

CITATION: Smurfit-Stone Container Canada Inc., 2010 ONSC 50
COURT FILE NO.: CV-09-7966-00CL
DATE: 20100128

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C. 1985, c. B-3, AS AMENDED

IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SMURFIT-
STONE CONTAINER CANADA INC. AND OTHER APPLICANTS

BEFORE: Pepall, J.

COUNSEL: *Sean F. Dunphy and Alexander Rose* for the Applicants
Robert J. Chadwick and Christopher G. Armstrong for the Monitor
Gavin H. Finlayson and Sean H. Zweig for the Unsecured Creditors
Committee
Kevin McElcheran and Heather L. Meredith for the Fund Managers
Seema Aggarwal for Manufacturers and Traders Trust Company as Indenture
Trustee

REASONS FOR DECISION

Nature of Proceedings

[1] A motion is brought by Smurfit-Stone Container Canada Inc. ("Smurfit Canada") and others ("the Applicants") seeking directions regarding the intercompany claim of Stone Container Finance Company of Canada II ("Finance II") against Smurfit Canada including whether, having regard to the CCAA proceedings, such claim is in the nature of equity or debt and whether the amount of the claim that is a provable claim within the meaning of section 12 (1) of the CCAA is zero (the "characterization motion"). They also brought a motion to extend the stay of proceedings (the "stay extension motion"). A third motion was brought by Aurelius Capital Management, LP and Columbus Hill Capital Management, the Fund Managers who represent certain noteholders ("the Fund Managers") for an order declaring that Stikeman Elliott LLP could not continue to act as counsel for Finance II and adjourning the aforementioned scheduled characterization motion to permit new counsel to prepare and to consider whether the motion should proceed by way of a joint hearing of this court and the US Bankruptcy court (the "adjournment motion").

- [2] I dismissed the Fund Managers' adjournment motion with reasons to follow and heard the characterization motion as scheduled. I reserved my decision on that motion. On December 23, 2009, I granted the stay extension motion and gave reasons. These are my reasons for decision with respect to the characterization motion and the adjournment motion.
- [3] The claims that may be asserted in this CCAA proceeding are at the heart of this dispute. The noteholders represented by the Fund Managers assert claims for \$200 million against Finance II and also against Smurfit Stone Container Enterprises Inc. ("Enterprises"), formerly known as Stone Container Corporation ("SCC"), based on a guarantee. They also wish to have Finance II assert a claim against Smurfit Canada in respect of the same \$200 million so that they would rank pari passu with the unsecured creditors of Smurfit Canada. This motion is designed to address the nature and value, if any, of Finance II's claim against Smurfit Canada.

Background Facts

- [4] Certain of the facts that are relevant to these motions are outlined in my endorsement of October 20, 2009 in these proceedings but for ease of reference, I will repeat many of them.

(i) The Three Companies

- [5] Finance II is a Nova Scotia unlimited liability company that is wholly owned by Smurfit Stone Container Enterprises Inc. ("Enterprises"), formerly known as Stone Container Corporation ("SCC"). It is a special purpose company with no employees and no operations. Smurfit Canada, one of the two Smurfit operating entities in Canada, is also a wholly owned subsidiary of Enterprises.

(ii) The Offering Memorandum

- [6] In 2004, Finance II raised funds in the public debt market by issuing unsecured notes due in 2014 in the principal amount of \$200 million pursuant to a Trust Indenture dated July 20, 2004. Manufacturers and Traders Trust Company is the indenture trustee. The intended use of the proceeds was to fund the payment of US\$185 million of notes due in

2006 and to repay bank debt. The Offering Memorandum relating to the issuance of the notes described Finance II's role:

Stone Finance II is a wholly-owned special purpose finance subsidiary of Stone Container Corporation, formed as an unlimited company under the *Company Act* of Nova Scotia, Canada. Stone Finance II is a holding company whose only business is to access bank financing and capital markets on behalf of Stone Container. Otherwise, Stone Finance II conducts no independent business or operations.¹

- [7] The Offering Memorandum also described the role of SCC (now Enterprises) as guarantor:

[SCC], exclusive of its subsidiaries (the "guarantor"), alone will unconditionally guarantee the payment of principal and interest, including additional interest, if any, on the notes. None of the subsidiaries will guarantee the notes.²

(iii) The Three Agreements

- [8] Three bilateral internal and intercompany agreements were entered into by Finance II, Smurfit Canada and Enterprises. These agreements were not disclosed in the Offering Memorandum and therefore were not material to any investment decision. The agreements are all premised on the basis that Enterprises would be responsible for providing the cash to repay the notes.
- [9] By a Loan Agreement dated July 20, 2004 between the two Canadian companies, namely Finance II and Smurfit Canada, Finance II agreed to lend \$200 million to Smurfit Canada. This sum represented the proceeds of the issuance of the notes. Smurfit Canada's obligation to pay interest to Finance II was to be satisfied through the issuance of Class C shares. The Class C shares were non voting shares. Smurfit Canada also agreed to repay the outstanding balance of the loan on July 15, 2014. The Loan Agreement described various events of default including, by way of example, commencement of a proceeding relating to a liquidation or an arrangement. The parties concede that commencement of the CCAA and the Chapter 11 proceedings constituted events of default under the Loan Agreement. The Loan Agreement provided that it

¹ Offering Memorandum, p.1.

