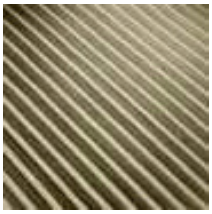
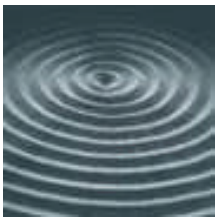


2500, 20 Queen St. West
Toronto, ON M5H 3S1
Canada
Tel. 416.595.8500
Fax.416.595.8695
www.millerthomson.com



MILLER THOMSON LLP

Barristers & Solicitors, Patent & Trade-Mark Agents

TORONTO VANCOUVER CALGARY EDMONTON WATERLOO-WELLINGTON MARKHAM WHITEHORSE WASHINGTON, D.C.

Air Canada and the treatment of set-off in initial CCAA orders

Jeffrey C. Carhart

January 30, 2004

INDEX

N:\corp\jcarhart\SEMINAR\Cbao 2004\Paper\Paper.doc

AIR CANADA AND THE TREATMENT OF SET-OFF IN INITIAL CCAA ORDERS

By Jeffrey Carhart

INTRODUCTION

Air Canada[1] filed for protection under the *Companies' Creditors Arrangement Act* (the "CCAA")[2] on April 1, 2003.

Paragraph 5 of the Initial Order restrained:

> ...the right of any person, firm, corporation, governmental authority or other entity to assert, enforce or exercise any right, option or remedy arising by law against an Applicant...including...rights...of...set-off.

In turn, paragraph 9 of the Initial Order read as follows:

> 9. THIS COURT ORDERS that persons may exercise only such rights of set-off as are permitted under section 18.1 of the CCAA as of the date of this Order. For greater certainty, no person may set-off any obligations of an Applicant to such person which arose prior to such date.

Our firm was engaged by a number of Canadian Airport Authorities, including the Vancouver, Calgary, Edmonton, Winnipeg, Ottawa, Montreal and Halifax airport authorities. In our view, these provisions of the Initial Order were inconsistent and excessive.

In our view, paragraph 5 (which restrained set-off) was inconsistent with paragraph 9 (which allowed set-off, although only within certain limits) and Air Canada readily agreed to add the words "(subject to paragraph 9 hereof)" after the reference to set-off in paragraph 5.

However, and more substantively, we also felt that paragraph 9 went much too far. In our view, the paragraph should simply read as follows:

---

[1] The filing also covered a number of other Applicant companies in the Air Canada group of companies, including Jazz Air Inc.

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

> 9. THIS COURT ORDERS that persons may exercise only such rights of set-off as are permitted under section 18.1 of the CCAA

In that regard, section 18.1 of the CCAA (which was introduced as part of the 1997 amendments to that Act) provides simply as follows:

> 18.1 The law of set-off applies to all claims made against the 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.

Obviously section 18.1 does not define the right of parties to exercise set-off by reference to the CCAA "filing date" or the date of the initial CCAA order in any particular CCAA case.

The Initial Order in the *Air Canada* case contained a typical "comeback clause" and we brought a motion seeking amendments to paragraph 9. The R/T Banking Syndicate and Bell Canada brought similar motions. Through a variety of procedural steps, these motions were adjourned until May, 2003 and were eventually heard on May 30, 2003.

Prior to the hearing at the end of May, a number of amendments were made to the Air Canada Initial Order. These included the introduction, by Air Canada, of a new paragraph 9A which read as follows:

> 9A. THIS COURT ORDERS that nothing in this Order shall be construed as overriding any provision of the CCAA.

In addition, paragraph 9 was amended by Air Canada to read:

> 9. THIS COURT ORDERS that persons may exercise only such rights of set-off as are permitted under Section 18.1 of the CCAA as of the date of this order. For greater certainty, no person may set off any obligations arising on or after April 1, 2003 against any obligations of an Applicant to such person which arose prior to such date.

Although materials had been filed indicating actual or potential set-off situations involving the Airport Authorities, the R/T Syndicate and Bell Canada, when the motions were heard on May 30, 2003 all of the parties agreed that Mr. Justice Farley could consider the matter on a purely theoretical level, without reference to the facts of any individual situation involving those parties.

