National Insolvency Review

General Editor: Adam M. Slavens, B.A., LL.B.

VOLUME 32, NUMBER 6 Cited as (2015), Nat. Insol. Review DECEMBER 2015

• STAYING SET-OFF RIGHTS IN *CCAA*: CASE COMMENT ON *NORTH AMERICAN TUNGSTEN CORPORATION v. GLOBAL TUNGSTEN AND POWDERS CORP.* •

John R. Sandrelli, Cindy Cheuk, Jordan Schultz, and Tevia R. M. Jeffries
Dentons Canada LLP

Introduction

On September 30, 2015, the British Columbia Court of Appeal gave reasons that concluded a series of applications dealing with claims of set-off in proceedings commenced under the *Companies' Creditors Arrangement Act* [*CCAA*][1] in *North American Tungsten Corporation v. Global Tungsten and Powders Corp.* [*North American Tungsten*].[2] *North American Tungsten* is the first appellate level decision in Canada to interpret s. 21 and confirm a supervising court's jurisdiction to stay set-off rights as part of the general stay of proceedings that is typically ordered under the *CCAA*, notwithstanding the preservation of such rights (as provided in s. 21) in *CCAA* proceedings. Although the scope of the decision is limited to the jurisdictional issue, it also confirms the broad authority of the supervising judge in a *CCAA* proceeding to make orders that preserve the status quo and enhance the prospects of a debtor company's being in a position to present a plan of compromise and arrangement to its creditors.

• In This Issue •

LexisNexis®

NATIONAL INSOLVENCY REVIEW

The **National Insolvency Review** is published bi-monthly by LexisNexis Canada Inc., 123 Commerce Valley Drive East, Suite 700, Markham, Ontario L3T 7W8

ISBN: 0-409-91078-3 ISSN: 0822-2584
ISBN: 0-433-44393-6 (Print & PDF)
ISBN: 0-433-44694-3 (PDF)

Subscription rates: $465/year (Print or PDF)
$555/year (Print & PDF)

Please address all editorial inquiries to:

Boris Roginsky, Journals Editor
LexisNexis Canada Inc.
Tel. (905) 479-2665; Toll-Free Tel. 1-800-668-6481
Fax (905) 479-2826; Toll-Free Fax 1-800-461-3275
E-mail: nir@lexisnexis.ca.

The Court in *North American Tungsten* also commented on the applicable law in a leave to appeal application from a decision under the *CCAA*, confirming that although the usual test applies, leave will be granted sparingly given the unusual circumstances typically present in *CCAA* cases, and further confirming the relevance of such factors as the impact of granting leave on a debtor's restructuring efforts and the efforts of parties to circumvent the reorganization.

This article provides a brief background to the set-off issue that arose in the restructuring proceedings commenced by North American Tungsten Corporation Ltd. ("NATC"), and a review of the three decisions leading up to and including the Court of Appeal's recent decision on claims of set-off. The article concludes with some commentary by the authors on the relevant statutory provisions.

Background Facts

NATC owned and operated a tungsten mine located in the Northwest Territories known as the "Cantung Mine". NATC produced "tungsten concentrate", which was sold to two customers, one of which was Global Tungsten and Powders Corp. ("GTP"). Low tungsten prices and significant debt service obligations were two of a number of factors that resulted in NATC's seeking creditor protection.

On June 9, 2015, NATC applied for and obtained an initial order under the *CCAA*. Soon after commencing the proceeding, acknowledging that tungsten prices were unlikely to rebound before the winter set in in the Northwest

Territories, NATC developed an "Operating Plan" under which (among other things) it would continue mining operations at the Cantung Mine during the autumn of 2015, and thereafter transition the mine into short-term care and maintenance over the winter. This Operating Plan was predicated on NATC's two customers' continuing to pay for the tungsten concentrate they received after the *CCAA* filing date, in the ordinary course of business.

Under NATC's supply agreement with GTP, GTP was obligated to pay for shipments within 30 days of NATC's delivery of proof of shipment to GTP. Pursuant to a factoring agreement with a third-party lender, NATC actually received payments within five days of shipment, and the lender was later paid by GTP according to the 30-day payment terms. As a result of these arrangements, GTP did not owe any amounts to NATC in respect of shipments of tungsten as of the *CCAA* filing date.