² Offering Memorandum, p.5.

superseded all prior commitments, agreements and understandings and could only be amended in writing. The Loan Agreement was to be interpreted in accordance with and governed by the applicable laws of Quebec and the laws of Canada. This Loan Agreement is central to the request for directions and will be discussed in much more detail subsequently in these reasons.

- [10] Also on July 20, 2004, Smurfit Canada and Enterprises entered into a Forward Purchase Agreement. Enterprises agreed to invest \$200 million in Smurfit Canada by subscribing for Class A shares on the earlier of July 15, 2014 and the date of the performance by Smurfit Canada of its obligations under the Loan Agreement. Thus Enterprises would provide Smurfit Canada with the cash to repay the US\$200 million to Finance II and would receive Class A shares of Smurfit Canada in return. The Forward Purchase Agreement would be null and void under certain circumstances including an adjudication of insolvency. It too provided that it was to be interpreted in accordance with and governed by the applicable laws of Quebec and the laws of Canada and also had an entire agreement provision.
- [11] Lastly, Enterprises and Finance II entered into a Subscription Agreement dated July 20, 2004, in which Enterprises agreed to provide Finance II with the cash to pay interest on the notes on January 15 and July 15 of each year commencing in 2005. Every six months until 2014, Enterprises subscribed for one common share of Finance II at a price of US\$7,375,000 being the amount of interest due on the notes. This agreement contained the same choice of law and amendment provisions as the Loan Agreement.
- [12] The transactions reflected in these three agreements were tax-driven and benefited from the different governing regimes in Canada and the U.S.³ In essence, the business enterprise, taken as a whole, would derive benefit from two interest payment deductions on the same amount of principal. Both the Loan Agreement and the Forward Purchase Agreement provided that for the purposes of the Internal Revenue Code of 1986, each of the parties to the respective agreements agreed and covenanted to treat the rights and obligations under the respective agreements as equity of Smurfit Canada. Although the

³ While the evidence of Mr. McFadyen on US tax law is admissible, I agree with counsel for the Applicants that his evidence on Canadian law is inadmissible. No witness, expert or otherwise, can provide an opinion on a pure question of domestic law: *Graat v. R.* (1982), 31 C.R. (3d) 289.

agreements are silent on the Canadian tax treatment, historically, the obligations were treated as debt for Canadian tax purposes.

(iv) The CCAA Proceedings and the Chapter 11 Proceedings

[13] On January 26, 2009, Enterprises, Smurfit Canada, Finance II and others obtained protection from their creditors under Title 11 of Chapter 11 of the US Bankruptcy Code. That same morning, Smurfit Canada, Finance II and others obtained protection from their creditors pursuant to the provisions of the CCAA.

[14] Under the terms of the Loan Agreement between Finance II and Smurfit Canada, the commencement of these proceedings and the Chapter 11 proceedings in the US each constituted an event of default. This fact is uncontested. Specifically, section 6.3 of the Loan Agreement stated that the following events, amongst others, constituted an event of default:

should [Smurfit Canada] or, its parent, [Enterprises], make an assignment for the benefit of creditors, or file or consent to the filing of a petition in bankruptcy, a proposal or a notice of intention under the Bankruptcy and Insolvency Act (Canada) or any other equivalent Law of any other jurisdiction or be adjudicated insolvent or bankrupt, or petition or apply to any tribunal for any receiver, trustee, liquidator or sequestrator of or for all or substantially all of its property; or should [Smurfit Canada] or [Enterprises] commence any proceeding relating to it or all or substantially all of its property under any reorganization, arrangement, readjustment, composition or liquidation Law of any jurisdiction; or should there be commenced against [Smurfit Canada] or [Enterprises] any such proceeding and it remains undismissed for a period of sixty (60) days; or should any receiver, trustee, liquidator or sequestrator of or for [Smurfit Canada] or [Enterprises] or all or substantially all of its property be appointed or should [Smurfit Canada] or [Enterprises] consent to or approve or accept any such proceeding or the appointment of any receiver, trustee, liquidator or sequestrator of or for [Smurfit Canada] or [Enterprises] or all or substantially all of its property.

