruptcy may have on the many different stakeholder groups affected by a company's insolvency. However, giving effect to these sentiments and implementing the purposes and objectives of the *CCAA* is not always easy and can often be controversial.

The controversy is often strongest where shareholders are concerned, and stems from the fact that in an insolvency situation, there will rarely be enough value left in the company to cover off all the claims or interests of affected stakeholders, regardless of whether the company is reorganized or liquidated. Indeed, given the typical order of distribution to the various stakeholders in a liquidation scenario, secured creditors have the greatest likelihood of realizing on a portion of their claims, followed of course by unsecured creditors. Because shareholders are at the bottom of the "natural and legal hierarchy of interests"[56] in terms of receiving value "in a liquidation or liquidation related transaction,"[57] where value does exist for distribution to shareholders even after creditors' claims have been satisfied, often "preferred shareholders receive their accrued dividends and redemption value of their shares first" and only then do common shareholders possess a residual claim to the company's assets if anything

[54] See for example, Larry W. Prentice, "The Position of Equity in a Restructuring" (2003) 1 Ann. Rev. Insol. L. 259 at 265 [Prentice, "Equity"].
[55] McElcheran, *Commercial Insolvency*, *supra* note 2 at 3.
[56] *T. Eaton Co. (Re)* (1999) 15 C.B.R. (4th) (Ont. Sup. Ct. J) [Commercial List] 311 at para. 9 [*Eaton's*]. See also *Royal Oak Mines (Re)* (1999) 14 C.B.R. (4th) 279 (Ont. Sup. Ct. J) [Commercial List] [*Royal Oak*].
[57] *Royal Oak* at para. 2.

remains.[58] However, such a distribution to shareholders is rare because it is most often the case that where the company is insolvent, all shareholders' interests are generally underwater with marginal possibility of realization.

Thus, due to the nature of the priority of interests under Canadian law, there is a low likelihood that any creditor of an insolvent debtor company, other than perhaps the senior secured creditor(s), would fully recover its claim upon liquidation. Because of this, the attraction of negotiating a plan of arrangement with the debtor company is patent.[59] Indeed, as Professor Sarra notes, "[a] plan will ultimately offer an opportunity for creditors of all classes and shareholders to receive a far greater recovery than would be available in a forced liquidation."[60] Nevertheless, even despite the possibility of a 'far greater recovery,' there is still "generally a shortfall suffered by affected creditors in their pre-existing accounts due from the company."[61] Moreover, any plan that is developed in respect of an insolvent debtor company that gives any value at all to shareholders will undoubtedly controversial because it will likely involve a 'far greater recovery' being advanced to those shareholders than they could expect in a liquidation because as unsecured residual claimants, their claims would have been underwater with little chance of recovery. Thus, any value they do receive under such a plan comes at the expense of other creditors higher in priority to them, and a variation of this scenario occurred in *Uniforêt*, *infra*.

Quite surprisingly, the provisions of the *CCAA* do not address the basic problem of how the pre-existing shareholder equity of an insolvent debtor, which is generally under water, should be treated when the company proposes a plan of compromise or arrangement under *CCAA* restructuring proceedings.[62] This lack of direction provided by the *CCAA* is problematic because it creates a situation where the highly praised flexibility of the statute, which is often

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[58] Prentice, "Equity", *supra* note 54 at 266.
[59] See *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.) where Farley J. observed at p. 32 that, "[o]ne 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."
[60] Sarra, *supra* note 8 at 16.
[61] Prentice, "Equity", *supra* note 54 at 262.
[62] Jacob Zeigel, Anthony J. Duggan & Thomas G.W. Telfer, eds., *Canadian Bankruptcy and Insolvency Law: Cases Text and Materials* (Toronto: Emond Montgomery Publications Limited, 2003) at 521 [Zeigel *et al.*, *Canadian Bankruptcy*].

lauded as its most prized feature,[63] ultimately fosters a certain amount of confusion and uncertainty. For example, section 20 of the *CCAA* stipulates that the statute "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",[64] but this provision may actually complicate matters. This is because provincial and federal corporations' statutes are not in complete accord with respect to the sanction of compromises, arrangements and reorganizations.

For example, on the federal front, section 191 of the *Canada Business Corporations Act*[65] permits the court to alter the interests of shareholders without their direct consent in the context of a restructuring process. This language is mirrored in s.186 of the *Ontario Business Corporations Act*.[66] However, some of the provincial corporate statutes, such as those in British Columbia and Alberta, have significantly different language and require shareholder approval of any compromise, arrangement or reorganization that affects shareholder rights and interests. As Larry Prentice points out, "current provincial legislation [in this area] provides a patchwork framework that virtually guarantees that the outcome of two similar restructuring situations could be very different, depending simply on the act of incorporation of each entity."[67]

The requirement that shareholders approve, pursuant to the relevant corporate statutes that supplement the *CCAA* under section 20, a plan that is said to affect their equity interests seems on one hand to suggest that shareholder equity in the capital of an insolvent debtor has tangible value – even though in an insolvency scenario, shareholder equity is usually worthless. However, according to Professor Zeigel the courts have made it clear, particularly in *Loewen Group In. (Re)*,[68] "that this assumption is not correct and the court can authorize the vesting of property of a plan free of shareholder claims even if the law governing the debtor's

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[63] McElcheran, *supra* note 2, states that the "flexibility in Canadian insolvency law has invited Canadian courts to become instrumental in (1) creating mechanisms for the preservation of value of the underlying business or its assets for the benefit of all stakeholders and (2) providing a forum for the orderly resolution of competing rights and objectives of individual stakeholders of insolvent business enterprises.
[64] *CCAA*, *supra* note 4, s. 20.
[65] R.S.C. 1985, c. C-44 [*CBCA*].
[66] R.S.O. 1990, c. B-16 [*OBCA*].
[67] Prentice, "Equity," *supra* note 54 at 267-269.
[68] (2001), 32 C.B.R. (4th) 54 (Ont. Sup. Ct. J.) [Commercial List] [*Loewen*].

incorporation requires court approval of any change in the company's structure."[69] This is echoed by Farley J. in *Campeau* where he cites the following passage from the reasons of Forsyth J. in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*[70]

> it is clear that the *CCAA* grants a court the authority to alter the legal rights of parties other than the debtor company without their consent…the primary purpose of the *Act* is to facilitate reorganizations and this factor must be given due consideration at every stage of the process…

Although there is a certain amount of commentary addressing this issue, there is a lack of clear and coherent legislative direction with respect to how the problem of pre-existing shareholder equity should be addressed. This lack of legislative guidance, in combination with the disconnect between the stipulations of the *CCAA*, the relevant corporations statutes, and the position taken by Mr. Justice Farley in *Loewen*, means that the relevant case law must be considered for direction regarding the treatment of shareholder equity in *CCAA* workouts.

