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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: MOTORS LIQUIDATION COMPANY, *et al.*, f/k/a General Motors Corporation, *et al.*, Debtors.	Chapter 11 Case No.: 09-50026 (REG) (Jointly Administered)
MOTORS LIQUIDATION COMPANY GUC TRUST, Plaintiff, v. APPALOOSA INVESTMENT LIMITED PARTNERSHIP I, *et al.*, Defendants.	Adversary Proceeding Case No.: 12-09802

GUC TRUST'S POST-TRIAL BRIEF IN CONNECTION WITH (I) OFFICIAL COMMITTEE OF UNSECURED CREDITORS' FIRST AMENDED OBJECTION TO CLAIMS FILED BY GREEN HUNT WEDLAKE, INC. AND NOTEHOLDERS OF GENERAL MOTORS NOVA SCOTIA FINANCE COMPANY AND MOTION FOR OTHER RELIEF (BANKR. DKT. NO. 7859) AND (II) MOTORS LIQUIDATION CO. GUC TRUST V. APPALOOSA INVESTMENT LTD. PARTNERSHIP I, *ET AL.*

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11.	*Olympia & York Developments (Re)*, [1998] OJ No. 4903, 4 CBR (4th) 189 (Ont. Bktcy.)

The Motors Liquidation Company GUC Trust (the "**GUC Trust**") respectfully submits this post-trial brief in connection with (i) *Official Committee of Unsecured Creditors' First Amended Objection to Claims Filed by Green Hunt Wedlake, Inc. and Noteholders of General Motors Nova Scotia Finance Company and Motion for Other Relief* (Bankr. Dkt. No. 7859); and (ii) *Motors Liquidation Co. GUC Trust v. Appaloosa Investment Ltd. Partnership I, et al.*, Adv. Pro. No. 12-09802.

PRELIMINARY STATEMENT

The capstone to the successful rescue of GM was this Court's order, in which the sale of assets to New GM[1] was approved. In considering the sale, this Court recognized the urgent need to protect the public from what would otherwise be staggering injury:

> This case involves not just the ability of GM creditors to recover on their claims . . . it involves the interests of 225,000 employees (91,000 in the U.S. alone); an estimated 500,000 retirees; 6,000 dealers and 11,500 suppliers. If GM were to have to liquidate, the injury to the public would be staggering. This case likewise raises the specter of systemic failure throughout the North American auto industry, and grievous damage to all of the communities in which GM operates.

In re Gen. Motors Corp., 409 B.R. 24, 33 (Bankr. S.D.N.Y. 2009).

What was not known to the Court at the time that it entered the Sale Order was that, even as many constituents were racing against the clock to avoid the systemic failure of the auto industry, a small group of hedge funds (with the cooperation of a handful of conflicted GM employees and advisors) were racing against the clock to achieve a different purpose: their unjust enrichment at the expense of all other unsecured creditors of Old GM.

[1] Capitalized terms used but not defined in this preliminary statement shall have the meanings ascribed to them in the continuation of this brief.

All references herein to "Pl. Ex." and "Def. Ex." refer to the GUC Trust's and Defendants' exhibits admitted into evidence in connection with the trial in the above-captioned proceedings. All references herein to "Decl." refer to the direct testimony affidavits submitted in connection with the above-captioned proceedings.

For too long, through a combination of non-disclosures and half-disclosures, the implications of the deal struck by these hedge funds were unknown, and the deal went unchallenged. Now that the trial of this matter has finally exposed the deal to the light of day, this Court has an opportunity to redress the harm inflicted upon all other creditors by this small faction of overreaching creditors. Among other revelations, the trial has shown that:

- the $367 million postpetition payment to the Noteholders was funded by Old GM with cash that belonged to the Old GM estate as of the filing of the petition, due to the parties' failure to satisfy express conditions in the trust agreement that governed the funds at issue;

- knowing that the Lock-Up Agreement deal was inequitable and would be vulnerable to challenge, the Lock-Up Noteholders worked with certain GM employees in an unsuccessful effort to shield the settlement from scrutiny and attack;

- even this small group of extremely successful distressed investors had never before been involved in a deal in which they were paid 36% of the face amount of their notes as a "Consent Fee";

- no party ever sought this Court's approval of the Lock-Up Agreement, even though Old GM is a party and it was not completed until after Old GM filed its petition on the morning of June 1, 2009; and

- following execution of the Lock-Up Agreement, the hedge funds that orchestrated the deal continued to pull all the strings to the detriment of Old GM's other creditors by, among other acts, manipulating the timing of the GM Nova Scotia bankruptcy filing in Canada in an effort to insulate the Consent Fee from challenge in Canada, blocking the appointment of inspectors for the GM Nova Scotia bankruptcy estate, and cajoling New GM and their hand-picked Nova Scotia bankruptcy trustee into asserting an improper swap claim against Old GM.