[15] Thus various insolvency proceedings constituted an event of default as did such non-insolvency events such as a liquidation or an arrangement.

[16] The focus of the parties' dispute is section 7 of the Loan Agreement. It stated:

7. If an Event of Default shall have occurred and in every such event:...

7.2 upon the occurrence of an Event of Default specified in subsection 6.3, [Smurfit Canada] shall lose the benefit of the Term and the entire amount of the Loan then outstanding in principal and interest shall be immediately due and payable, all without any action by [Finance II] and without presentment, demand, protest, or any other notice of any kind, all of which are waived. Thereupon [Finance II] may exercise any and all of its rights and recourses under this Agreement, provided, however, that [Smurfit Canada] shall perform its obligations in this regard hereunder by the issuance to [Finance II] of Class B Shares having a value no less than the dividend or other amount that otherwise would be received by [Finance II].

(v) Memorandum and Articles of Association

- [17] Smurfit Canada's Memorandum and Articles of Association provided for 5 classes of shares and, amongst other things, addressed the rights, privileges, restrictions, and conditions that attached to the Class B shares. Class B shares were voting shares. No Class B shares were to be issued unless an event of default had occurred. The description of an event of default mirrored that contained in paragraph 6.3 of the Loan Agreement.
- [18] On a liquidation, dissolution or winding-up, the holders of Class B shares were expressly entitled to receive an amount in priority to other shareholders but were not entitled to share any further in the distribution of the property or assets of Smurfit Canada. The conditions contained no other express provision or entitlement in the event of an insolvency.

Issues

- [19] In essence, there are four issues to be decided. Firstly, is Finance II's claim against Smurfit Canada a claim for debt or equity? Secondly, if a debt, is it a debt provable in bankruptcy and hence in the CCAA proceedings? Thirdly, if it is a debt provable in bankruptcy, what is the quantum of Finance II's claim? Lastly, if it is a debt provable in bankruptcy, has it been subordinated to the claims of the unsecured creditors?

Positions of the Parties

- [20] Even though the Fund Managers spent considerable time on indicia of debt in their factum and argument, throughout, the Applicants have conceded that the Loan Agreement, by its terms, represented debt for all commercial purposes prior to the occurrence of an insolvency event of default. As such, it is unnecessary to review the facts and argument relating to that feature of the case.
- [21] All parties submit that the provisions of the Loan Agreement are clear and unambiguous.⁴
- [22] In brief, the Fund Managers state that the Loan Agreement reflects a debt obligation that is intended to be provable in a bankruptcy or other insolvency proceeding against Smurfit Canada. As a consequence of the event of default, section 7.2 of the Loan Agreement applies and provides that the entire amount of the Loan then outstanding in principal and interest shall be immediately due and payable by Smurfit Canada. Furthermore, section 7.2 does not stipulate a certain number of shares, but only that the shares have a value no less than the amount that otherwise would be received by Finance II. They submit that the provision does not alter the fundamental nature of the transaction which was intended to be and was treated as debt for all purposes. The intention was made clear by the financing structure employed by the Smurfit Group which required that it be a debt obligation for tax purposes. Section 7.2 simply provides that the debt obligation, when proved in the CCAA proceeding and/or the Chapter 11 proceeding, is to be satisfied by the issuance of equity having a value no less than the dividend or other amount that otherwise would be received by Finance II. As to the subordination argument, there is no such provision in the Loan Agreement.
- [23] The Fund Managers are supported by the Indenture Trustee. It submits that the true nature of the relationship between the parties on the date of insolvency determines whether an obligation constitutes a debt provable in bankruptcy. The obligation of Smurfit Canada under the Loan Agreement was to repay the loan and this obligation did not change upon an insolvency event of default. Whether Smurfit Canada satisfies the debt obligation by payment in cash or shares is irrelevant as upon insolvency, Smurfit

⁴ With the possible exception of the Indenture Trustee. As for the Fund Managers, see paragraph 85 of their factum.

Canada had an obligation to repay its debt to Finance II. It is the existence of the debt obligation and not how it is satisfied that gives rise to a provable claim in bankruptcy. As outlined by the Supreme Court of Canada in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*⁵, the source of funds is irrelevant where the payments remain mere repayments for monies advanced. Even if the Class B shares provision introduces an equity feature into the Loan Agreement, that feature alone is insufficient to alter the true nature of the transaction. The conditions attaching to the Class B and Class C shares are consistent with a debt obligation. Lastly, subordination requires an express indication of which security interests are to have priority and there is no basis on which to conclude that the requirements for subordination have been satisfied in this case.