In addition to being one of only two customers of the Cantung Mine, GTP had also advanced a loan to NATC to support the Cantung Mine operations. As of the *CCAA* filing date, the amount owing to GTP was approximately $4.4 million (the "Loan Debt").

After the *CCAA* filing date, the factoring agreement was terminated. NATC continued shipping to GTP in the ordinary course but was required to seek other arrangements to finance the receivables in order to meet its cashflow obligations in a timely way. In the interim, however, GTP continued to pay for post-filing shipments as they came due.

On July 22, 2015, in the midst of NATC's negotiating a new financing arrangement for the GTP receivables, GTP declared that it intended to set-off all further amounts owing for post-filing shipments against the pre-filing Loan Debt and would not be paying for any further shipments as they came due. As this was about 45 days into the restructuring process, the post-filing receivables had accumulated to a significant amount, totalling approximately US$1.7 million (the "GTP Receivables").

In the face of GTP's set-off claim, NATC was not able to generate sufficient cashflow to meet its post-filing obligations, and the entire restructuring was at risk of immediate termination if GTP was not compelled to pay the outstanding invoices and to pay for further shipments in the ordinary course of business.

As a result, NATC immediately brought an application for a declaration that (1) GTP had violated the stay of proceedings under the initial order, (2) GTP had no right of set-off between pre-filing and post-filing obligations, and (3) in the alternative, any right of set-off was and should continue to be stayed for the duration of the restructuring process. GTP opposed NATC's application and brought a cross application seeking a declaration that it had a valid right of set-off between the Loan Debt and the GTP Receivables.

Statutory Provisions

The relevant provisions of the *CCAA* engaged by these applications were relatively straightforward. With respect to the stay, ss. 11 and 11.02

set out the court's jurisdiction and are well known by all insolvency practitioners:

> **General power of the court**
>
> 11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.
>
> […]
>
> **Stays, etc. – initial application**
>
> 11.02(1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,
>
> (*a*) staying, until otherwise ordered by the court, [for any period that the court considers necessary,] all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;
>
> (*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
>
> (*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

With respect to set-off, the relevant provision that, if known, is certainly less commonly invoked is as follows:

> **Law of set-off or compensation to apply**
>
> 21. The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

B.C. Supreme Court Decision[3]

The application of NATC and the cross-application of GTP were heard over two days. On July 27, 2015, submissions were made by NATC that GTP's unilateral assertion of a right of set-off and refusal to pay for outstanding shipments constituted enforcement of a remedy and was therefore in violation of the Court's order staying same. GTP responded to the allegation that it was in contempt of the initial order by taking the Court through the substance of its argument that s. 21 of the *CCAA* preserves both the existence of and the enforcement of rights of set-off notwithstanding any order that may be made under the *CCAA*. In short, GTP argued that the court could not stay set-off rights and thus any such order was ineffective.

The remainder of the applications were put over for three days; however, on July 27, Justice Butler did issue initial oral reasons for judgment finding that

1. by refusing to pay its post-filing obligations to NATC on the basis of an alleged claim of set-off, GTP was in violation of the stay of proceedings imposed by paras. 15 and 16 of the amended and restated initial order entered in the proceedings (the "ARIO");
2. GTP was not, at the date of hearing, in contempt of court, having raised an issue as to whether the initial order was clear with regard to set-off; and
3. GTP was required to make immediate payment of all due or past due invoices issued by NATC after June 9, 2015, and before July 22, 2015 (the date it gave notice of its alleged set-off claim).

Parties spoke to the remaining elements of the application on July 30. NATC's position was supported by Callidus Capital Corporation

("Callidus"), NATC's interim lender on certain assets, and the Government of the Northwest Territories, as senior secured creditor on other of the NATC's assets. The court-appointed Monitor also spoke to the application, highlighting the negative impact that the exercise of set-off rights by GTP would have on NATC's restructuring.

In his reasons delivered July 30, Butler J. characterized the issues raised by the parties as follows:

1. Is there a debt due and owing by NATC to GTP?
2. In any event, is it immaterial that the debt has not yet fallen due for payment?
3. Is legal set-off available for pre-filing and post-filing obligations?
4. Does the court have jurisdiction to stay set-off rights once those have been determined?

In respect of the first two issues, the judge did find that (1) an amount was due and owing by NATC to GTP because NATC was in default of its obligations under the loan agreement between GTP and NATC, and (2) even if NATC's debt to GTP was not yet payable, GTP's legal right of set-off under the supply agreement would not be defeated.