This Court has at its disposal various remedies to redress the harm to Old GM's unsecured creditors caused by this group. For reasons explained herein, this Court should disallow the claim of the Nova Scotia Trustee and the claims of the Noteholders in their entirety under section 502(d) of the Bankruptcy Code, because the claimants received avoidable transfers that they have not returned to Old GM. *See* Argument Section I below. This relief comes closest to achieving fairness for Old GM's unsecured creditors, but even this result leaves the

Noteholders better off than any other creditor. Through the $367 million Consent Fee, which represents approximately 36% of the face amount of the Notes, this select group of Noteholders has already obtained a cash recovery greater than the percentage recovery of any other unsecured creditor. Thus, while disallowing all of the claims at issue in full comes closest to righting this wrong to the estate, it still leaves the Noteholders in a better position than their fellow unsecured creditors.

Alternatively, if this Court does not altogether disallow the claims, this Court should equitably subordinate the claim of the Nova Scotia Trustee and the claims tainted by those Noteholders who engaged in the inequitable conduct proven at trial and described in detail herein. *See* Argument Section II below.

Finally, as a third alternative form of relief and for the reasons described below in Argument Sections III through VII, the Court should disallow the Nova Scotia Trustee's claim in its entirety and disallow the Guarantee Claims, except for that portion of the Guarantee Claims that corresponds to the principal amount due on the Notes minus the Consent Fee, which should properly be considered as a payment against the principal amount of the Notes. This third alternative form of relief translates into approximately $700 million in allowed claims, instead of the more than $2.67 billion in disputed claims currently asserted by, or for the benefit of, the Noteholders.

FACTUAL BACKGROUND

I. OLD GM'S NEGOTIATIONS WITH THE LOCK-UP NOTEHOLDERS

A. Old GM Struggles To Reach A Settlement With The Lock-Up Noteholders

On the afternoon of Sunday, May 31, 2009, less than twenty-four hours before General Motors Corporation ("**Old GM**") filed its historic bankruptcy case (the "**Bankruptcy Case**") at 7:57 a.m. on June 1, 2009 (the "**Petition Date**"), a group of hedge funds (funds managed by

Appaloosa, Fortress, Elliott and Aurelius, collectively, the "**Lock-Up Noteholders**") gathered with representatives of Old GM at the New York offices of Old GM's counsel, Weil, Gotshal & Manges LLP ("**Weil Gotshal**").[2] The purpose of this meeting was to negotiate and document a settlement of the Lock-Up Noteholders' claims relating to two series of notes (the "**Notes**") issued on July 10, 2003 by Old GM's wholly-owned subsidiary, General Motors Nova Scotia Finance Company ("**GM Nova Scotia**") and guaranteed by Old GM.[3] If Old GM failed to negotiate a resolution with the Lock-Up Noteholders, it planned to file a Canadian insolvency proceeding on the morning of June 1 for Old GM's wholly-owned subsidiary, General Motors of Canada Limited ("**GM Canada**"), the entity to which GM Nova Scotia had loaned all the proceeds of the Notes pursuant to two intercompany loan agreements (the "**Intercompany Loans**").[4]

In anticipation of a settlement with the Lock-Up Noteholders, Old GM, on Friday, May 29, 2009, the last business day before Old GM's bankruptcy filing, initiated a transfer of $450 million to GM Canada (the "**$450 Million Loan**").[5] These funds were moved out of Old GM's account in anticipation of Old GM's bankruptcy filing, even though there was no deal among the parties as of May 29, 2009 and the amount of any settlement payment had not yet been agreed.[6] Old GM and GM Canada documented this transfer by a promissory note dated May 29, 2009 (the "**Promissory Note**") and a trust agreement, dated May 29, 2009 (the "**Trust Agreement**"), which provided that the funds could only be used to settle the Intercompany Loans and exchange

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[2] Joint Pretrial Submission, dated August 3, 2012, Section A, Statement of Uncontested Facts ("**Statement of Uncontested Facts**"), ¶¶ 28, 59.