TYPES OF SET-OFF

Black's Law Dictionary[3] defines "set-off" in part as:

> ...a debtor's right to reduce the amount of a debt by any sum the creditor owes the debtor ...

Historically, Canadian courts have recognized three types of set-off: (i) legal set-off (ii) equitable set-off and (iii) set-off by statute or by contract.

Legal Set-Off

The doctrine of legal set-off is succinctly discussed as follows by Madam Justice Paperny in her decision in *Re Canadian Airlines Corp.* (2001) 14 B.L.R. (3d) 258 (Alberta Q.B.)[4]

> In its simplest form, legal set-off requires "the fulfilment of two conditions. The first is that both obligations must be debts. The second is that both debts must be mutual cross-obligations": *Telford v. Holt* (1987), 41 D.L.R. (4th) 385 (S.C.C.) at 393, adopting *Canadian Imperial Bank of Commerce v. Tuckerr Industries Inc.* (1983), 149 D.L.R. (3d) 172 (B.C.C.A.) at p. 174. However, as stated by K. Palmer in *The Law of Set-Off in Canada* (Aurora: Canada Law Book, 1993) at 21, each of these elements has its own problems and parts. Mr. Palmer goes on to provide a neat summary of the various expressions of the test that reflect these:
>
> 1. The cross claims must be enforceable in debt, which entails setting up a claim which is liquidated, enforceable and mature.
>
> 2. The mutual claims for any rights to set-off must have accrued to the original creditor and debtor prior to any assignment to the existing plaintiff or defendant.

In the Palmer text, the passage quoted by Madam Justice Paperny goes on to provide that:

> "there is no requirement in legal set-off that the debts be connected in any manner. This is probably the most important difference remaining

---

[3] Seventh Edition; 1999 The West Group; St. Paul, Minnesota

[4] At page 264.

between equitable and legal set-off which allows a claim in legal set-off to have any effect."

Equitable Set-Off

Generally speaking, the doctrine of equitable set-off arises where the requirements with respect to legal set-off cannot be established but where, among other things, there is a relationship between the claims of the parties such that it would be inequitable not to permit set-off.

In the decision of the Alberta Court of Appeal in *Re Blue Range Resource Corp* [2000] 11 W.W.R. 117 and 84 Alta. L.R. (3d) 65, the following summary of the relevant principles from the Supreme Court of Canada decision in *Telford v. Holt* (1987), 41 D.L.R. (4th) 385 is set out:

1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands;

2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed;

3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the crossclaim;

4. The plaintiff's claim and the cross-claim need not arise out of the same contract; and

5. Unliquidated claims are on the same footing as liquidated claims.

JURISPRUDENCE WITH RESPECT TO SET-OFF IN THE INSOLVENCY CONTEXT AND IN PARTICULAR IN THE CONTEXT OF CCAA PROCEEDINGS

The courts have recognized that both legal and equitable set-off may be established in a situation where one of the parties is formally insolvent.

In that regard, in Palmer's text on set-off[5] he writes as follows in the introduction to the chapter dealing with set-off in insolvency situations:

> One overall point is worthy of note. The application of the principles of set-off in Canada do not differ in any meaningful way between solvent and

---

[5] In *Workers' Compensation Board v. Husky Oil Operations Ltd. et al* (1995) 128 D.L.R. (4th) 1 at page 24 the Supreme Court of Canada commends the Palmer text for "a particularly thorough and helpful discussion of the issues relating to set-off in bankruptcy and insolvency."

> insolvent situations. Certain issues, such as mutuality, do take on a greater importance due to the transfer of the insolvent's estate to the trustee. Few Canadian cases, however, treat the principles of set-off any differently in an insolvency than in a case where both debtor and creditor are solvent. This differs from the approach taken in other jurisdictions where the application of set-off in bankruptcy can be quite different than in solvent situations. Accordingly, readers seeking guidance for an insolvent set-off are referred as well to the chapters regarding legal and equitable set-off which describe the basic principles which a court will apply.

Certainly the courts in Canada have recognized the dilemma between allowing a creditor in an insolvency situation to claim set-off successfully, thereby achieving full recovery on some or all of his debt while other creditors receive only a partial recovery and requiring a creditor to pay monies to an insolvent entity knowing that the insolvent is not going to honour its obligations. In *Citibank Canada v. Confederation Life Insurance Company* (1996) 42 C.B.R. (3d) 288 Mr. Justice Blair considered the set-off sections in the *Winding-Up Act*[6] and the *Bankruptcy and Insolvency Act* (the "BIA")[7] and stated (at page 296):

> "set-off becomes the policy mechanism whereby the competing "equities" emerging from the dilemma...are balanced."