Justice Butler then analyzed whether legal set-off is available as between pre- and post-filing obligations. Following *Air Canada (Re)* [*Air Canada*],[4] Butler J. held that the commencement of a *CCAA* proceeding does not result in a loss of mutuality as between pre- and post-filing debts. Although the judge found that the policy arguments against such finding of mutuality had merit, he was not prepared to find that *Air Canada* was wrongly decided. The result of Butler J.'s analysis of the first three issues, as he characterized them, was a finding that GTP had an existing legal right of set-off under the supply agreement as between the Loan Debt and the GTP Receivables. That determination then put front and centre the issue of whether such rights could be stayed.

Justice Butler then went on to find that even if a creditor has a right of set-off, a *CCAA* court has the jurisdiction to stay enforcement of set-off rights. Relying on *Air Canada* and *Tucker v. Aero Inventory (UK) Limited*,[5] the judge confirmed that a temporary stay of set-off rights can be granted to further the purpose of the initial order and the purposes of the *CCAA*. The judge went on to find that GTP's post-filing position would not be prejudiced by a stay of enforcement of its right of set-off.

In response to GTP's argument that s. 21 of the *CCAA* limits the *CCAA* court's discretion to stay set-off, Butler J. found that s. 21

> does not exempt set-off claims from stays, determined or not. It merely confirms the rights of set-off. Exempting set-off claims would not accord with the policy of the *Act*. Sections 11 and 11.02 of the *Act* give the Court a very broad discretion which must be exercised in furtherance of *CCAA* purposes. Quite simply, it would be illogical if the Court had the discretion to broadly stay claims and proceedings and make relevant ancillary orders necessary to further the purpose of the *Act* and the purpose of the initial order, but could not do so with regard to set-off claims.[6]

B.C. Court of Appeal Chambers Decision[7]

GTP filed two notices of application for leave to appeal the July 27 and July 30 orders of Butler J.

to the Court of Appeal of British Columbia on the grounds that

1. the Court erred in law in interpreting s. 11 and/or s. 11.02 of the *CCAA* to confer upon it the jurisdiction to stay otherwise valid rights of set-off;
2. the Court erred in law in failing to give effect to s. 21 of the *CCAA*, which protects GTP's ability to assert its rights of set-off; and
3. the Court erred in law by finding that GTP violated para. 15 and/or para. 16 of the ARIO, by asserting a right of set-off arising from amounts owing by NATC to GTP.

At hearing, GTP limited its submissions on the merits to the argument that, properly interpreted, s. 21 limits the discretion of judges under the *CCAA* and, as such, enforcement of set-off rights is incapable of being stayed under the *CCAA*.

In his reasons, Justice Savage considered the test for leave to appeal—namely, whether the appeal is *prima facie* meritorious, whether the point on appeal is of significance to the practice, whether the point raised is of significance to the parties, and whether the appeal will unduly hinder the progress of the action. Justice Savage also considered the interests of justice and stated that leave to appeal is to be granted sparingly in *CCAA* cases, given the deference afforded to a *CCAA* judge seized of the proceedings below.

Starting with the merits of GTP's application, Savage J.A. noted the merits requirement is to be applied "strictly" on applications made under the *CCAA*. The judge found GTP's argument on the merits, that the language of s. 21 precluded jurisdiction to stay enforcement of set-off rights, weak and unconvincing. In particular, the judge found:

> That s. 21 does not restrict the jurisdiction of the court is made clear when it is contrasted with other provisions of the *CCAA* which specifically prevent the court from staying certain rights and proceedings (see ss. 11.04, 11.06, 11.08, and 11.1). Set-off is clearly a remedy which is specifically stayed by the ARIO, but also generally stayed in insolvency proceedings: see e.g. *Re Quintette Coal* (1990), 51 B.C.LR. (2d) 105 at 111-14, 2 C.B.R. (3d) 303. Clearly, if an attempt at compromise or arrangement is to have any prospect of success there must be a means of holding creditors at bay.[8]

Justice Savage also went through the implications of granting leave to appeal, specifically that Callidus would cease to advance funds, that NATC would be unable to continue operations and meet post-filing obligations, and that an immediate shut down and liquidation would ensue.

Given GTP's weak position on the merits and the devastating effect that granting leave to appeal would have on NATC's attempts to restructure, Savage J.A. denied leave to appeal.