[3] *Id*. at ¶¶ 1, 2, 18.

[4] *Id*. at ¶¶ 4, 6; Ammann Decl., ¶¶ 9, 23.

[5] *See* Statement of Uncontested Facts, ¶ 36; Trial Tr. (8/9/2012), 69:15-17 (Buonomo).

[6] Trial Tr. (8/9/2012), 69:15-70:7 (Buonomo).

the Notes into cash.[7]

With the funds transfer initiated, Weil Gotshal circulated a draft of an agreement in the early morning of Sunday, May 31, 2009,[8] outlining the terms of a potential settlement as the parties understood it at the time.[9] Greenberg Traurig LLP ("**Greenberg Traurig**"), counsel for the Lock-Up Noteholders, circulated its revisions to Weil Gotshal's draft in the afternoon of May 31, 2009.[10] In the words of Lawrence Buonomo, the Old GM in-house attorney leading the negotiations, the drafts were like "ships passing in the night in virtually every respect."[11] The Greenberg Traurig draft contemplated adding Old GM, GM Canada and other GM entities as parties to the settlement, whereas Old GM's proposal included only one GM party – GM Nova Scotia, the issuer of the Notes.[12] Further, the Old GM proposal required extinguishment of the Notes, whereas the Greenberg Traurig proposal left the Notes outstanding.[13] Given the vast differences between the two drafts, when the parties met in the afternoon of May 31, 2009, it was clear that they faced an uphill battle to complete an agreement before Old GM filed for bankruptcy first thing in the morning on Monday, June 1, 2009.

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[7] Statement of Uncontested Facts, ¶ 37; Buonomo Decl., ¶ 44; Pl. Ex. 144 (steps list); Pl. Ex. 134, ¶ C (NGM000000602).

[8] Statement of Uncontested Facts, ¶ 29; Truong Decl., ¶ 50; Gropper Decl., ¶ 65; Trial Tr. (8/8/2012), 48:23-49:5 (Zirinsky). *See also* Pl. Ex. 7 (email from A. Woodworth to B. Truong, D. Gropper, D. Prieto, and others, dated May 31, 2009, attaching draft of Lock-Up Agreement); Trial Tr. (8/8/2012), 64-65 (Zirinsky) (explaining that certain documents as printed out reflect Central time as opposed to Eastern time); Def. Ex. 148 (email chain, dated May 31, 2009, showing 1:45 a.m. transmittal email for initial draft of Lock-Up Agreement).

[9] *See* Bolin Decl., ¶ 44.

[10] *See* Pl. Ex. 11 (email from A. Marsico, dated May 29, 2009, attaching revised Lock-Up Agreement). *See also* Trial Tr. (8/8/2012), 66:19-25 (Zirinsky).

[11] Trial Tr. (8/9/2012), 226:3-13 (Buonomo).

[12] *Compare* Pl. Ex. 7 at AUR_GM025054, 62 (Weil draft) *and* Pl. Ex. 11 at ELL_GM001288, 1301 (Greenberg draft). *See also* Trial Tr. (8/8/2012), 67:1-7 (Zirinsky).

[13] *Compare* Pl. Ex. 7, ¶ 5 (AUR_GM025057-58) (Weil draft) (includes "full and final release" provision) *and* Pl. Ex. 11, ¶ 5 (ELL_GM001295) (Greenberg Traurig draft) (deletes "full and final release" provision). *See also* Trial Tr. (8/8/2012), 67:14-23 (Zirinsky).