In our view, there was jurisprudence to support the proposition that both legal and equitable set-off can be utilized where one party has sought and obtained protection pursuant to the CCAA. That jurisprudence clearly involved situations which "crossed the line of the CCAA filing date."

In that regard, reference may be made to *Re Blue Range Resource Corp.* (already cited), *Re Canadian Airlines Corp.* (also already cited) and the trial[8] and appeal[9] decisions in *Algoma Steel Inc. v. Union Gas Ltd.*

Re Blue Range Resources Corp.

Duke Energy Marketing Limited Partnership ("Duke") and Engage Energy Canada Limited Partnership ("Engage") were parties to long-term contracts for the supply of natural gas with Blue Range Resources Corp. ("Blue Range") and Humble Petroleum Marketing Limited ("Humble").

---

[6] R.S.C. 1985, c. W-11

[7] R.S.C. 1985, c. B-3, as amended

[8] (2001) 30 C.B.R. (4th) 163 (Ontario Superior Court of Justice)

[9] (2003) 63 O.R. (3d) 78

Blue Range and Humble filed for CCAA protection on March 2, 1999. Duke and Engage owed certain amounts to Blue Range and Humble for gas delivered in the pre-filing period.

On March 29, 1999, Blue Range and Humble sent letters to Duke and Engage confirming that the natural gas supply contracts would be terminated as of March 31, 1999.

In essence, the court held that Duke and Engage were entitled to set-off pre and post filing debts for gas supplied against post-filing damages which arose from the termination of the gas supply contracts by Blue Range and Humble. In this regard, the Alberta Court of Appeal held in part:[10]

> The important point for invoking equitable set-off is the close connection of the transactions.
>
> ...
>
> *The fact that the damages owed to Duke and Engage arise after the stay order is not relevant* when the obligations arise out of the same contracts.
>
> (Emphasis added)

Re Canadian Airlines

Canadian Airlines Corp. ("Canadian Airlines") filed for CCAA protection on March 24, 2000.

As at the time of filing, Canadian Airlines owed various taxes (in the amount of about $1.6 million) to the B.C. government relating to the sale of various consumable products, capital additional, liquor sales and uniforms, as well as penalties and interest and Canadian Airlines owed another $187,000 with respect to the unauthorized use of coloured motor fuel.

After the CCAA filing, the B.C. government owed about $1.7 million in tax refunds (relating to rebates for motor fuel used on international flights) to Canadian Airlines.

Madam Justice Paperny made a very careful analysis[11] of the applicability of the doctrines of legal set-off , equitable set-off and statutory set-off to this situation.

---

[10] [2000] 11 W.W.R. 117 at page 123

[11] In the trial decision in *Algoma Steel v. Union Gas Ltd.* (2001) 30 C.B.R. (4th) 163 Mr. Justice Farley notes the "significant lengths" which Madam Justice Paperny "went to" in her decision.

In short, she held that the B.C. government could exercise rights (across the line of the CCAA filing date) under the doctrines of legal set-off,[12] equitable set-off,[13] and statutory set-off.[14] In so ruling, among other things, she followed the decision of the Alberta Court of Appeal in *Blue Range* to the effect that the fact that the amount which the "creditor" was setting off "arose after the [CCAA] stay order" was "not relevant"[15] in the circumstances.

Algoma Steel v. Union Gas

Algoma Steel filed for CCAA protection on April 23, 2001.

At that point, Union Gas owed "pre CCAA debt" to Algoma of about $460,000 for gas supplied and $1.3 million pursuant to an indemnity agreement for a failure to pay TransCanada Pipelines under a contract for the delivery of gas (the "November 1, 2000 Transportation Agreement").

"On the other side of the ledger" Algoma Steel owed Union Gas approximately $2.2 million dollars for rebates contemplated after a future decision of the Ontario Energy Board dealing with overpayments which had occurred in 1999.