The Case Law: Shareholders Have No Stake in an Insolvent Corporation

A discussion of under water shareholder equity in a *CCAA* proceeding and what to do about it cannot occur without reference to the seminal case of *In re Tea Corporation, Limited, Sorsbie v. Same Company*.[71] When discussing *Tea Corp.* in another case, Mr. Justice Farley explained that it stands for the proposition that "where shareholders…have 'no interest' in a matter under consideration, the vote of that class should not be considered."[72] In *Tea Corp.*, a debtor company had classified its creditors and shareholders with the result that the preferred and common shareholders were divided up into separate classes. When the classes voted on a reorganization plan, the majority of the preferred shareholders voted in favour of the scheme. However, as Lord Justice Vaughn Williams noted, the common shareholders argued "that the scheme…[was] rendered defective because the ordinary shareholders did not vote in favour of it."[73] Vaughn Williams L.J. accepted the findings of the trial judge that the preferred shareholders had some legitimate interest that was recoverable, but that the common

[69] Zeigel *et al.*, *Canadian Bankruptcy, supra* note 64 at 521.
[70] (1989), 72 C.B.R. (NS) 20 (Alta. Q.B.) [*Norcen*].
[71] 1 Ch. D.12 (C.A.) [*Tea Corp.*].
[72] *Cadillac Fairview Inc. (Re),* [1995] O.J. No. 707 (Ont. Sup. Ct. J.) [Commercial List] [*Cadillac Fairview*].
[73] *Tea Corp.*, *supra* note 79 at page 23.

shareholders had “no interests whatever in the assets” and he determined further that “having regard to this fact, their dissent from the scheme was immaterial.”[74] Additionally, Vaughn Williams L.J. concluded that according to the provisions of the statute he was considering,

> you are to divide the contributories into classes and to call meetings of each class, and if you have the assent to the scheme of all those classes *who have an interest in the matter, you ought not to consider the votes of those classes who have really no interest at all.* It would be very unfortunate if a different view had to be taken, for if there were ordinary shareholders who really had no interests in the company’s assets, the ordinary shareholders would be able to say that it should not be carried into effect unless some terms were made to them.[75]

Mr. Justice Farley cited the above comments of Vaughn Williams L.J. with approval in the 1990 case of *Cadillac Fairview* and expressed the same concern that shareholders whose shares no longer hold economic value due to insolvency and who therefore have no interest in the company should not be permitted to “extract some ransom by keeping…[interested creditors and stakeholders] hostage with the threat of…[their] veto position.”[76] Furthermore, on the facts of *Cadillac Fairview*, Farley J. decided that neither the preferred nor the common shares had any economic value and that the shareholders therefore had no “legitimate interest to protect”.[77] As a result, his view was that it was completely appropriate for them to vote as one class as opposed to separately. He further stated that “it is not appropriate to have a situation where a franchise could be exercised not only capriciously but contrary to the interests of those who do have economic value and legitimate interests to protect.”[78] In his mind, allowing the two classes of shareholders to vote separately would have effectively granted each class a veto where they probably should not even have had a vote owing to their lack of economic value.

As briefly mentioned above, the position of shareholder equity was also addressed in the case of *Loewen* where Farley J. dealt with a motion by Group Loewen, a British Columbia incorporated company, for an order to recognize a U.S. Plan of Arrangement and to grant a

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[74] *Ibid.*
[75] *Ibid.* at pages 23-24 [emphasis added].
[76] *Supra* note 74 at para. 8.
[77] *Ibid.*
[78] *Ibid.*

vesting order. The U.S. Plan was made pursuant to a bankruptcy reorganization that did not involve any reorganization of share capital. Consistent with U.S. law, the shareholders received no value under the plan and did not vote on it. The question before Farley J. was whether recognition of the plan in Canada required it to be approved by shareholders. Mr. Justice Farley noted that,

> under U.S. bankruptcy law, shareholders have *no economic interest to protect* and *have no right to vote* on a plan of reorganization. Consistent with *that appropriate economic and legal principle*, courts in Ontario and Alberta have held that *where shareholders similarly have no economic interest to protect, it would defeat the policy objectives of the CCAA to give those shareholders a right to veto a plan of arrangement*.[79]

Furthermore, Farley J. noted that “a requirement for shareholder approval would defeat the purpose of Loewen’s bankruptcy reorganization because it would give shareholders, who have no economic interest to protect, a right to veto and potentially extract an economic benefit.”[80]

Two other noteworthy cases have also addressed this important issue. In *Laidlaw Inc. (Re)*,[81] shareholders of that company sought, *inter alia*, a right to participate in a *CCAA* plan of reorganization. The shareholders hinged their belief and argument that their shares held value on the fact that Laidlaw had a $6.5 billion claim pending against another company; however, the shareholders did concede that the relief they sought would be not be appropriate if the court concluded that the company was so insolvent that the shareholder equity was floundering under water with “no reasonable expectation…[of] having a positive economic interest in the corporation”.[82] Farley J. remarked that the hypothetical $6.5 billion claim was “far from” certain,[83] and noted that the Monitor and the valuation service provider had

> concluded that on any reasonable scenario the shareholders are very significantly under water. Further, it is realistic to note that creditors…will take a very severe “haircut” so that they will not come close to being paid out in full. Thus, under all foreseeable

[79] *Ibid.* at para. 8 [emphasis added].
[80] *Ibid*. at para. 14.
[81] (2002) 34 C.B.R. (4th) 72 (Ont. Sup. Ct. J.) [Commercial List] [*Laidlaw*].
[82] *Ibid.* at para. 2.
[83] *Ibid*.

> circumstances, it appears that the shareholders have no economic interest to protect.[84]

Remarking that he did "not see any reasonable prospect for the shareholders to be on the cusp of economic value," Farley J. nevertheless emphasized that if a "radical change in major parts of the equation" occurred such as "unexpected good fortune smil[ing] on Laidlaw,"[85] then safeguards existed that would ensure that shareholders would recover appropriate value *post hoc*.[86] Thus, he dismissed the shareholders' motion for participation in the Plan.

The final case in which the courts have denied recovery to shareholders by refusing to accord value to the shares of an insolvent debtor corporation is one which has been cited often with respect to this issue. The Alberta case of *Re Canadian Airlines Corporation* arose when,[87] after ten years of financial turmoil, Canadian Airlines Corp. (CAC) finally sought protection under the *CCAA*. In *Canadian*, minority shareholders were asked to accept their shares had no value, and they opposed the restructuring on the basis that Air Canada's involvement both before and during the restructuring process had increased the value of CAC and in turn the value of their shares. Further, the shareholders argued that the proposed share capital reorganization pursuant to section 185 of the *Alberta Business Corporations Act* was illegal under section 167 of the same act.[88] Paperny J. discussed the rationale behind the corporate reorganization provisions such as what was then section 185 as espoused in the renowned Dickerson Report[89] and concluded that,

> [t]he rationale for allowing such a reorganization [as proposed by CAC] appears plain: the corporation is insolvent, which means that on liquidation the shareholders would get nothing. In those circumstances…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 shareholders (whose interest has the lowest priority) to have any ability to block a reorganization.*[90]

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[84] *Ibid*.
[85] *Ibid.* at para 3.
[86] *Ibid*. at para. 5.
[87] *Canadian Airlines Corp.(Re)* (2000) 20 C.B.R. (4th) 1 (Alta. Q.B.) [*Canadian*].
[88] R.S.A., 2000, c. B-9 These sections are now 192(2) and 173 respectively.
[89] R. Dickerson et al, Proposals for a New Business Corporation Law for Canada, Vol.1: Commentary [the "Dickerson Report"].
[90] *Canadian*, *supra* note 89 at para. 76 [emphasis added].