Faced with a deadline, the parties worked through the afternoon and then through the night, going through many versions of the Lock-Up Agreement, in order to finalize a deal.[14] On the morning of June 1, 2009, more than an hour after Old GM's bankruptcy petition was filed, the parties finalized the Lock-Up Agreement.[15]

B. The Terms Of The Lock-Up Agreement Richly Rewarded The Lock-Up Noteholders, Who Collectively Held Over 2/3 Of The Notes

The Lock-Up Agreement provided that the holders of the Notes ("**Noteholders**") would receive, postpetition, a "consent fee" of approximately $367 million in cash (the "**Consent Fee**").[16] This Consent Fee equaled approximately 36% of the face amount of the Notes.[17] According to Old GM's Controller's office, this Consent Fee "effectively represent[ed] an actual return on the bondholders' investment,"[18] and Old GM personnel initially understood the Consent Fee to be a settlement of GM Nova Scotia's obligations to the Noteholders.[19] Yet, under the terms of the Lock-Up Agreement, payment of the Consent Fee did not reduce the principal amount of the Notes by a single dollar.[20] This Consent Fee was ultimately paid to the Noteholders on June 26, 2009 *pro rata* on the basis of their holdings, regardless of whether a

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14 Statement of Uncontested Facts, ¶¶ 12, 18-28; Truong Decl., ¶¶ 42-48; Gropper Decl., ¶¶ 33-47; Bolin Decl., ¶¶ 32-45; Ammann Decl., ¶ 19-21; Trial Tr. (8/8/2012), 18:4-24:15, 33:1-10 (Zirinsky); Trial Tr. (8/9/2012), 46:16-47:1 (Buonomo); Trial Tr. (9/28/2012), 57:24-11 (Gropper). *See generally* Pl. Ex. 3 at AUR_GM021446-4517 (Prieto Notebook).

15 *See* Factual Background Section III(A).

16 Pl. Ex. 16, ¶ 2 (WGM00000795) (executed copy of the Lock-Up Agreement), A-4 (WGM00000816) (extraordinary resolution). *See also* Cederholm Decl., ¶ 56(A); Buonomo Decl., ¶ 49.

17 *See* Gropper Decl., ¶ 52; Pl. Ex. 607 at FOR_GM002643 (email from L. Cowen to B. Truong, May 30, 2009). *See also* Pl. Ex. 16 (executed copy of the Lock-Up Agreement), ¶ 2 (WGM00000795), A-4 (WGM00000816) (extraordinary resolution).

18 Pl. Ex. 152 at NGM000017558 (email from NYTO Controller's Group to file, dated July 8, 2009).

19 Pl. Ex. 439 at NGM000030547.

20 *See* Pl. Ex. 16, ¶ 6(iv) (WGM0000800); Pl. Ex. 152 at NGM000017558.

particular Noteholder gave its consent.[21] Although the Consent Fee was nominally paid by GM Nova Scotia with funds it received from GM Canada in settlement of the Intercompany Loans, such funds can, with absolute certainty, be traced back to Old GM's transfer of the $450 Million Loan to GM Canada that was earmarked for this purpose.[22]

In addition to the $367 million Consent Fee, the Lock-Up Agreement provided that Old GM would support allowed claims in its Bankruptcy Case for the benefit of the Noteholders of over two-and-a-half times the face amount of the Notes.[23] First, the Lock-Up Agreement compelled Old GM to support allowed claims in its Bankruptcy Case for the full amount of the Notes based on Old GM's guarantee of the Notes without any deduction for the Consent Fee (the "**Guarantee Claims**").[24] Second, the Lock-Up Agreement required Old GM, as sole shareholder of GM Nova Scotia, to deliver its consent to an involuntary bankruptcy filing against GM Nova Scotia, an unlimited liability company organized under the Nova Scotia Companies Act (the "**Companies Act**").[25] This consent was to be given for the sole purpose of permitting the Lock-Up Noteholders to manufacture a claim under section 135 of the Companies Act, which requires that Old GM, as GM Nova Scotia's sole shareholder, contribute to the assets of GM Nova Scotia in an amount sufficient for payment of its debts and liabilities in the event of GM Nova Scotia's winding up.[26] In furtherance of this scheme and despite the fact that the Notes are subject to a separate contractual guarantee, the Lock-Up Agreement required that Old GM support the allowance in its Bankruptcy Case of a claim under section 135 of the Companies Act (the "**Nova**

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21 Statement of Uncontested Facts, ¶¶ 33, 74.

22 *See* Pl. Ex. 16, ¶ 2 (WGM0000795); Pl. Ex. 144 at CC000135 (steps list); Pl. Ex. 277 (settlement agreement between GM Nova Scotia and GM Canada); Buonomo Decl., ¶¶ 43, 44.

23 *Id.* at ¶ 6 (WGM00000799-800).