At trial Mr. Justice Farley held that "there is a close connection sufficient to ground equitable set-off as to the gas supply portion of the October 15, 2000 Agreement vis-à-vis any rebate which is authorized by the Board, but not any monies owing by Algoma to Union as a result of the November 1, 2000 Transportation Agreement."

The Court of Appeal held that Union Gas could also invoke equitable set-off with respect to the November 1, 2000 Transportation Agreement. In that regard, Mr. Justice Rosenberg held "[i]n my view, there is such a close connection between the 2000 gas service contract and the 2000 assignment agreement, that the amounts owing on them cannot be severed for the purposes of equitable set-off."[16]

THE SCOPE AND FUNCTION OF INITIAL CCAA ORDERS

In our view, the wording that we wanted to have removed from paragraph 9 of the Air Canada Initial Order was not "usual" wording for an Initial CCAA Order. (Clearly, one

---

[12] (2000) 14 B.L.R. (3d) 258 at 264-267

[13] (2000) 14. B.L.R. (3d) 258 at 267-270

[14] (2000) 14 B.L.R. (3d) 258 at 270-274

[15] (2000) 14 B.L.R. (3d) 258 at 275

[16] (2003) 63 O.R. (3d) 78 at 89-90

could imagine that the results in *Blue Range, Canadian Airlines* and *Algoma Steel* would have been different had the initial orders in those cases contained such wording.)

An initial CCAA Order is meant to serve an important stabilizing function (by preserving the status quo in order to give the debtor a legitimate breathing space within which to attempt a reorganization). However, it should not simply confiscate or eliminate legal rights in a way which would colour the entire future course of the proceeding.

In *Re Royal Oak Mines Inc.* (1999) 6 C.B.R. (4th) 314 at pages 321 – 322 (Ontario Court – General Division) Mr. Justice Blair spoke of the legitimate scope of Initial Orders under the CCAA as follows:

> ... in my opinion, extraordinary relief ... should be kept, in Initial Orders, to what is reasonably necessary to meet the debtor company's urgent needs over the sorting-out period.
> ...
>
> [T]he object should be to "keep the lights [of the company] on" and enable it to keep up with appropriate preventative maintenance measures, but the Initial Order itself should approach that objective in a judicious and cautious matter.
> ...
>
> I conclude these observations with a word about the "comeback clause".
> ...
>
> The comeback provisions are available to sort out issues as they arise during the course of the restructuring. However, they do not provide an answer to overreaching Initial Orders, in my view. There is an inherent disadvantage to a person having to rely on those provisions. By the time such a motion is brought the CCAA process has often taken on a momentum of its own, and even if no formal "onus" is placed on the affected person in such a position, there may well be a practical one if the relief sought goes against the established momentum.

Of course, the basic "motherhood" statement added to the Air Canada Initial Order in paragraph 9A – that "nothing in this Order shall be construed as overriding any provision of the CCAA" – could have been placed anywhere in the Order. By being styled as seemingly "part of paragraph 9" it seemed arguable that paragraph 9A was meant to modify (i.e. "override") paragraph 9 and allow parties the unfettered ability to exercise set-off rights afforded to them in section 18.1 of the CCAA notwithstanding what paragraph 9 said. However, in the hearing before Ms. Justice Farley, Air Canada

made it clear that in their view paragraph 9A did not modify paragraph 9 – at least insofar as legal set-off was concerned.[17]

THE MAY 30, 2003 HEARING BEFORE MR. JUSTICE FARLEY

At the hearing before Mr. Justice Farley, Air Canada conceded that equitable set-off could be established, in CCAA cases, with respect to the "pre" and "post" filing time periods.[18]

However, Air Canada argued that the initial filing date was nevertheless important in terms of the issue of legal set-off. In essence, Air Canada argued that a CCAA filing irrevocably severed the "mutuality" necessary to establish a claim of set-off based on the doctrine of legal set-off which involved the "pre" and "post" filing period.

In this regard, Air Canada argued that a filing under the CCAA represents a milestone which is equivalent to a company having been placed into liquidation under the *Winding-up and Restructuring Act*.[19] They put forward the cases of *P. Lyall & Sons v. Baker* [1933] O.R. 286 (C.A.) and *Citibank Canada v. Confederation Life Insurance Co.* (1998) 37 O.R. (3d) 226 (Ont. C.A.) to support the proposition that in proceedings under the *Winding-Up Act*, "mutuality" is erased at the time of filing with the Court such that contractual and legal set-off is unavailable in relation to post-filing and pre-filing claims.