Further, Paperny J. asserted firmly that "[t]o require a vote suggests the shares have value. They do not."[91] Additionally, in rejecting the view that Air Canada's involvement had somehow created realizable value for the shares and in concluding that the shareholders had no legitimate interest to protect, Paperny J. opined that

> [w]here 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 and interest in an insolvent company where creditor's claims are not being paid in full…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…[92]

Furthermore, she explained that,

> [i]t 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.[93]

Paperny J. also dismissed as "speculative" the view held by some of CAC's shareholders "that somehow, despite insolvency, their shares have some value on a going concern basis."[94] Further, foreshadowing an argument that was made in the Stelco restructuring, she concluded with finality that, "[t]hese companies are not just technically or temporarily insolvent, they are massively insolvent."[95]

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[91] *Ibid.* at para. 79.
[92] *Ibid.* at para. 143 [emphasis added].
[93] *Ibid.* at para 145.
[94] *Ibid.* at para 163.
[95] *Ibid.* at para 163.

The Case Law: Shareholders Might Have a Stake in an Insolvent Debtor in Certain Circumstances

As seen above, the courts have generally been very consistent in refusing to give the opportunity to vote and potentially obstruct a plan to shareholders whose interests are so far under water that they are essentially without value, even if corporate legislation in the relevant jurisdiction authorizes such a vote. In addition, the courts have been quite willing to allow valueless shares to be cancelled by the debtor corporation to make way for the issuance of new equity. However, situations may nevertheless exist in which it could be argued that shareholders should be permitted to have "a seat at the table" in the *CCAA* restructuring and potentially recover value.[96] This is precisely the issue that arose in both the Woodward's Stores Ltd. and the T. Eaton Co. restructurings referred to above, and it also arose in *In the Matter of the Arrangement of Uniforêt inc. c. Richter & Associés*.[97] Further, as will be seen below, it was also a central issue in the Stelco restructuring.

In the 1993 Woodward's Stores Ltd. restructuring under the *CCAA*,[98] The Hudson's Bay Company ("The Bay"), a critical player in the restructuring, wanted to access "the substantial tax losses accumulated by Woodward's over the years, and was prepared to pay additional value to do so."[99] Under Canadian law, in order for The Bay to be able to access these tax losses, a merger had to be effected between Woodward's and one of The Bay's subsidiaries. As Larry Prentice points out, this merger formed part of the entire *CCAA* plan, and "as a consequence, the plan allowed the shareholders of Woodward's to vote on a share reorganization plan and exchange their shares in Woodward's for preferred shares in the merged entity."[100] This is a real-world example of the 'disconnect' mentioned above that may occur between the provisions, or lack thereof, of the *CCAA* and the provisions of certain provincial corporate statutes where the corporate statute supplements the *CCAA*, with the result that a vote of the shareholders is held. As such, the Woodward's shareholders ended up receiving cash value

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[96] Prentice, "Equity," *supra* note 54 at 259.
[97] (2003) 43 C.B.R. (4th) 254 (Q.S.C.) [*Uniforêt*].
[98] *Woodward's Ltd. (Re)* (1993), 20 C.B.R. (3d) 74 (B.C.S.C.) [*Woodward's*].
[99] Prentice, "Equity," *supra* note 54 at 261.
[100] *Ibid.*

for their shares even though "creditors were suffering a shortfall of up to 68% of the amounts they were owed."[101]

Interestingly, in *Eaton's* restructuring,[102] which was a workout where shareholders received value for their investment due to a unique situation involving tax losses, Farley J. admitted that he was hesitant about the "size of the pot going to shareholders," but he nevertheless sanctioned the plan.[103] However, before doing so, he cited his above-quoted observations from *Cadillac Fairview* and further emphasized that "it is important for at least future situations that in devising and considering plans persons recognize that there is a natural and legal 'hierarchy of interest to receive value in a liquidation or liquidation related transaction' and that in that hierarchy the shareholders are at the bottom."[104]

Sears Canada Inc. occupied a position in the *Eaton's* workout similar to that of The Bay in the *Woodward's* restructuring. Among other commitments, Sears agreed to pay an additional $20 million in order to purchase all the outstanding Eaton's shares so that it could utilize the associated tax losses.[105] Exemplifying how the *CCAA* and provincial corporate statutes operate together when connected pursuant to a *CCAA* restructuring, in addition to the usual creditor approval required for the Plan, the shareholders also had to approve the plan of arrangement because it involved an alteration of the share capital of Eaton's. Not surprisingly, the shareholders approved the plan, since under a liquidation scenario they would have received nothing for their shares. Thus, equity holders were given some value despite the fact that other more senior creditors were taking a haircut. In his reasons, Farley J. was clear that *Eaton's* was a unique and fact specific scenario and in the future, the courts might not look favourably on plans purporting to compensate shareholders while creditors receive less than full value for their claims.[106]

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[101] *Ibid.*
[102] *Supra* note 58.
[103] *Ibid* at para. 9.
[104] *Ibid.*
[105] David F.W. Cohen & Ned Djordjevic, "The Eaton's CCAA Liquidation—A One Shot Deal?" in *BI Lines: CBA Bankruptcy and Insolvency Section* (March 2000) at 1.
[106] *Supra* note 58 at para 9.

In *Uniforêt*, the debtor corporation sought the court's sanction of a second amended plan or arrangement, and six creditors representing almost 28% of their class opposed the sanction application based on a number of serious allegations. *Uniforêt* first obtained *CCAA* protection on April 17, 2001, and while the details of the restructuring are too complicated to reproduce here, the ultimate problem was the belief of the opposing creditors that the plan heavily favoured Jolina Capital Inc., a significant creditor *and* shareholder of the debtor corporation. In a report commissioned by the opposing creditors, Price Waterhouse Coopers stated, *inter alia*, that the Plan did not treat secured creditors in accordance with their existing rights and priorities and that it would provide significantly higher recovery to certain unsecured creditors than to other secured creditors. Notable was the repayment of 100 cents no the dollar in respect of Jolina's unsecured shareholder loan. Ultimately, the court stated at paragraph 20 that "there is no doubt that Jolina has been relatively well treated" but went on to explain its view that,

> Jolina is Uniforêt's White Knight…Accordingly the White Knight's several claims have received generous treatment under the Plan, as well they should. After all, Jolina is Uniforêt's largest and most important creditor, apart from being a major shareholder. Plans of arrangement cannot hope to succeed without the approval of such a creditor. The Plan proposes, in effect, to make Jolina more or less whole, at least eventually.[107]

In the next paragraph, the court stated that,

> [i]t does not necessarily follow that a plan generous to some creditors must therefore be unfair to others. A plan can be more generous to some creditors and still fair to all creditors. A creditor like Jolina that has stepped into the breach on several occasions to keep Uniforêt afloat in the 4 years preceding the filing of the first plan warrants special treatment.[108]

Despite the detailed report provided Price Waterhouse Coopers indicating that many aspects of this Plan were contrary to established insolvency norms, and despite the fact that the opposing creditors were not receiving any meaningful equity in the restructured company, the court nevertheless sanctioned the Plan. While different than both Woodward's and

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[107] *Uniforêt*, *supra* note 99 at para. 20.
[108] *Ibid*. at para. 21.