24 *Id.* at ¶¶ 6(a), (b)(ii).

25 *Id.* at ¶¶ 6(a), (b)(i); Statement of Uncontested Facts, ¶ 1.

26 *See* Companies Act, R.S.N.S., c. 81, s. 135.

Scotia Trustee Claim," and together with the Guarantee Claims, the "**Disputed Claims**").[27] This claim was to include the full amount of the Notes plus the amounts purported to be due under currency swaps (the "**Swaps**") entered into by Old GM and GM Nova Scotia when the Notes were issued.[28] Third, the Lock-Up Noteholders extracted an agreement from Old GM that any amounts due on account of the Swaps would be subordinated in full to payment of the Notes if any portion of the Nova Scotia Trustee Claim was disallowed in the Old GM Bankruptcy Case.[29]

The cumulative effect of the Lock-Up Agreement is that, in addition to a cash payment of approximately 36 cents per dollar outstanding on the Notes,[30] the Noteholders were permitted to assert claims in the Old GM Bankruptcy Case exceeding two-and-a-half times the face amount of the Notes.[31] Because the Lock-Up Noteholders held over 2/3 of each series of the Notes,[32] most of the Lock-Up Agreement benefits flowed to the Lock-Up Noteholders.

C. The Lock-Up Noteholders Achieved The Settlement By Manipulating Old GM's Prepetition Restructuring Efforts And Exploiting Old GM's Need To Restructure GM Canada

For the Lock-Up Noteholders, this extraordinary settlement was the culmination of a series of actions they took in the weeks and months preceding the Old GM bankruptcy filing. All Lock-Up Noteholders, with the exception of Fortress, began acquiring Notes in mid- to late

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27 Pl. Ex. 16, ¶¶ 6(a), (b)(iii) (WGM00000799-800).

28 *Id.* at ¶¶ 6(a), (b)(iii).

29 *Id.* at ¶¶ 6(a), (b)(v).

30 Gropper Decl., ¶ 52; Trial Tr. (9/20/2012), 24:5-16 (Truong); Pl. Ex. 605 at FOR_GM002652-53 (email from B. Truong to P. Briger and others, dated May 30, 2009).

31 Trial Tr. (9/20/2012), 21:19-22:8, 25:4-16 (Truong) (Fortress' claim under the Lock-Up Agreement will be 2.25 times assuming the Nova Scotia Trustee Claim is allowed in full); Pl. Ex. 175 at FOR_GM002639 (email from B. Truong to P. Briger and others, dated May 30, 2009); Pl. Ex. 605 at FOR_GM002652-53 (email from B. Truong to P. Briger and others, dated May 30, 2009).

32 Ammann Decl., ¶ 22; Trial Tr. (8/9/2012), 41:13-17 (Buonomo).

2008,[33] near the time it became apparent that the automotive industry was in dire financial difficulty,[34] and the Lock-Up Noteholders began positioning themselves to obtain maximum leverage in their negotiations with Old GM.

In early 2009, certain creditors of Old GM formed an ad hoc committee (the "**Ad Hoc Committee**") to pursue an out-of-court restructuring of Old GM's debts.[35] Elliott and Fortress were members of the steering committee (the "**Steering Committee**") for the Ad Hoc Committee.[36] From the outset, however, Bao Truong, the primary analyst responsible for Fortress' investment in the Notes,[37] tried to rally the Steering Committee members to push for a chapter 11 filing,[38] while positioning his fund to maximize its profit from such a filing. Both Fortress and Elliott held credit default swaps ("**CDS**") referencing Old GM, which insured the holder of the CDS against an Old GM bankruptcy filing. As holders of such CDS, Elliott and Fortress received payment when Old GM filed its Bankruptcy Case.[39] Neither Fortress nor Elliott disclosed their CDS holdings in any public way; nor did they disclose their CDS holdings in any of the Rule 2019 statements that their counsel, Greenberg Traurig, filed in the Old GM Bankruptcy Case.[40]

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[33] *See* Cederholm Decl., ¶ 9 (Elliott initially purchased Notes in Sept. 2008); Bolin Decl., ¶ 9 (Appaloosa first purchased Notes on Oct. 16, 2008); Gropper Decl., ¶ 14 (Aurelius began acquiring Notes on June 24, 2008); Trial Tr. (9/20/2012), 13:9-15 (Truong) (Fortress first purchased Notes in 2006).