Functionally, of course, there are enormous differences between a *Winding-up and Restructuring Act* proceeding and a CCAA proceeding. For example, with a CCAA proceeding existing management continues to run the company. With a *Winding-Up Act* proceeding management is replaced. On August 14, 1994, Paul Cantor was the CEO of Confederation Life. On August 15, 1994, he was replaced in that role by Robert

---

[17] Paragraph 4(10) of Air Canada's Modified and Continued Preliminary Injunction Order (dated April 29, 2003) in their ancillary case under section 304 of the United States *Bankruptcy Code* provided as follows:

> All persons shall be enjoined from taking any action that would be in violation of the Initial Order (as defined herein) and it is further ORDERED, that any person may exercise only such rights of set-off as permitted under Section 18.1 of the CCAA as of the date of the Initial Order as and to the extent permitted in the Initial Order, but may not exercise any further or additional rights of set-off; ...

Of course, that language also clearly indicated that (notwithstanding paragraph 9A) Air Canada itself acknowledged that the Initial Order limited what rights were otherwise available under Section 18.1 of the CCAA.

[18] This concession was contained in paragraphs 19 and 20 of Air Canada's Amended Factum of May 28, 2003. If only for that reason, of course, paragraph 9 of the Air Canada Order – which made no distinction between "types" of set-off in denying creditors the ability to set-off on a "pre" and "post" filing basis – went too far.

[19] R.S.C. 1985, c. W-11 (formerly *The Winding-up Act*)

Sanderson of KPMG. In contrast, Robert Milton was the CEO of Air Canada, on March 30 and he was still the CEO after the CCAA filing the next day.

Indeed, at page 291-292 of the decision in the *Lyall & Sons* case, the court states:

> ...the winding-up order establishes ... an entity essentially distinct from the original corporation when carrying on business for the benefit of its shareholders.

In addition, as already noted, section 18.1 of the CCAA provides as follows:

> 18.1 The law of set-off applies to all claims made against a debtor company and to all actions instituted by it for the 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.

In contrast, section 73.1 of the *Winding-up and Restructuring Act* provides as follows:

> The law of set-off, as administered by the courts, whether of law or equity, applies to all claims on the estate of a company, and to all proceedings for the recovery of debts due or accruing due to a company at the commencement of the winding-up of the company, in the same manner and to the same extent as if the business of the company was not being wound-up under this Act.
>
> (Emphasis added)

Clearly, the winding-up legislation states that the commencement of the winding-up of the company is meant to serve as a demarcation point. Those kinds of words are not in section 18.1 of the CCAA.

In essence, our point was that the law of set-off itself eliminates the right in the circumstances which Air Canada had referred to (i.e. a winding-up proceeding) because the mutuality of debts has been destroyed according to the statute and the case law which establishes that there has been a "quasi trust" established or because there are "different interests at work" or because there has been an assumed change when the winding-up order is granted.[20]

Our position was that all we were asking was to let the law of set-off – such as it is – apply to the Air Canada situation (which was not a winding-up case).

---

[20] As discussed by Mr. Justice Farley in his decision, Palmer discusses the three ways in which Canadian courts have dealt with these issues in the context of *Winding-up Act* cases in those terms: (i) different interests; (ii) quasi-trust and (iii) change assumed.

In this regard, we also referred to the discussion in *Palmer*[21] with respect to the purpose of the *Winding-up and Restructuring Act*:

> "The purpose of the *Winding-up Act* is similar to bankruptcy, in that the object is to "provide a mechanism" for the orderly gathering and the realization of the assets of the debtor company and the rateable distribution thereof among its creditors under the supervision of the court".
>
> [J.A. Carfagnini, "Proceedings Under the *Winding-up Act* (Canada)" (1988) 66 C.B.R. (N.S.) 77]

In contrast, in Air Canada's own words:[22]

> In the CCAA, the debtor remains in possession and in control of its assets albeit subject to certain rights and restrictions imposed by the initial order. In the event of a failed Plan of Arrangement or a lapse of the stay, the creditors and the debtor are left in the same legal position as if the filing had not occurred.