Eaton's restructurings which involved the utilization of tax losses, this case is notable as a further example of certain unique situations where shareholders may given influence over the restructuring process by way of a vote and the opportunity to extract value,[109] despite the fact that nominally their shares held no value. Certainly this case also highlights the problem that may arise where a company's largest shareholder is also a significant creditor.

PART III: DIRECTORS' DUTIES IN INSOLVENCY SITUATIONS

In an insolvency situation, and particularly in a *CCAA* workout, the enforcement of the bottom-rung position occupied by the shareholders of a corporation through such mechanisms as cancellation of valueless shares can be controversial. The controversy stems from a number of different sources. Certainly, the prospect of completely losing an investment does not sit well with any category of investor, regardless of whether the investor is an individual or a company. However, as seen in the Stelco restructuring discussed *infra*, the most vocal critics of a company cancelling its existing shares as part of a *CCAA* workout are very often large institutional investors. In some instances, such investors may have purchased their shares in the capital of the financially distressed company when the proverbial 'writing was on the wall', speculatively anticipating to beat the market and turn a profit.

Another source of the controversy is undoubtedly rooted in the conception that the shareholders "own" the corporation and therefore that the directors should at all times, including in insolvency, put the interests of the shareholders first and foremost and make decisions with a view to maximizing shareholder value. Ultimately, this is somewhat misconceived, because all corporate statutes in Canada require the directors to act in the best interests of the corporation as a whole and the statutes do not single out the shareholders for special consideration by directors and officers. Thus, while shareholders do not exactly "own" the company, what they do own, however, is shares in the capital of the company, which shares have a bundle of rights attached to them. One of the rights in that bundle is a right to elect directors to "manage, or supervise the management of, the business and affairs of a

[109] It is important to note, however, that the right to vote does not emerge from nowhere, it is authorized pursuant to certain corporate legislation that supplements the *CCAA* pursuant to section 20 of that statute.

corporation."[110] To this end, Major and Deschamps JJ. noted in *Peoples Departments Stores Inc. (Trustee of) v. Wise* that,[111]

> [i]n deciding to invest in, lend to or otherwise deal with the corporation, shareholders and creditors transfer control of their assets to the corporation, and hence to the directors and officers, in the expectation that the directors and officers will use the corporation's resources to make reasonable business decisions that are to the corporation's advantage.[112]

Thus, it is clear that in performing their management and supervisory function, directors must act in the best interests of the whole corporation,[113] but they are not required to completely ignore shareholders and other stakeholders. In fact, the directors are free to keep shareholders' interests in mind while in the pursuit of the best interests of the corporation;[114] and often, the interests of the corporation and of the shareholders will converge such that maximization of shareholder value will be in the best interests of both the company and the equity holders. In addition, precisely what comprises the best interests of the corporation may change in an insolvency situation where shareholder value maximization is no longer necessarily a priority because saving the corporation from dismemberment by creditors gains significantly more importance, and creditors often hold the key for a successful restructuring. Ultimately, the undeniable fact is that there is a hierarchy of interests that remains static throughout the life of the corporation, and shareholders, as emphasized by Paperny J. above, occupy a position at the bottom of that hierarchical ladder of interests.

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[110] *CBCA*, *supra* note 67, s.102 .
[111] (2004) 4 C.B.R. (5th) 215 (S.C.C.) [*Peoples*].
[112] *Ibid* at para 34.
[113] *CBCA*, *supra* note 67, s.122(1)(a). See also: *British Columbia Business Corporations Act*, S.B.C., 2002, c.57, s. 142(1)(a) [*BCBCA*]; *Alberta Business Corporations Act*, R.S.A., 2000, c. B-9, s.122(1)(a) [*ABCA*]; *OBCA*, *supra* note 68, s.134(1)(a).
[114] Indeed, as Bowen L.J. remarked in *Hutton v West Cork Rly Co* (1883) 23 Ch D 654 at 672, "The law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company". Similarly, the Supreme Court of Canada in *Peoples* stated at paragraph 42 that,

> We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

Just as the hierarchy of interests remains static, so too do the directors' duties. This proposition that directors' statutory fiduciary duties remain static throughout the life of the corporation and do not shift at any point, particularly in insolvency, only recently became solidified in Canadian law. For some time prior to the Supreme Court of Canada's decision in *Peoples*, the extent of directors' duties to creditors of financially distressed companies was unclear. In other countries, Britain, New Zealand and Australia being notable examples,[115] fiduciary duties have been imposed upon directors in favour of the creditors of the corporation such that directors are required to act in the best interests of the creditors as the corporation approaches insolvency. Directors' statutory fiduciary duties and duty of care are somewhat of a cornerstone of Western corporate law; and as such, the suggestion that a shift occurs as the company nears insolvency and that the duties of directors should then be owed to the creditors in addition to, or rather than, the corporation, has been controversial. Nevertheless, this was precisely the direction in which the law in Canada seemed to be moving before the Supreme Court of Canada rendered its decision in 2004.

In a unanimous decision, the Supreme Court held that Canadian corporate law imposes statutory fiduciary duties on directors in favour of the corporation only, and not in favour of the corporation's creditors. To begin with, in discussing fiduciary duties and the duty of care, Major and Deschamps JJ. noted at paragraph 32 that,

> The first duty has been referred to in this case as the "fiduciary duty". It is better described as the "duty of loyalty"…This duty requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation. The second duty is commonly referred to as the "duty of care". Generally speaking, it imposes a legal obligation upon directors and officers to be diligent in supervising and managing the corporation's affairs.

Recognizing the crux of the problem presented by insolvency, which was also one of the major problems facing Stelco as it attempted to restructure its operations and affairs, the Court discussed the tension that exists between the interests of the corporation and the interests of the creditors of the corporation as insolvency approaches:

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[115] See paragraph 190 of *Peoples Department Stores Inc. (Trustee of) v. Wise* (1998), 23 C.B.R. (4th) 200 (Q.C.S.C.), rev'd (2002), 4 C.B.R. (4th) 225, aff'd (2003), 4 C.B.R. (4th) 215 (S.C.C.) where Greenberg J. cites Professor Zeigel's article, "Creditors as Corporate Stakeholders: The Quiet Revolution - An Anglo-Canadian Perspective", (1993) 43 U.T.L.J. 511.