B.C. Court of Appeal Panel Review

GTP appealed Savage J.A.'s decision denying leave to appeal by applying for a review of the decision before a panel of three judges of the B.C. Court of Appeal. The test on a review application is whether the chambers judge made an error in law or principle, or misconceived the facts. If an error exists, the court will consider whether a variation of the order is appropriate. GTP's application rested on alleged errors of law or principle.

The decision of the panel was delivered September 30, 2015, by Justice Groberman, with Justices Neilson and Fenlon concurring.

GTP made several arguments regarding alleged errors; however, the Court focused on four issues:

- Did the chambers judge apply too stringent a test for leave to appeal?
- Did the chambers judge err in finding the appellant's interpretation of ss. 11 and 21 of the *CCAA* is not meritorious?
- Did the chambers judge err in considering the probable failure of the *CCAA* restructuring as a factor militating against the granting of leave?
- Did the chambers judge err in considering GTP's conduct as a factor in denying leave?

With respect to the first issue, following its earlier decision in *Re Edgewater Casino Inc.*,[9] the Court stressed that the test for leave to appeal is the same in a *CCAA* proceeding as it is in any other proceeding. The Court found that while it is correct that leave is granted sparingly from decisions made in a *CCAA* proceeding, it is a result of an application of the usual test to the unusual circumstances of *CCAA* proceedings, not a different standard being applied to these cases.

The Court concluded that the language used by Savage J.A. did indicate that he applied a more stringent test in assessing GTP's leave application and found that, to the extent this more stringent test affected his decision, it was an error in principle.

However, and with respect to the second issue, the Court went on to consider whether Savage J.A. erred in finding that the appeal lacked merit. The Court agreed with GTP that the threshold was low; the issue was not whether the appellant was correct, but whether it had raised an arguable case. Nevertheless, the Court concluded Savage J.A. did not make any error in concluding the proposed appeal lacked merit. As Savage J.A. also noted in his interpretation of s. 21, the Panel found that "it is clear that the section does not preclude the making of an order such as the one made by the Supreme Court judge in this case".[10]

In reaching this conclusion, the Court relied on the broad discretion provided by s. 11 (citing *Century Services Inc. v. Canada*[11]), the placement of s. 21 in the general part of the *CCAA* dealing with "claims", and the fact that Parliament used express language to limit the jurisdiction in s. 11 in other parts of the Act (see, for example, ss. 11.04, 11.06, 11.08, and 11.1).

Turning to the relevant case law, the Court recognized that *Quintette Coal Ltd. v. Nippon Steel Corp. (1990)*[*Quintette Coal*][12] supported finding that the court had jurisdiction to stay set-off rights, though noted that this case predated s. 21. The Panel went on to consider *Cam-Net Communications v. Vancouver Telephone Co.*,[13] concluding that this case found only that a stay should not be granted where it is unfairly prejudicial, not that the court could not grant the stay in other circumstances. The Panel's assessment of the merits of GTP's interpretation of s. 21 is arguably much stronger than Savage J.A.'s assessment. While Savage J.A. found GTP's

argument on the merits "weak", the Panel entirely dismissed the proposition that s. 21 limits a *CCAA* court's jurisdiction to stay set-off, finding at para. 40 of its reasons that "there does not appear to be any arguable basis for [GTP's] proposition, either in the language of the statute, or the jurisprudence".

Turning to the third issue, the Panel agreed with Savage J.A. that it was proper to consider the impact of granting leave on the underlying restructuring proceeding. In that regard, the Panel endorsed the decision of Justice Tysoe in *Re Great Basin Gold Ltd.*[14]

Lastly, the Panel also agreed with Savage J.A. in his consideration of GTP's conduct. The Panel found that the possibility GTP was manipulating proceedings for its own benefit (essentially building up a payable so as to exercise set-off) was a legitimate consideration in assessing whether to grant leave to appeal, holding that courts must be vigilant to ensure *CCAA* proceedings are not used by creditors to subvert the reorganization of the debtor company.