Air Canada also tried to make an analogy to (the treatment of the issue of set-off within) bankruptcy and proposal proceedings as well as interim receiverships. In essence, again, in our view, what they were trying to establish was that the law with respect to set-off in those situations "should be" the law dealing with CCAA situations. Yet, of course, none of those cases were CCAA cases. Again, our position was that it is the law of set-off itself that drives the result that legal set-off is lost on a bankruptcy (with the appointment of the trustee in bankruptcy – someone who is not in place with respect to a CCAA proceeding). In a bankruptcy, clearly the assets vest in the trustee in bankruptcy.

With respect to proposal proceedings under the BIA, Air Canada put forward a provision in Houlden & Morawetz to the effect that set-off is not allowed for post-proposal claims as against pre-proposal claims in a BIA proposal proceeding. However, in our view, what Messrs. Houlden and Morawetz were talking about in that case was that set-off is not allowed in a particular situation which involved the purchase of goods after the filing and then an attempt to set off the purchase price against a pre-filing debt owed by the bankruptcy because that would be a fraud on the bankruptcy system. We noted the *728835 Ontario Limited* case[23] in which ("pre versus pre") set-off was allowed and where the passage in question in Houlden & Morawetz was again taken to support the proposition that allowing an attempt at setting-off pre-filing debt against post-proposal

---

[21] At page 207.

[22] Paragraph 12 of their Factum. As noted by Mr. Justice Farley in his decision, Air Canada submitted that CCAA proceedings sometimes amount – at least in a practical sense – to a "liquidation" in that the assets of the insolvent company are sold within the structure of the CCAA proceedings.

[23] *In the matter of the proposal of 728835 Ontario Limited* (1998) 3 C.B.R. (4th) 211

filing purchase obligations would be a fraud on the bankruptcy system. In our view, those cases were very fact specific and were, again, not CCAA cases.

In fact, of course, we had actual CCAA case law – in the form of the decision in *Re Canadian Airlines* – to support the proposition that (pre versus post) legal set-off is allowable in a CCAA case.

In our view, in that regard, it was important to look very carefully at the *Canadian Airlines* decision.[24] Air Canada attempted to distinguish the Canadian Airlines case on the basis that the terms of the actual plan which was filed in *Canadian Airlines* was critical. Air Canada said that, "unlike most CCAA plans, the plan in *Canadian* permitted the debtor to compromise all tax liabilities arising up to and including the Effective Date as opposed to the filing date."[25] Of course, as we submitted, if what Air Canada was saying about what the law "should be" with respect to CCAA proceedings, then it would seem that what they would suggest happened in the *Canadian Airlines* case was something like this: At the date of the initial CCAA order, the right of legal set-off was irretrievably severed and lost forever (and where, of course, the application would have been made, and the Order given, with no notice to the B.C. government). Then, presumably, Canadian Airlines itself "chose" to confer that right "back" on creditors, such as the B.C. government, through the plan. Therefore, the right which was lost – with no input from the creditors on the *ex parte* application for a CCAA stay order – was somehow "reborn" in the plan.

However, one of the problems with that suggested scenario – i.e. "even if it was right" which we did not accept - was that presumably then Canadian Airlines would have been "happy" that the BC government took the position that they did because presumably, that's what the plan more or less "invited them" to do. Of course, that was not correct because Canadian Airlines vigorously disagreed with what the BC government did. In fact, Canadian Airlines tried to make the argument that legal set-off was not available[26] and, after careful consideration, that submission was rejected by Madam Justice Paperny who decided, to the contrary, that legal set-off was available across the "pre versus post" filing line.

---

[24] Air Canada conceded in their Factum that their submission on what the law of set-off "the context of CCAA proceedings should be" was unsupported by any case law (although they also submitted that it was "consistent with existing law").

[25] Paragraph 46 of Air Canada's Factum. It is correct that Madam Justice Paperny noted ((2001) 14 B.L.R. (3d) 258 at page 276) that the "wording of the Plan...supports [the] result" reflected in her decision.

[26] Although, again, the approach which the B.C. government took was consistent with Canadian's own Plan.