> Insofar as the statutory fiduciary duty is concerned, it is clear that *the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders"*. From an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation…However, the courts have long recognized that *various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation*…We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation *it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment*.
>
> The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the CBCA. *At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.*
>
> The interests of shareholders, those of the creditors and those of the corporation may and will be consistent with each other if the corporation is profitable and well capitalized and has strong prospects. However, this can change if the corporation starts to struggle financially. *The residual rights of the shareholders will generally become worthless if a corporation is declared bankrupt.* Upon bankruptcy, the directors of the corporation transfer control to a trustee, who administers the corporation's assets for the benefit of creditors.
>
> Short of bankruptcy, as the corporation approaches what has been described as the "vicinity of insolvency", the residual claims of shareholders will be nearly exhausted. *While shareholders might well prefer that the directors pursue high-risk alternatives with a high potential payoff to maximize the shareholders' expected residual claim, creditors in the same circumstances might prefer that the directors steer a safer course so as to maximize the value of their claims against the assets of the corporation.*[116]

Despite laying this foundation with respect to the tensions that exist between the competing and conflicting interests of shareholders and creditors (among others), the court nevertheless firmly emphasized that,

> The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency"…

[116] *Peoples*, *supra* note 113 at paras. 42-45 [citations omitted and emphasis added].

> … In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the *directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders.* If the stakeholders cannot avail themselves of the statutory fiduciary duty (the duty of loyalty, *supra*) to sue the directors for failing to take care of their interests, they have other means at their disposal.[117]

Thus, having established that the statutory fiduciary duty is always owed to the corporation and that that creditors of a financially distressed corporation have no recourse against the directors with respect to this duty, the Court turned to consider the statutory duty of care requiring directors and officers to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."[118] The Court held that directors and officers do owe in fact a duty of care to creditors, stating that,

> unlike the statement of the fiduciary duty in s. 122(1)(*a*) of the CBCA, which specifies that directors and officers must act with a view to the best interests of the corporation, the statement of the duty of care in s. 122(1)(*b*) of the CBCA does not specifically refer to an identifiable party as the beneficiary of the duty. Instead, it provides that "[e]very director and officer of a corporation in exercising their powers and discharging their duties shall . . . exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." *Thus, the identity of the beneficiary of the duty of care is much more open-ended, and it appears obvious that it must include creditors.*[119]

Notably, the Supreme Court of Canada also explicitly endorsed the business judgment rule, explaining that,

> Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(*b*) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors

[117] *Ibid* at 46-47 [emphasis added].
[118] *CBCA*, *supra* note 67, s. 122(1)(b). See also: *BCBCA*, *supra* note 115, s. 142(1)(b); *ABCA*, *supra* note 115, s.122(1)(b); *OBCA*, *supra* note 68, s.134(1)(b).
[119] *Peoples*, *supra* note 113 at para. 57 [emphasis added].

> have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.[120]

The court ultimately recognized "[t]he fact that creditors' interests increase in relevancy as a corporation's finances deteriorate",[121] but this fact alone does not create any increased duties beyond the duty of care. The discussion of the court in *Peoples* is important in the context of considering the position of shareholder equity in a restructuring because it delineates once and for all to whom the various duties are owed and when they are so owed.

PART IV: FOCUSING THE LENS ON STELCO

As mentioned above, apart from the restructuring of Air Canada, which itself garnered much media attention, one of the most notable *CCAA* restructurings in recent years involved the restructuring of Stelco Inc., an Ontario steel company. Stelco is one of the 'iconic' Canadian companies referred to above that has successfully restructured pursuant to the provisions of the *CCAA*. Similar to the other companies discussed at the beginning of this paper, Stelco has had a long history in Canada; it was formed in May 1910 through the amalgamation of several small steelworks including the Rolling Mills, the Hamilton Steel and Iron Company, the Canada Screw Company and the Canada Bolt and Nut Company.[122] It is yet another historic Canadian company that has been pulled back from the brink of insolvency through resort to the flexible provisions of the *CCAA.*

On March 31, 2006, Stelco finally emerged from court-ordered protection under the *CCAA*, more than two years after the Ontario Superior Court had first granted such protection on application by Stelco and four of its subsidiaries.[123] The Stelco restructuring in general and the sanction order and reorganization order in particular, offer an opportunity to draw together

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[120] *Ibid*. at para. 67 [emphasis added].
[121] *Ibid.* at para. 49.
[122] McMaster University Archives, The William Ready Division of Archives and Research Collections, "Steel Company of Canada." http://libraryssl.mcmaster.ca/archives/findaids/fonds/s/stelco.htm
[123] See "Initial Order" dated January 29, 2006: http://www.mccarthy.ca/en/ccaa/docs/47.pdf.

much of the above discussion with respect to the purposes and underpinnings of the *CCAA*, the nature of directors' statutory fiduciary duties in a *CCAA* workout and the manner in which Canadian courts will deal with shareholder equity in a restructuring. The Stelco restructuring had numerous well-documented highs and lows, and in addition to providing ample material for insolvency professionals and lay people alike to consider and debate, it was also particularly notable for the several new and important precedents that it established in Canadian insolvency law. A few of these precedents will be discussed here, but a detailed analysis is unfortunately beyond the scope of this paper. Of particular note for the purposes of this paper, however, is the controversy surrounding the shares of the once financially beleaguered company. As such, a discussion of this topic will follow the examination of the notable precedents created by the Stelco restructuring.

The Definition of "Insolvency" Under the CCAA

February 18, 2004 presented the first, and almost immediate, bump in the road to achieving "the successful emergence of Stelco from its *CCAA* proceedings as a long-term viable and competitive participant in the domestic and international steel industry, with the maximum benefit for the stakeholders on a collective basis through the facility of a better corporation."[124] On that date, Locals 1005, 5328 and 8782 of the United Steelworkers of America (the "Union") applied to have Farley J. rescind the initial order and dismiss Stelco's application for "access to the protection and process" of the *CCAA*.[125] The Union argued that such access should be denied on the basis that Stelco "had failed to bring itself within the ambit of the legislation, by failing to demonstrate that it is a debtor company" as defined in section 2 of the *CCAA* because it was not insolvent at the time of filing.[126] The Union advanced this position even in the face of the fact that Stelco had pension plan liabilities of more than $1 billion and was predicted to run out of operating cash in a matter of months. The uniqueness of the subject matter of the application has been noted by Vern W. DaRae in "Is 'Insolvency' Still a Prerequisite to Restructuring?":

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[124] *Stelco Inc. (Re)* (2005), 7 C.B.R. (5th) 310 at para. 1 (Ont. Sup. Ct. J.) [Commercial List] [*Stelco: Application to Remove*].
[125] *Stelco Inc. (Re)* (2004), 48 C.B.R. (4th) 299 at para. 1 (Ont. Sup. Ct. J.) [Commercial List] [*Stelco: Application to Rescind*].
[126] See "Motion by The United Steelworkers of America (Local Unions) returnable February 13, 2004, re rescission of Initial Order", page 7-8. http://www.mccarthy.ca/en/ccaa/docs/106.pdf.