[24] The Applicants state that the terms of the Loan Agreement are clear that the advance was intended to be an equity investment in the event of insolvency. Finance II is only entitled to repayment through the issuance of Class B shares of Smurfit Canada and not in cash. As equity, a shareholder does not have a claim that is a debt provable in bankruptcy within the meaning of section 12 (1) of the CCAA. Put differently, Finance II could not assert a claim as against Smurfit Canada. Its claim would be against Enterprises. The practical implication of such a determination is that if it does have a debt claim against Smurfit Canada, given the quantum, it would swamp the unsecured creditors in Canada who are owed funds by Smurfit Canada. Finance II has a debt claim as against Enterprises as contemplated by the Offering Memorandum. In the alternative, if Finance II has a debt claim against Smurfit Canada, it is debt to be paid in shares that have no value and therefore the value of the claim must be zero. Lastly, and in the further alternative, the provisions of the Loan Agreement manifest an intention to subordinate repayment of this intercompany debt to the claims of other unsecured creditors.

[25] The Applicants are supported by the Official Committee of Unsecured Creditors. It repeats many of the same arguments as the Applicants. It also submits that whether Finance II's claim against Smurfit Canada is in the nature of debt or equity, the quantum of the provable claim is zero. If the claim is in the nature of equity, courts have consistently held that equity claims are subordinate to the claims of all creditors. If the claim is determined to be in the nature of debt, Smurfit Canada may only satisfy the

⁵ [1992] 3 S.C.R. 558.

claim with the issuance of shares which have no value. A declaration by the court that Finance II's intercompany claim has value that ranks *pari passu* with the claims of unsecured creditors would place the creditors of Finance II in a position that was never contemplated by those creditors, Finance II, Smurfit Canada or anyone else. It would also prejudice all other unsecured creditors in this proceeding. Furthermore, the financing was sold as an Enterprise credit investment and the court should not now rewrite the contract to favour Finance II and the noteholders.

Discussion

[26] Section 12(1) of the CCAA states that a claim "means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act*."

[27] Section 121(1) of the BIA describes a debt provable in bankruptcy.

All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

[28] One must first ascertain whether Finance II's claim against Smurfit Canada is for debt or equity.

[29] The starting point in this analysis is consideration of the Loan Agreement and the principles applicable to contract interpretation. The essential guide is found in the Supreme Court of Canada's decision of *Eli Lilly & Co. v. Novopharm Ltd.*⁶

The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party's subjective intention has no independent place in this determination.

⁶ [1998] 2 S.C.R. 129 at 166.

Indeed, it is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face.⁷

- [30] More recently, the Court of Appeal decision in *Ventas Inc. v. Sunrise Senior Living REIT*⁸ outlined applicable principles of contract interpretation.

A commercial contract is to be interpreted,

(a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;

(b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the “cardinal presumption” that they have intended what they have said;

(c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties; and (to the extent there is any ambiguity in the contract),

(d) in a fashion that accords with sound commercial principles and good business sense, and that avoids commercial absurdity.

- [31] Assistance is also provided by the Supreme Court of Canada’s decision in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*⁹. In that case, the issue was whether \$255 million advanced to Canadian Commercial Bank (“CCB”) was in the nature of a loan or a capital investment. If the latter as opposed to the former, unsecured creditors would have priority over shareholders on a winding up of CCB.

- [32] Briefly, the facts were as follows. A group of banks had agreed to provide emergency financial assistance to CCB on certain terms. They agreed to purchase a participatory interest in a portfolio of assets held by CCB and CCB agreed to repay the full amount advanced. In the event of an insolvency or wind-up of CCB, any amount remaining unpaid would constitute indebtedness of CCB to members of the bank group. The participation agreement entered into by the parties provided that the rights of the participants to monies owing to them under the agreement ranked *pari passu* with the rights of depositors. CCB’s financial status ultimately deteriorated and it was ordered to be wound up.

⁷ *Ibid* at p. 166.

⁸ (2007), 85 O.R. (3d) 254 (C.A.) at 263.

⁹ *Supra*, note 5.

[33] The Supreme Court concluded that the banks' advances constituted a loan. Iacobucci J. determined that the words chosen by the parties in their agreement supported the conclusion that in substance, the programme involved a loan and there was nothing in the surrounding circumstances that detracted from this characterization.

As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.¹⁰

[34] He noted that characteristics associated with both debt and equity financing were present.

Instead of trying to pigeonhole the entire agreement between the participants and the CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance reflects a debtor-creditor relationship...It is permissible and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement.¹¹

[35] This decision was applied by the Ontario Court of Appeal in *Re Central Capital Corporation*¹², a case relied upon by all parties to the motion before me.

[36] Central Capital was insolvent and sought protection pursuant to the provisions of the CCAA. The appellants held preferred shares of Central Capital. The shares each contained a right of retraction, that is, a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. One shareholder exercised his right of retraction and the other shareholder did not but both filed proofs of claims in the CCAA proceedings.