MR. JUSTICE FARLEY'S DECISION

Mr. Justice Farley "reached the conclusion that paragraph 9 of the Initial Order should be modified by striking out the complained of wording so that paragraph 9 should read as:

> "9. THIS COURT ORDERS that persons may exercise only such rights of set-off as are permitted under Section 18.1 of the CCAA."[27]

In this regard, Mr. Justice Farley held, in part, that the three different approaches taken by Canadian courts in dealing with winding-up cases:[28]

> ...are all within a liquidation scenario. However, while a liquidation scenario under the CCAA is possible, the CCAA proceedings in [the Air Canada] case are not aimed at a liquidation, but a restructuring...[I]t does not seem to me that given the difference in wording between s. 18.1 [of] the CCAA and s. 73(1) of the [*Winding-up and Restructuring Act*]...that I should apply the different interests approach to these present [Air Canada] CCAA proceedings. That is particularly so when one appreciates that in the normal order under the [*Winding-up and Restructuring Act*], a liquidator as a Court Officer is appointed to take charge of the liquidation (even though there is not a vesting of assets as in BIA with a trustee in bankruptcy). Here however, the Court appointed Monitor does not have any similar powers to a liquidator. [Air Canada] is in a restructuring mode under the CCAA. ... [I]t would take more explicit language in s. 18.1 of the CCAA where one is dealing with a restructuring situation to import the concepts of a section in the [*Winding-up and Restructuring Act*] which by the very wording of s. 73(1) requires that the company be in a liquidation mode. The draftsperson and Parliament had the advantage of reviewing the three insolvency statutes and the set-off provisions (and specific wording thereof in the first two statutes), the [BIA], the old WUA and the CCAA when s. 18.1 of the CCAA was drafted and enacted. Identical wording for set-off provisions was not adopted.

---

[27] Paragraph 24. Mr. Justice Farley held that the determination and enforcement of set-off rights determined in the context of actual factual situations "should await until a convenient time when [Air Canada] has stabilized (or ... alternatively cratered)."

[28] The different interests approach, the quasi-trust approach and the change assumed approach [see footnote 10, *supra*]

THE MOTION FOR LEAVE TO APPEAL

Air Canada sought leave to appeal the decision of Mr. Justice Farley[29] on the issues of whether:

> ... the granting of an Initial Order pursuant to the provisions of the CCAA sever[s] the mutuality required for a claim of legal set-off as between pre-filing and post-filing debts such that claims for legal set-off cannot be acquired post-filing in relation to pre-filing debts?

Air Canada suggested that "while it is not disputed that Parliament intended to allow [a] preference of some creditors over others [by allowing set-off within the context of insolvency proceedings]...the scope of this allowance must be properly circumscribed." Of course, in that vein, Air Canada suggested, as they had done before Mr. Justice Farley, that a filing under the CCAA severs the mutuality necessary to ground a claim in legal set-off and that to hold otherwise – as Mr. Justice Farley had done -"fundamentally undermine[d] the intention and purpose of the CCAA."

Air Canada submitted that "mutuality is severed in cases under the BIA and [the *Winding-up and Restructuring Act*] because of a change in relationship between the debtor and its stakeholders at the time of filing." They further submitted that "a similar change in the essential nature of the entity occurs on the granting of an Initial Order under the CCAA."

We submitted that Mr. Justice Farley had struck an appropriate balance between not depriving parties of possible set-off rights by the terms of Air Canada's Initial Order and ensuring that the court maintains control over the determination and enforcement of such rights.

We also noted that the test to grant leave to appeal from an order rendered in a CCAA proceeding is an onerous one. McFarland, J.A. of the British Columbia Court of Appeal held in *Re Pacific National Leaseholding Corp.* [1992] 15 C.B.R. (3d) 265 at 272:

> ...[T]his court should exercise its power sparingly when it is asked to intervene with respect to questions which arise under the CCAA.

On September 23, 2003, the Court of Appeal denied leave to appeal in this matter.

---

[29] (Although relatively detailed factums were filed) the application for leave to appeal was dealt with entirely in writing.

CONCLUSION

In dealing with the subject of set-off, initial CCAA stay orders should properly go no further than to reiterate the fundamental statement made in section 18.1 of the CCAA (to the effect that the law of set-off applies to all claims made against the 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). Such orders should not attempt to establish the CCAA filing as representing a line that "cannot be crossed" in the exercise of those rights.

Jeffrey Carhart
Miller Thomson LLP - Toronto
December, 2003