> In most restructurings, the meaning of 'insolvency' is not an issue. The dire financial position of the debtor makes it unnecessary to interpret the concept. Also, the 'voluntary' nature of the majority of filings and the potential benefits of restructuring over liquidation often discourage serious treatment of the concept of 'insolvency'. What distinguishes *Stelco Inc.*, *Re* is not only the court's consideration of the meaning of 'insolvency' in the context of a restructuring but also the adoption of a liberal, 'reasonable foreseeability' test of insolvency.[127]

In refusing the Union's motion, Farley J. held that Stelco *was* in fact insolvent at the time it applied for protection from its creditors, and in the course of so deciding, he expanded the definition of insolvency for the purposes of the *CCAA*. He explained that the date of filing is the key time in terms of assessing whether a corporation is insolvent and therefore able to avail itself of the provisions of the *CCAA.*[128] While section 2 of the *CCAA* stipulates that proceedings under the *CCAA* may only be commenced in respect of a "debtor company",[129] the *CCAA* does not otherwise define "insolvent" or "insolvency". As such, Farley J. looked for guidance to section 2(1) of the *BIA*, which defines an "insolvent person" as someone who:

> is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due,
>
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
>
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.[130]

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[127] Vern W. DaRae, "Is 'Insolvency' Still a Prerequisite to Restructuring?" (2004) 49 C.B.R. (4th) 163.
[128] *Stelco: Application to Rescind*, *supra* note 127 at para. 4.
[129] See paragraph 28 of *Stelco: Application to Rescind* where Farley J. states that, "The *BIA* tests are disjunctive so that anyone meeting any of these tests is determined to be insolvent: see *Re Optical Recording Laboratories Inc.*, (1990), 75 D.L.R. (4th) 747 (Ont. C.A.) at p. 756; *Re Viteway Natural Foods Ltd.* (1986), 63 C.B.R. (N.S.) 157 (B.C.S.C.) at p. 161. Thus, if I determine that Stelco is insolvent on *any one* of these tests, then it would be a 'debtor company' entitled to apply for protection under the *CCAA*."
[130] *BIA*, *supra* note 6, s. 2(1).

Considering Stelco's "looming liquidity condition or crisis" and its significant "legacy" obligations to its retirees in terms of the pension fund and its deficit,[131] Farley J. determined that Stelco was in fact insolvent and entitled to seek shelter from its creditors under the *CCAA*. He concluded that although a company may not be technically insolvent under the strict *BIA* tests noted immediately above when it applies for creditor protection, a looming liquidity crisis may nevertheless render it insolvent for the purposes of the *CCAA*. He said the following at paragraph 26 of *Stelco: Application to Rescind*:

> It seems to me that the *CCAA* test of insolvency advocated by Stelco and which I have determined is a proper interpretation is that the *BIA* definition of (a), (b) or (c) of insolvent person is acceptable with the caveat that as to (a), a financially troubled corporation is insolvent if it is reasonably expected to run out of liquidity within reasonable proximity of time as compared with the time reasonably required to implement a restructuring. That is, there should be a reasonable cushion…

Furthermore, he stated at paragraph 40 that

> …a proper contextual and purposive interpretation…would be to see whether there is a reasonably foreseeable (at the time of filing) expectation that there is a looming liquidity condition or crisis which will result in the applicant running out of 'cash' to pay its debts as they generally become due in the future without the benefit of the stay and ancillary protection and procedure by court authorization pursuant to an order…

Summarizing his conclusions as to whether Stelco was insolvent when it applied for *CCAA* protection, Farley J. stated that,

> In the end result, I have concluded on the balance of probabilities that Stelco is insolvent and therefore it is a "debtor company" as at the date of filing and entitled to apply for the *CCAA* initial order. My conclusion is that (i) *BIA* test (c) strongly shows Stelco is insolvent; (ii) *BIA* test (a) demonstrates, to a less certain but sufficient basis, an insolvency and (iii) the "new" *CCAA* test again strongly supports the conclusion of insolvency.[132]

[131] *Stelco: Application to Rescind*, *supra* note 127 at para. 40.
[132] *Stelco: Application to Rescind*, *supra* note 127 at para. 69.

Stelco's Shareholder Directors

The Stelco restructuring also produced a very notable Ontario Court of Appeal decision that clarified the scope of the Court's jurisdiction to oversee and interfere with corporate governance issues in the context of the restructuring of a financially distressed corporation.[133] The context behind this precedent-setting decision, being also the first Canadian decision to apply the *Peoples* decision, is interesting.

By November 30, 2004, Stelco's board had lost four of its directors, which left it three directors short of the minimum complement required. Having operated with only seven directors for a number of months, Stelco appointed two new directors on February 18, 2005. The new directors, prior to being appointed to the board, had been vocal and ardent advocates for the shareholders they represented. Roland Keiper, described by Globe and Mail reporter John Daly as "The Smartest Guy on Bay Street",[134] is president of the Toronto-based in vestment manager, Clearwater Capital Management Inc. ("Clearwater") and Michael Woollcombe, in addition to having been an adviser to Clearwater, is a principal at VC & Co. Incorporated and acts as a strategic advisor to institutional and other shareholders in their investments in public and private companies.[135]

At the time Keiper and Woollcombe were appointed to the board, Clearwater and another company called Equilibrium Capital Management together held slightly less than 20% of Stelco's outstanding publicly traded common shares on a fully diluted basis. Moreover, Clearwater and Equilibrium had been very active in the restructuring proceedings, and had even announced in a press release on January 25, 2005, less than a month before their appointment to Stelco's board, that they had reached an understanding to jointly pursue efforts to maximize shareholder value at Stelco. This joint pursuit, which followed a few months after a failed $125

[133] See generally Pamela L.J. Huff and Russell C. Silberglied, "From *Production Resources to Peoples Department Stores:* A Similar Response by Delaware and Canadian Courts on the Fiduciary Duties of Directors to Creditors of Insolvent Companies." (January 2006) Annual Review of Insolvency Law, 157. Online: http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1007&context=blc_2005.
[134] See Globeandmail.com Report on Business Magazine, John Daly, "Genius Provocateur: The Smartest Guy on Baystreet." https://secure.globeadvisor.com/focus/focus_20040205.html
[135] Stephanie Ben-Ishai, "A Team Production Theory of Canadian Corporate Law," (2006) Vol. 02, No. 01 CLPE Research Paper.

million capital proposal by the two companies,[136] would, according to the press release, include seeking to ensure that the interests of Stelco's equity holders were appropriately protected by its board of directors and, ultimately, that Stelco's equity holders had "an appropriate say, by vote or otherwise, in determining the future course of Stelco."[137] The press release specifically quoted Keiper as stating the following:

> There is no doubt that there is significant equity value in Stelco and that, in such circumstances, equity holders are critical stakeholders whose interests must be fairly respected. In our view, the value of Stelco's equity in fact materially exceeds the current market capitalization of Stelco", commented Roland Keiper, President of Clearwater. "We also intend to ensure that shareholders enjoy the significant increase in value that we anticipate will occur once the CCAA process is behind Stelco and management has the opportunity to carry on business free from restructuring proceedings.[138]

Not surprisingly, given that background, it is clear why the appointment to the board of two such "spokespersons for the shareholders" did not occur without controversy.[139] Although six additional shareholders holding just over 20% of the shares of Stelco wrote to the board expressing their support for the proposed appointment of Keiper and Woollcombe,[140] the appointment caused serious discontent among the various other stakeholders, particularly because Keiper and Woollcombe were appointed to the Board the same day that the board was to commence its review of the various bids put forth during the restructuring process. Consequently, another of Stelco's stakeholder groups, the salaried employees, brought a motion on February 25, 2005 for a declaration that the appointment of Woollcombe and Keiper be declared of no force and effect and that the two directors be removed from the board.[141] Pursuant to what he said was his "inherent jurisdiction and the discretion given to the court under the *CCAA*",[142] Farley J. granted the motion and rescinded the appointment of the two shareholder-directors, noting disapprovingly along the way that the men were spokespersons for

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[136] Press Release, November 9, 2004: http://www.newswire.ca/en/releases/archive/November2004/09/c0779.html
[137] Press release, January 25, 2005: http://www.newswire.ca/en/releases/archive/January2005/25/c6583.html.
[138] *Ibid*.
[139] *Stelco: Application to Rescind*, *supra* note 127 at para. 20.
[140] *Ibid.* at para. 12.
[141] *Supra,* note 127.
[142] *Stelco: Application to Remove*, *supra* note 126 at para. 24

certain groups of shareholders and likely had short term maximization of shareholder value as their goal.[143]

In a unanimous decision, the Ontario Court of Appeal overturned Farley J's decision to void the appointment of the shareholder-directors. Blair J.A., writing for the Court, noted that the various other stakeholders opposed the appointments of Keiper and Woollcombe to the board because they perceived that the appointments were

> a threat to their well being in the restructuring process, because the appointments provided [Keiper and Woollcombe], and the shareholders they represent, with direct access to sensitive information to which other stakeholders (including themselves) are not privy. The Employees fear that participation of the two major shareholder representatives will tilt the bid process in favour of maximizing shareholder value at the expense of bids that might be more favourable to the interests of the Employees.[144]

Nevertheless, the Court of Appeal was not persuaded by these very real concerns. Blair J.A. stated that the issue to be considered was "the court's jurisdiction to intervene in corporate governance issues during a *CCAA* restructuring, and the scope of its discretion in doing so…"[145] Although it is beyond the scope of this paper to discuss this decision in detail, particularly with respect to its merits or demerits, it is important to note that ultimately, the Court of Appeal disagreed with the assertion made by Farley J. that inherent jurisdiction was at play. Blair J.A. instead clarified that in supervising restructurings pursuant to the provisions of the *CCAA*, a judge does not exercise inherent jurisdiction but rather statutory jurisdiction pursuant to section 11 and perhaps (in an indirect way) section 20 of the *CCAA*. In support of the business judgment of directors, Blair J.A. endorsed the following statement made by the Supreme Court of Canada in *Peoples*, explaining that,

> [i]t is well-established that judges supervising restructuring proceedings—and courts in general—will be very hesitant to second guess the business decisions of directors and management. As the Supreme Court of Canada said in *Peoples*, *supra*, at para. 67:

[143] *Ibid.* at paras. 12-13 & 20.
[144] (2005), 9 C.B.R. (5th) 135 (Ont. C.A.) [*Stelco: Reappointment*].
[145] *Ibid*. at para. 25.

> Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making…[146]

Although Farley J. had acknowledged at paragraph 8 of his reasons that Keiper and Woollcombe had "not been alleged to have done anything wrong since their appointment as directors", he nevertheless though that the concept of "reasonable apprehension of bias" could be "usefully borrow[ed]" to address the issue brought forth by the salaried employees in their motion to have the two shareholder directors removed. In response to this, Blair J.A. said at paragraph 74 that the concept of reasonable apprehension of bias is "foreign to the principles that govern the election, appointment and removal of directors, and to corporate governance considerations in general."

Shareholder Equity in the Stelco Restructuring

The final, and for the purposes of this paper, most interesting, aspect of the Stelco restructuring stems from the previous discussion regarding Keiper and Woollcombe's vocal assertions that the shareholder equity in Stelco was not under water and in fact allegedly held significant value. As is evident from the discussion above regarding these two former shareholder directors, there was a fairly organized group of Stelco equity holders who were very vocal about their belief that the equity continued to have good value throughout the stay period and the restructuring process. In particular, the shareholders grasped onto the fact that Stelco seemed oblivious to its own insolvency, posting substantial profits at various times during the course of the two-year stay period, and experiencing share price increases from time to time. However, neither of these factors alone, or even together, is a measure of the actual value of the shareholder equity of an insolvent corporation. In fact, as Farley J. noted in his reasons for the Sanction Order, "[t]he redness of the visage of Stelco is not a true indication of health and well being; rather it seems that it is rouge to mask a deep pallor."[147] Furthermore, as should be clear based on the foregoing discussion with respect to the liberal approach to characterizing a company as insolvent taken by Farley J., neither the status of the stock price nor the activity of the markets on any given day means much if a looming liquidity crisis exists.

[146] *Ibid.* at para. 65.
[147] *Sanction Order, supra* note 12 at para. 8.

Despite their varied, energetic and no doubt best efforts to influence the outcome of the restructuring favourably in respect of their own interests, the shareholders in Stelco were completely wiped out when the company emerged from the cocoon of its *CCAA* stay on March 31, 2006. The Stelco workout was affected in connection with an arrangement pursuant to section 191 of the *CBCA*, which enabled the company to cancel the shares of existing shareholders and issue new shares to new persons or entities. Farley J. discussed the issue of shareholder equity in his reasons granting Stelco's application to implement the arrangement under the *CBCA.*[148]

He noted that due to conditions imposed by Stelco's *CCAA* financing provider and plan sponsor, Tricap Management Ltd, the actual *CCAA* Plan could not be implemented without the *CBCA* arrangement. As such, he noted at paragraph 8 of reorganization order, "the proposed *CBCA* arrangement represents the only prospect for Stelco to emerge successfully from the *CCAA* proceedings…[and] to optimize its chances of long term viability." He noted that the parties had raised the issue of whether a vote of existing shareholders needed to be taken in connection with the reorganization, and at paragraph 10 he said that the facts of the situation were such that the existing shareholders of Stelco had no economic interest in the company. In the result, he approved the *CBCA* reorganization, and emphasized that the *CBCA* "contains no requirement that there be a vote or meeting of security holders held (although the supervising judge has the discretion to give directions in that respect."[149]