¹⁰ Ibid, at p.590-591.

¹¹ Ibid, at p.590-591.

¹² (1996), 38 C.B.R. (3d) 1 (Ont. C.A.).

- [37] The issue before the Court of Appeal was whether, for the purposes of the CCAA, the two appellant shareholders had debt claims provable against Central Capital in the CCAA proceedings. The approach adopted by the two majority judges was somewhat different.
- [38] Laskin J.A. addressed the issue of characterization by considering the substance of the relationship between the shareholders and the company and section 36(2) of the Canada Business Corporations Act¹³ which prohibited redemption of shares in an insolvent company. He concluded that while the relationship had characteristics of debt and equity, in substance, the appellants were shareholders, not creditors. If creditors, the purpose of section 36(2) of the CBCA would be defeated. Following the Supreme Court in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, Laskin J.A. stated that if the instrument contains features of both equity and debt, that is, it is hybrid in character, the court must determine the substance of the relationship between the company and the holder of the certificate. The court looks to what the parties intended. In reaching his conclusion that the appellants were shareholders and not creditors, he noted that the conditions attaching to the preferred shares provided that on a wind-up, the holders ranked with other shareholders and not with creditors. The conditions also stated that on payment of the amount owing to them, the appellants "shall not be entitled to share in any further distribution of assets of the corporation." He noted that in the CCB case, Iacobucci J. placed considerable weight on a provision in the agreement stating that each participant would rank *pari passu* with the rights of the depositors. Laskin J.A. held that the appellants had to be shareholders or creditors but could not be both.
- [39] Weiler J.A. also determined that to decide whether the obligation to redeem the preferred shares was a claim provable in bankruptcy, it was necessary to characterize the true nature or substance of the transaction. Amongst other things, she noted that evidence of a debtor-creditor relationship was lacking in the articles. There was no provision that on an insolvency, the parties were entitled to rank *pari passu* with creditors. She viewed as significant the fact that the articles provided that in the event of liquidation, dissolution or wind-up, the appellants were only entitled to rank after creditors. This represented a clear intent that holders of retractable shares were not to be dealt with on the same footing as

¹³ R.S.C. 1985, c. C-44.

ordinary creditors even after the retraction date. She decided that the nature of the relationship was equity and not debt.

- [40] In the event that she was wrong and the relationship was debt and not equity, she also examined whether the appellants held claims provable in bankruptcy thereby entitling them to be claimants under the CCAA.
- [41] The motions judge, Feldman J., had relied upon the definition of debt found in Black's Law Dictionary, 1990, 6th ed., at p.409.¹⁴

A sum due by certain and express agreement. A specified sum of money owing to one person from another, including not only obligation of debtor to pay but right of creditor to receive and enforce payment.

- [42] She held that to have a provable claim, the appellants had to be able to obtain a judgment against the company for the retraction price and be entitled to seek payment on the judgment. In discussing this issue, Weiler J.A. stated that: "Persuasive authority already exists to the effect that in order to be a provable claim within the meaning of section 121 of the BIA the claim must be one recoverable by legal process: *Farm Credit Corp. v. Holowach (Trustee of)*, [1988] 5 W.W.R. 87 (Alta. C.A.) at 90, leave to appeal to the Supreme Court of Canada dismissed at [1989] 4 W.W.R. lxx (note)."¹⁵
- [43] Weiler J.A. noted that in *Holowach*, legislation precluded certain claims but did not serve to extinguish or satisfy an underlying debt. Nonetheless, the Alberta Court of Appeal had held that a provable claim was barred because it could not be recovered by legal process. Similarly, in *Central Capital*, Weiler J.A. determined that due to the provisions of section 36 of the CBCA, there was no right to enforce payment even though there was a right to receive payment and therefore, the promise could not be proved as a claim in the CCAA proceedings.

Here, the contract to repurchase the shares, while perfectly valid, is without effect to the extent that there is a conflict between the corporation's promise to redeem the shares and its statutory obligation under s. 36 of the *CBCA* not to reduce its capital where it

¹⁴ (1995) CanLII 7415 at para. 34.