[34] Def. Ex. 75 at NGM000007371 (form S-4 filed on April 27, 2009) (describing market conditions in the automotive industry and Old GM's restructuring efforts in 2008).

[35] Statement of Uncontested Facts, ¶ 9.

[36] *Id.*; Cederholm Decl., ¶ 16; Truong Decl., ¶ 24.

[37] Truong Decl., ¶ 6.

[38] Pl. Ex. 166 (email from B. Truong to M. Breckenridge, dated Jan. 22, 2009); Trial Tr. (9/20/2012), 71:4-72:12 (Truong).

[39] Trial Tr. (9/20/2012), 15:18-16:1; 16:21-23, 79:9-12 (Truong); Trial Tr. (9/6/2012), 20:22-21:5; 21:12-20 (Cederholm).

[40] Pl. Exs. 38, 53, 386, 387 (Greenberg Traurig's Rule 2019 statements); Trial Tr. (9/6/2012), 20:6-11, 21-23 (Cederholm); Trial Tr. (9/20/2012), 18:7-11 (Truong). Bruce Zirinsky of Greenberg Traurig

Footnote continued on next page

On March 2, 2009, while the Ad Hoc Committee was active, Aurelius, Fortress and Appaloosa, as a group, commenced an action (the "**Oppression Action**") in the Supreme Court of Nova Scotia against Old GM, GM Nova Scotia, GM Canada and certain of their officers and directors, among others, claiming that two transfers in May 2008 from GM Nova Scotia to Old GM in the amount of $500,000 and CAD $16,000,000 (the "**May 2008 Transfers**") impaired the Noteholders' ability to recover on the Notes and, therefore, were oppressive under Canadian law.[41] This lawsuit – asserting a remedy that Elliott described as the "last refuge of scoundrels" that would permit a judge to "fashion remedies out of whole cloth"[42] – was meritless from the start.

At the time these Noteholders brought the Oppression Action, GM Nova Scotia had not missed any payments on the Notes.[43] Further, none of the Noteholders would have had any expectation that any funds would remain in GM Nova Scotia, as the offering circular for the Notes made clear that GM Nova Scotia existed solely as a financing vehicle for Old GM and its affiliates and that all the proceeds of the Notes would be provided, directly or indirectly, to Old GM.[44] In addition, the May 2008 Transfers were publicly disclosed in a special resolution filed with the Nova Scotia Office of Registrar of Joint Stock Companies in May 2008,[45] before

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readily admitted that his clients may have held securities other than those listed in the Rule 2019 statements. Trial Tr. (8/8/2012), 126:17-21 (Zirinsky). Elliott conceded that it held other securities not disclosed in Greenberg Traurig's Rule 2019 statements. Trial Tr. (9/6/2012), 20:18-21 (Cederholm).

[41] Statement of Undisputed Facts, ¶ 11; Truong Decl., ¶¶ 28, 32; Bolin Decl., ¶¶ 10, 19; Pl. Ex. 382 at NGM000005440-41.

[42] Pl. Ex. 54 at ELL_GM002484 (email from D. Miller of Elliott to D. Cederholm, dated Jan. 16, 2009).

[43] Trial Tr. (9/27/2012), 27:13-16 (Bolin).

[44] Def. Ex. 14 at 23 (NGM000012074), 26 (NGM000012077) (offering circular).

[45] Trial Tr. (9/20/2012), 131:20-132:1 (Truong); Pl. Ex. 633, ¶¶ 23-25 (FOR_GM03955-56) (Gropper Affidavit filed in the Oppression Action).

Aurelius and Appaloosa purchased any Notes.[46] Tellingly, Appaloosa, which claimed to have learned of the May 2008 Transfers in late October 2008 and claimed to be "oppressed" by the transfers, then went on to more than triple its holdings of the Notes in December 2008.[47]

While Aurelius, Fortress and Appaloosa continued to prosecute the Oppression Action, Old GM launched a public out-of-court exchange offer on April 27, 2009 for approximately $27.2 billion of its debts, including the Notes, in exchange for Old GM common stock (the "**Bond Exchange Offer**").[48] Each of the Lock-Up Noteholders rejected the Bond Exchange Offer,[49] with Truong concluding that the Noteholders would never accept it.[50] The Bond Exchange Offer expired on Tuesday, May 26, 2009, without achieving the required threshold for acceptances.[51]