Observations on s. 21 of the *CCAA*

The arguments in this case raise a relatively novel issue. Much of the case law citing s. 21 of the *CCAA* concern the issue of when equitable set-off applies. In *North American Tungsten*, however, a right of legal set-off had been found, which finding was not appealed. The critical determination here was whether s. 21 preserved a party's right to set-off such that it could not be stayed in *CCAA*. The decision of the B.C. Court of Appeal in *Quintette Coal* made clear that, absent s. 21, enforcement of a right of set-off could be stayed. Here, the courts had to analyze whether the subsequent enactment of s. 21 changed that result. In other words, does "applies […] in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be" exempt set-off from being stayed? This turn of phrase is not found elsewhere in the *CCAA*.

There is no real judicial discussion of what "in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be" means. While legislators may have had some idea of what is meant by this phrase, practitioners have been left in the dark. In the authors' view, this phrasing lacks the specificity and clarity required to limit the broad discretion of a *CCAA* court to make orders to further the purposes of the *CCAA* and aid in a debtor company's attempts to restructure. At present, it appears that the courts concur with this view, and enforcement of set-off rights may be stayed in *CCAA*. Unfortunately, existing case law does not shed light on the interplay between the phrase "in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be" and the repeated interactions of creditors and a debtor company, in particular when compared with the more one-off judgment interaction between a plaintiff and defendant in ordinary civil litigation. The phrase may make some sense in the context of a bankruptcy, where a trustee in bankruptcy is monetizing a debtor's assets and distributing same among creditors. In *CCAA*, however, these words add unnecessary ambiguity and may be deserving of some attention in the next round of legislative reform of the *CCAA*.

[*Editor's note*: The authors are all lawyers with the Restructuring, Insolvency and Bankruptcy Group of Dentons Canada LLP and have been acting for *North American Tungsten* throughout its *CCAA* Proceedings.]

1 *CCAA*, R.S.C. 1985, c. C-36.
2 *North American Tungsten*, [2015] B.C.J. No. 2309, 2015 BCCA 426.
3 *North American Tungsten Corp. Ltd. (Re)*, [2015] B.C.J. No. 1725, 2015 BCSC 1382.
4 *Air Canada*, [2003] O.J. No. 6058, 39 B.L.R. (3d) 153 (Ont. S.C.J.).
5 [2009] O.J. No. 4797, Court file no. 09-CL-8456-00CL (Ont. S.C.J.).
6 *Supra* note 3, para. 28.
7 *North American Tungsten Corp. (Re)*, [2015] B.C.J. No. 1983. 2015 BCCA 390 (in chambers).
8 *Ibid*., para. 16,
9 [2009] B.C.J. No. 174, 2009 BCCA 40.
10 *Supra* note 2, para. 35.
11 [2010] S.C.J. No. 60, 2010 SCC 60.
12 [1990] B.C.J. No. 2497, 51 B.C.L.R. (2d) 105 (B.C.C.A.).
13 [1999] B.C.J. No. 2855, 1999 BCCA 751.
14 Court file no. CA040276, Vancouver, British Columbia Court of Appeal, October 3, 2012 (unreported).

• *RE NELSON EDUCATION LIMITED* AND THE ROLE OF THE MONITOR •

Lily Coodin
Torys LLP

In the recent case of *Re Nelson Education Limited* [*Re Nelson*],[1] a monitor under the *Companies' Creditors Arrangement Act*[2] was replaced after the court held that there was a lack of independence based on the monitor's prior involvement as an advisor to the company. Justice Newbould of the Ontario Superior Court commented on the role of monitors in general and held that even though there was no wrongdoing on the part of the monitor in this case (the "Monitor"), it was not appropriate for the Monitor to give the court advice on an essential issue when it had played a central role in advising the company on this very issue prior to the commencement of the *CCAA* proceedings. This case is important in noting the need for independence from the debtor company on the part of a monitor in *CCAA* proceedings, as well as the need for the appearance of impartiality and lack of bias.

Nelson Education Ltd. and its parent company (collectively, the "Company") were in the business of education publishing and providing learning materials. They both sought and obtained an initial order pursuant to the *CCAA* on May 12, 2015. RBC, which was a first lien lender and the largest second lien lender, moved to have the Monitor replaced by a substitute monitor at the comeback hearing.

An affiliate of the monitor (the "Affiliate") had been involved since 2013 in advising the Company. In this advisory role, the Affiliate had entered into discussions regarding proposed transaction term sheets with a number of stakeholders, including RBC as the second lien agent, without any agreement being reached. The Company stopped making payments to the second lien lenders pursuant to a First Lien Support Agreement, to which RBC was not a signatory.