¹⁵ Supra note 12 at p. 40.

is insolvent. As was the case in the *Holowach* decision, this statutory overlay renders Central Capital's promise to redeem the appellants' preferred shares unenforceable. Although there is a right to receive payment, the effect of the solvency provision of the *CBCA* means that there is no right to enforce payment. Inasmuch as there is no right to enforce payment, the promise is not one which can be proved as a claim.¹⁶

- [44] Therefore, Weiler J.A. held that even if the company's obligation to redeem the shares created a debt or liability, the appellants did not have a claim provable within the meaning of section 121 of the BIA.
- [45] Turning to the facts in this case, firstly, I agree with the parties that there is no ambiguity in the language of the Loan Agreement between Finance II and Smurfit Canada. Furthermore, it is conceded by all that up until the event of default, Finance II's claim was for debt, not equity. Up until then, clearly the substance of the relationship was a debtor creditor one.
- [46] The question one must then ask is whether the substance of the relationship changed on an event of default. In both the Supreme Court of Canada in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank* and *Re Central Capital Corporation*, the parties to the agreements could not be characterized as both shareholders and as debtors. In both cases, as here, the arrangements were of a hybrid nature.
- [47] Relying on the jurisprudence, I must examine the substance of the parties' relationship. Having done so, I conclude that the substance of the relationship between Finance II and Smurfit Canada was a debtor creditor one. The Loan Agreement is clear in this regard. Indeed, section 7.2 of the Loan Agreement states that on the occurrence of an event of default, the loan is immediately due and payable by Smurfit Canada and no action is required of Finance II.
- [48] The next issue to determine is whether the \$200 million loan is a debt provable in bankruptcy. All of the parties take the position that a debt provable in bankruptcy must be a debt to which Smurfit Canada is subject on the day on which it commenced these CCAA proceedings, namely January 26, 2009. They rely on *Re Central Capital*

¹⁶ Ibid, at p.40.

Corporation although the dicta referred to do not actually say that. That said, to identify a claim for the purposes of the CCAA, section 12(1) of that Act directs one to the definition in section 121(1) of the BIA. It states that the relevant date is the day on which the bankrupt becomes bankrupt. By extension, at least in this case, it is reasonable to treat the CCAA filing date as the relevant date for CCAA purposes.

[49] On an event of default defined in section 6.3 of the Loan Agreement, there is a debt that can only be repaid by the issuance of shares. In substance, Finance II is owed funds but is only entitled to be paid with shares on an insolvency. Finance II may exercise its rights and recourses under the Loan Agreement provided that Smurfit Canada *shall* perform its obligations by the issuance of Class B shares. The language of the Loan Agreement is mandatory in this regard. Applying Weiler J.A.'s reasoning in *Re Central Capital*, Finance II would be unable to recover \$200 million by legal process. It would be limited to recovery of Class B shares.

[50] The response of the Fund Managers and the Indenture Trustee to this argument is that the Loan Agreement provides that Smurfit Canada shall perform its obligations by the issuance of Class B shares having a value no less than the dividend or other amount that otherwise would be received by Finance II. It seems to me, however, that the parties contemplated that on an insolvency there would be no value to Class B shares. It is clear from Smurfit Canada's Memorandum and Articles of Association that Class B shares would only be issued if there were an event of default. An event of default included an adjudication of insolvency but also included events that were not necessarily insolvency events of default such as an arrangement or a liquidation. Class B Amount was defined in the Articles but only as it related to dividends, liquidation, dissolution, winding-up and purchase by Smurfit Canada. In those cases, the Class B Amount of each class B share was to be an amount "equal to the aggregate of (i) the monetary consideration received by the Company upon the issuance of such share (denominated in the currency in which such consideration was paid to the Company), if such share has been issued for money, and (ii) the fair market value of the consideration received by the Company (including, without limitation, shares of another class of the Company) upon the issuance of such share, if such share has been issued for a consideration other than money, less (iii) all amounts paid in respect of such share on account of reductions of paid up capital".

- [51] There is no definition for Class B Amount in the event of insolvency. It seems to me that this must be what the parties intended. In the event of a non-insolvency event of default, the Class B shares would have a value and would rank ahead of other classes of shares but behind unsecured creditors. In an insolvency event of default, it was contemplated by the parties that the shares would have no value. Tax benefits would be derived but on an insolvency, creditors of Finance II would look to Enterprises to fulfill the cash payment obligations. This is also consistent with the interest payments being paid by Smurfit Canada through the issuance of Class C shares and funding by Enterprises absent an insolvency.
- [52] It seems to me that the parties contemplated such an outcome. Indeed, it is exactly what the clear and unambiguous language of the Loan Agreement says. It is also consistent with the commercial deal reflected in the Offering Memorandum. I also note that the Fund Managers state in their factum that Smurfit Canada may not be entitled to issue Class B shares because of the provisions of the Bankruptcy and Insolvency Act and the U.S. Bankruptcy Code. The intention of the parties was that if an event of default occurred as a result of an insolvency proceeding, there was no obligation to make any cash payment to Finance II.
- [53] In summary, I conclude that the substance of the parties' relationship was debt and not equity; however, the \$200 million claim was not a debt provable in bankruptcy in that payment was not recoverable by legal process. If I am wrong in that regard, there is no prospect that Smurfit Canada will have sufficient funds to satisfy all of its creditors and the Class B shares would have a value of zero in any event. Finance II's claim should not rank pari passu with the unsecured debt claims against Smurfit Canada and their claim should be valued at zero. In passing, I also note that this is consistent with the provisions of the Offering Memorandum. In light of my decision, there is no need to address the issue of subordination.
- [54] Lastly, as mentioned, this does not mean that the Fund Managers are without recourse as they still have their \$200 million claims against Finance II and Enterprises.
- [55] Turning then to my reasons for decision in the adjournment motion, it is helpful to review the history of these proceedings.