In the sanction order, Farley J. gave a slightly more detailed treatment to the issue of shareholder equity. He first noted that the only stakeholders opposed to the Plan were a group of equity holders whose submission was that the Plan was "not fair, reasonable and equitable because…there is currently sufficient value in Stelco to fully satisfy the claims of the affected and unaffected creditors and to provide at least some value to current shareholders."[150] Of course, this was not what the Plan provided. As noted, the Stelco Plan wiped out shareholders and eliminated their shares, making way for the company to create new equity in which the pre-existing shareholders would not be permitted to participate. Further, as it was entitled to do

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[148] (2006), 18 C.B.R. (5th) 173 [*Reorg. Order*].
[149] *Supra* note 151 at para. 10.
[150] *Supra* note 12 at para. 6.

under section 191 of the *CBCA*, Stelco did not permit its shareholders to vote on this alteration to the share structure. Farley J. reiterated that "it is well established that a reorganization pursuant to s. 191 of the *CBCA* may be made in conjunction with a sanction order under the CCAA and that such reorganization may result in cancellation of existing shares of the reorganized corporation based on these shares…having no present value."[151]

Just as he criticized shareholder speculation in *Laidlaw*, *supra*, Farley J. criticized the speculation by the Stelco shareholders that "something good may happen" in the form of an offer to purchase the company or that some "insolvency rescuer" would emerge "on the scene as the equivalent of a White Knight."[152] He further criticized the various other speculations of the sharholders as "unwise, imprudent and high stakes poker (with other people's money)."[153] However, he did express his empathy for the "pain and disappointment" that existing shareholders and "particularly those who have worked hard and long with perhaps their life savings tied up in [Stelco] shares," but ultimately noted that "regretfully for them I am not able to come to a conclusion that the existing equity has a true positive value."[154]

In determining that the shareholders could not "lay claim to there being any existing equity value" in the company,[155] Farley J. carefully analyzed and compared and contrasted the valuation report commissioned by the equity holders with those provided by Stelco's advisors. He highlighted numerous problems with the report obtained by the shareholders, and ultimately concluded that "it would be inappropriate to justify cutting in these existing shareholders for any piece of he emergent restructured Stelco. If that were to happen, especially given the relative values and the depth of submersion of existing equity, then it would be unfair, unreasonable and inequitable for the affected creditors."[156]

[151] *Ibid*. at para. 14.
[152] *Ibid*. at para. 36.
[153] *Ibid.*
[154] *Ibid*. at para. 22.
[155] *Ibid*. at para. 37.
[156] *Ibid*.

CONCLUSION

Despite having experienced major *CCAA* insolvency restructurings back to back in the cases of *Air Canada* and *Stelco Inc.*, the Canadian people and the Canadian economy are unlikely to experience restructurings of comparable significance in the near future. However, given the variety of important issues raised by the Stelco restructuring in particular, it is certain that lawyers and legal academics will be kept busy analyzing, applying and debating the various elements and aspects of that workout for some time yet.

This paper undertook to analyze the issue of shareholder equity in *CCAA* restructurings in depth and in the context of recent hot button Canadian insolvency cases. Against the background of a brief discussion of the historical and legislative purposes and underpinnings of the *CCAA*, the discussion above focused on setting up the essential problem with respect to arguably valueless shares and the shareholders that demand value for such under water equity. Moving on to a consideration of the nature of directors' statutory duties in a restructuring and to whom these duties are owed, the above discussion clarified that no particular duties are owed to shareholders specifically and that the focus is always on the best interests of the company. Although, as seen above, the interests of shareholders and other stakeholders such as creditors may be considered where appropriate, and indeed, the different sets of interests may even coincide at times. Following this, the discussion moved to a consideration of some of the key precedents that emerged from the Stelco restructuring, as well as to an examination of how the shareholder equity issue was addressed by Farley J. in his reasons with respect to both the Sanction Order and the order approving the *CBCA* reorganization.

Drawing together and synthesizing these various different threads of analysis and inquiry, it becomes clear that Stanley E. Edwards' comments on page one of this paper continue to echo through the years and will surely continue to do so into the future. It is essential to have a reliable and "adequate reorganization procedure" whereby debtor corporations may make compromises with their creditors and other stakeholders to avoid bankruptcy. Such a system ensures that the Canadian people and economy do not lose key enterprises that have going concern value and that need simply to be reorganized and restructured to capture efficiencies and synergies, enabling them to move forward on a productive and profitable basis. Uncertainty can be caused, and in Canadian restructurings clearly has been caused, by certain stakeholders such as activist and vocal shareholders attempting to "exact a ransom" from the company, and this uncertainty should be addressed and avoided.[157] The Stelco restructuring sends a clear message in this regard. Although it did not involve tax losses such as *Eaton's* and *Woodward's*, and neither of the shareholders was as powerful as Jolina in *Uniforêt*, it was still a case that made observers (and no doubt participants) wary because it seemed at times that it might go either way on the equity issue. Indeed, even Farley J. himself noted the following at an early point during the two year process:

> Who knows what the eventual outcome of Stelco will be?…Stelco is one of those rare situations in which a change of external circumstances…may result in the original equity having a more substantial "recovery" on emergence…[158]

Ultimately, the court made the right choice in permitting the cancellation of the shares, although there has certainly been residual controversy and grumbling as the new post-restructuring equity entered the market.

The increased shareholder activism that characterized the Stelco restructuring is no doubt beneficial in some ways and for some purposes; for one, undoubtedly it keeps boards of directors on their toes. However, where such self-interested and likely short-sighted shareholders are able to throw significant obstacles onto the path towards a successful workout, it is preferable that a solution be created that promotes the enduring viability of the various insolvent firms utilizing the *CCAA* and rewards those stakeholders who compromise or otherwise alter their claims in favour of promoting long-term vision for the corporations with which they are associated. To this end, the provincial corporations statutes in Canada should be amended to overtly reflect, if they do not already, the language in the *CBCA* permitting alterations to be made to share capital without a shareholder vote. The reorganization provisions in the *CBCA* have not been utilized capriciously by debtor corporations or their influential senior creditors, and indeed, the check is that for a Plan to be sanctioned by the court, it must be fair and reasonable.[159] Without any formal statutory change to accompany the new clarity provided

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[157] *Cadillac Fairview*, *supra* note 74 at para. 8.
[158] *Stelco: Application to Remove*, *supra* note 126 at para 5.
[159] *Supra* note 12 at para. 4.

by *Peoples* and the excellent approach to the shareholder equity issue taken by Mr. Justice Farley in the Stelco restructuring, shareholders, particularly large institutional and vocal ones such as Keiper and Woollcombe and their companies, will still find it worthwhile to gamble from the bottom rung of the priority ladder, thereby potentially prolonging or impeding the restructuring process.

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