With the failure of the Bond Exchange Offer, Old GM anticipated filing its Bankruptcy Case on the morning of June 1, 2009.[52] If Old GM could not settle with the Noteholders, then Old GM planned to file an insolvency proceeding for GM Canada on June 1, 2009 simultaneous with Old GM's bankruptcy filing, in order to protect GM Canada from Noteholder-driven claims seeking to collect on the Intercompany Loans.[53] Old GM also planned that the cornerstone of its

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46 Bolin Decl., ¶ 9 (Appaloosa first purchased Notes on Oct. 16, 2008); Gropper Decl., ¶ 14 (Aurelius began acquiring Notes on June 24, 2008).

47 At the time that Bolin allegedly learned of the transfers, Appaloosa held £35 million of Notes. Trial Tr. (9/27/2012), 32:23-33:1 (Bolin); Bolin Decl., ¶ 9. Appaloosa then purchased an additional £116 million of Notes in December 2008. Trial Tr. (9/27/2012), 33:2-18 (Bolin); Bolin Decl., ¶ 11.

48 *See, e.g.,* Pl. Exs. 87, 382, 452-459, 511 (pleadings filed in the Oppression Action in May 2009); Statement of Uncontested Facts, ¶ 13.

49 Truong Decl., ¶ 38 (Fortress rejected); Bolin Decl., ¶ 29 (Appaloosa rejected); Cederholm Decl., ¶ 30 (Elliott rejected); Gropper Decl., ¶ 31 (Aurelius rejected).

50 Pl. Ex. 190 at FOR_GM001136 (Bloomberg chat between B. Truong and M. Chung of Arrowgrass on April 27, 2009); Trial Tr. (9/20/2012), 75:3-79:2 (Truong).

51 Statement of Uncontested Facts, ¶ 17.

52 Def. Ex. 75 at NGM000007359 (form S-4 filed on April 27, 2009).

53 Buonomo Decl., ¶ 16.

Bankruptcy Case would be a quick sale under section 363 of the Bankruptcy Code (the "**363 Sale**") of substantially all of its assets to a newly formed entity, General Motors LLC ("**New GM**").[54] Appaloosa, Fortress and Aurelius were aware of this objective and formulated a plan to object to the 363 Sale if they did not reach a deal with Old GM.[55] It was against this backdrop that the Lock-Up Agreement was negotiated.

II. THE LOCK-UP AGREEMENT

A. The Terms Of The Lock-Up Agreement Were Not Reasonable

The parties to the Lock-Up Agreement recognized that the Noteholders received a disproportionately rich deal.[56] Buonomo, who along with Daniel Ammann, then of Morgan Stanley & Co., negotiated the agreement on behalf of the GM entities, knew that there would be objections down the road from Old GM's creditors.[57] Dennis Prieto, an analyst for Aurelius and a participant in the Lock-Up negotiations, noted that that they "do not want to give GM US creditors more reasons to object."[58] The parties, therefore, took care to structure the settlement in a way that they believed would not be subject to attack.[59]

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[54] Buonomo Decl., ¶ 3; Ammann Decl., ¶ 8.

[55] Trial Tr. (9/20/2012), 73:24-74:24 (Truong) (Appaloosa, Fortress, and Aurelius discussed this option with a public relations firm and would have engaged the firm to oppose the sale if a settlement had not been reached). *See also* Pl. Ex. 607 at FOR_GM002644-45 (email chain between P. Briger and B. Truong and others, dated May 30, 2009).

[56] The Lock-Up Noteholders themselves boasted about the remarkable deal they received. *See* Trial Tr. (10/3/2012), 150:10-15, 169:3-11 (Mayer) (Dan Gropper of Aurelius called Tom Mayer, counsel for the Official Committee of Unsecured Creditors (the "**Committee**"), weeks after the 363 Sale and bragged about what a great deal he received); Pl. Ex. 178 at FOR_GM002977 (email from B. Truong of Fortress to M. Chung of Arrowgrass, on June 1, 2009, commenting "[y]our net recovery is higher than the US government's!"); Pl. Ex. 174 (email from B. Truong commenting "[t]his is a good deal."); Pl. Ex. 179 at FOR_GM002982-83 (email chain between B. Truong and R. Pacholder of Sandell Management, dated June 1, 2009, in which Pacholder calls Truong a "rock star" for securing the deal and Truong replies ". . . I am pretty pleased with the negotiated outcome – esp. vis-à-vis other GM creditors . . .").