- [56] In October, 2009, the Fund Managers brought a motion for an order (a) declaring that the officers and directors of Finance II and each of the Monitor and counsel for the Applicants had irreconcilably conflicting interests with the interests of Finance II; (b) declaring that counsel for the Applicants, Stikeman Elliott LP, could not act for Finance II; (c) directing the officers and directors of Finance II to file an assignment in bankruptcy appointing a Trustee nominated by the Fund Managers; and (d) discharging the Monitor in respect of Finance II.
- [57] On October 20, 2009, I released my reasons for decision and declined to grant the relief requested. I also noted that both the Applicants and the Fund Managers had indicated that the characterization of Finance II's claims was a threshold issue. This was the description given by them to the intercompany claim referenced in the Loan Agreement. Consistent with the position advanced by counsel for the Monitor, I urged stakeholders to turn their minds to an appropriate process to address that issue and if they required assistance, they could arrange a 9:30 appointment before me.
- [58] Counsel attended before me on November 6 and 23, 2009 with a view to putting a procedure in place to properly and fairly address the Fund Managers' issues in a practical manner. As part of that process, on November 6, 2009 I ordered that counsel for the Applicants was to produce documents and motion materials by November 16, 2009 and counsel were to reattend before me on November 23 to address the status of the matter. I also scheduled a tentative hearing date of December 11, 2009.
- [59] On November 23, 2009, counsel reattended. Counsel met the time parameters of my November 16 endorsement but there was still more information the Fund Managers apparently required. On November 23, 2009, counsel also attempted to resolve the the issue of process. As noted in the preamble to my order of that date, Mr. McElcheran for the Fund Managers advised that he had no instructions to consent to any timetable but reserved his right to return before the Court in chambers, if necessary. I fixed the characterization motion for December 11, 2009 and for the purposes of the motion made the further following order:

(a) The Fund Managers were to have the identical interest and rights of Finance II for access to information.

(b) There were to be no restrictions on communication of information to the Fund Managers.

(c) The use of the information was for the December 11, 2009 motion.

(d) Counsel for the Fund Managers was to deliver to the Applicants a letter containing any additional information they required by November 27, 2009.

(e) The cross examinations were to take place no later than December 4, 2009.

(f) The aforementioned provisions applied equally to the Indenture Trustee.

(g) Any of these provisions could be varied by and were subject to further order of the court.

[60] At that time, counsel for the Applicants advised the court that the only documents that were not being produced were documents relating to another financing. Counsel for the Monitor also confirmed that the process seemed appropriate and properly aligned economic interests with rights.

[61] On December 7, 2009, counsel reattended to settle my order of November 23, 2009. I noted that contrary to the terms of my November 23, 2009 order, counsel for the Fund Managers had not delivered any letter containing any additional information they required by November 27, 2009 and the cross examinations had not taken place as ordered. In my endorsement, I also noted that information that had been requested had been provided except for tax returns which were in the process of being delivered. Counsel had consented to a new outline on productions. I wrote that to date, no counsel had been separately appointed to act for Finance II. As I was advised that the Fund Managers had served a motion for leave to appeal my November 23, 2009 order returnable December 9, 2009, I stated that the motion date continued to be December 11, 2009, however this issue would be addressed by the Court of Appeal, if it saw fit, on December 9, 2009.

[62] On the morning of the December 11, 2009 motion, I was advised that the leave to appeal motion had been withdrawn. I am unaware of any other leave to appeal motions or

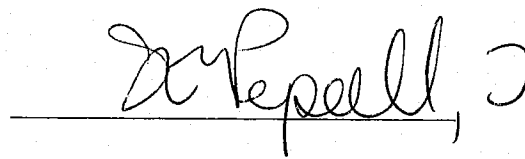
appeals outstanding brought by the Fund Managers or the Indenture Trustee. In addition, no production or refusals motions were ever brought even though on November 23, 2009, counsel for the Applicants had indicated that they were not producing the Finance I financing documents. At the outset of the motion scheduled for December 11, 2009, the Fund Managers requested an adjournment.

- [63] The stated purpose of the adjournment was to permit Finance II's new counsel (who they proposed be appointed by me but chosen by them) to prepare for the motion and to consider whether the motion should proceed by way of a joint hearing with the US Bankruptcy court. The Fund Managers also again asked for a declaration that Stikeman Elliott LLP could not continue to act as counsel for Finance II. I refused the request and heard the characterization motion.
- [64] In my view, the request for an adjournment and the other relief which was contested by the Applicants and the UCC was not justified. The date of December 11, 2009 had been tentatively scheduled on November 6, 2009. It was then fixed for hearing on December 11, 2009 on November 23, 2009. On December 7, 2009, I reiterated that the hearing date was December 11, 2009 subject to a different disposition by the Court of Appeal. As mentioned, on the morning of December 11, 2009, I was advised that the Fund Managers had withdrawn the leave to appeal motion.
- [65] As all counsel know, and as set forth in paragraph 29 of the Commercial List Practice Direction, counsel are expected to be ready to proceed with matters for which hearing times have been agreed or set and adjournments of previously scheduled matters shall be granted only in special circumstances and for material reasons. Canadian CCAA proceedings are not typically characterized by delays and are often time sensitive. Similarly, the Canadian system of discovery is not a deposition based process which frequently is protracted in nature.
- [66] I also addressed similar relief brought by the Fund Managers on October 20, 2009. The Fund Managers submit that they are not revisiting that decision. The major complaints of the Fund Managers and the Indenture Trustee this time were the failure of the Applicants to produce the documents relating to the Finance I transaction and to make witnesses available but no motion was ever brought in this regard. The delays were of the Fund

Managers' own making. The Applicants submit that the delays are in furtherance of the Fund Managers' own interests. While I draw no conclusion in that regard, I do note that there is no property in a witness and at least some of the people the Fund Managers wished to interview are no longer with the Smurfit organization.

- [67] In addition, the scope of discovery is not unlimited given the nature of the contractual issues, the lack of contractual ambiguity and Canadian law. I see neither the relevance of the information sought nor any material prejudice to the Fund Managers or the Indenture Trustee.
- [68] All interests are before the court. The Fund Managers were representing Finance II's economic interest and no useful purpose would be served by appointing new counsel. If Finance II had separate counsel, no different result would ensue. Finance II would be making the same enquiries of the same people and lawyers as the Fund Managers and Indenture Trustee are now. Instructions would be emanating from the same people regardless of legal counsel. Indeed, the Fund Managers and the Indenture Trustee were unable to identify any real or material prejudice.
- [69] In my decision of October 20, 2009, in these proceedings, I noted that it is not unusual for restructurings to involve consolidated plans that address intercompany claims and observed that section 3(1) of the CCAA contemplates group filings. I also stated that if one were to insist on independent counsel and an independent court officer for every instance of perceived conflict of interest, restructuring proceedings of corporate groups would become completely unwieldy and unproductive. In this case, the Monitor was supportive of the process adopted and was of the view that, consistent with other CCAA proceedings, one should look to who holds the economic interest in issue. Counsel for the Monitor advised that if the Monitor thought that interests were not being fairly addressed, it would so advise the court. Here, there was no such need as the process prejudiced no one.
- [70] As to a joint hearing, this issue had been canvassed in chambers on at least one past occasion. The CCAA and Chapter 11 proceedings have proceeded in parallel but without joint hearings. Indeed, the US Bankruptcy court has conducted numerous Smurfit Group hearings in matters that had a Canadian element without the need for a joint hearing or a

request for same. I would also observe that the parties to the Loan Agreement are Canadian companies and all three Agreements have Canadian governing law provisions. Lastly, no separate request was made for a joint hearing; it was simply part of the rationale for an adjournment. In all of these circumstances, I was of the view that the adjournment motion should be dismissed.

A handwritten signature in cursive script, appearing to read "J. Pepall", is written above a horizontal line. The signature is written in dark ink on a white background.

Pepall J.

Released: January 28, 2010

CITATION: Smurfit-Stone Container Canada Inc., 2010 ONSC 50
COURT FILE NO.: CV-09-7966-00CL
DATE: 20100128

ONTARIO

SUPERIOR COURT OF JUSTICE

IN THE MATTER OF THE *COMPANIES'*
CREDITORS ARRANGEMENT ACT,
R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF THE *BANKRUPTCY AND*
INSOLVENCY ACT,
R.S.C. 1985, c. B-3, AS AMENDED

IN THE MATTER OF A PLAN OF COMPROMISE
OR ARRANGEMENT OF SMURFIT-STONE
CONTAINER CANADA INC. AND OTHER
APPLICANTS LISTED ON SCHEDULE "A"

REASONS FOR DECISION

Pepall J.

Released: January 28, 2010