[57] Trial Tr. (8/10/2012), 113:6-12 (Buonomo).

[58] Pl. Ex. 3 at AUR_GM021453 (Prieto notebook).

[59] *See* Pl. Ex. 3 at AUR_GM021457.

B. The Lock-Up Agreement Was Tainted By Conflicts On The Part Of Those Responsible For Acting On Behalf Of Old GM

At the time Old GM entered into the Lock-Up Agreement, the individuals who negotiated the settlement on Old GM's behalf expected that they would transition to New GM at the close of the sale.[60] As expected, both Buonomo and Maurita Sutedja of Old GM did transition to New GM immediately after the sale.[61] After Morgan Stanley, Ammann, Old GM's outside financial advisor, joined New GM as its Treasurer and now serves as its Chief Financial Officer.[62] The trial testimony demonstrates that the parties who negotiated the Lock-Up Agreement were tainted with self-interest and did not clearly separate and protect Old GM's interests. Asked who he was working for when he negotiated this transaction, Buonomo replied, "[i]t's very hard for me to bifurcate myself and say it's one or the other. We certainly knew, as we're negotiating this, that we were going to be on the other side of it when it was over. It was a very complicated exercise from that perspective."[63] Buonomo also acknowledged that Old GM's analysis of what would have been a reasonable settlement with the Noteholders was thought of as analyzing what it would be worth to *New GM* to avoid a GM Canada bankruptcy.[64] Sutedja testified that they viewed the GM entities as an "enterprise" and did not differentiate their work among the various GM entities.[65]

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60 *See, e.g.*, Trial Tr. (8/9/2012), 24:25-25:3 (Buonomo); M. Sutedja Depo. Tr. (5/31/2012), 10:3-2.

61 M. Sutedja Depo. Tr. (5/31/2012) (admitted by designation), 10:14-16; Trial Tr. (8/9/2012), 24:25-25:5 (Buonomo).

62 *See* Trial Tr. (9/27/2012), 178:5-8 (Ammann); Ammann Decl., ¶ 1.

63 Trial Tr. (8/10/2012), 36:3-8 (Buonomo).

64 *Id.* at 24:19-24.

65 M. Sutedja Depo. Tr. (5/31/2012) 112:4-5, 8-13.

1. The Consent Fee Alone Exceeded Old GM's Analysis Of What It Should Pay To Avoid A GM Canada Bankruptcy Filing

The amount of the Consent Fee far exceeded Old GM's own analysis of what would be a reasonable settlement with the Noteholders. In the weeks preceding the May 31 meeting, Old GM did a series of analyses (the "**Indifference Analyses**") to ascertain a reasonable amount for Old GM to pay to settle the Noteholders' claims and avoid a GM Canada bankruptcy filing.[66] These Indifference Analyses reflect the only effort by Old GM to quantify a reasonable settlement with the Noteholders.[67] According to Ammann, Old GM made no other requests for analysis and there was, to his recollection, no written analysis of any of the qualitative judgments relevant to a GM Canada bankruptcy filing.[68]

Although there were multiple iterations of the Indifference Analyses, all versions showed that the "indifference point" – that is, the point at which Old GM, considering the transaction costs, tax implications and business impact of a GM Canada bankruptcy filing, would be indifferent as between filing bankruptcy for GM Canada and settling with the Noteholders[69] – was no more than $285 million in exchange for cancellation of the Notes.[70] The Consent Fee alone exceeded the indifference point by over $82 million and was in exchange for a settlement that not only did not cancel the Notes, but provided for allowance of claims equal to more than two-and-a-half times the face amount of the Notes.

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66 Pl. Exs. 126, 130, 211.

67 Trial Tr. (8/10/2012), 108:25-109:7 (Buonomo); Trial Tr. (9/27/2012), 76:1-77:19, 79:25-80:5, 80:13-15, 83:22-84:1, 102:5-8 (Ammann).

68 Trial Tr. (9/27/2012), 80:6-9, 169:15-25 (Ammann).

69 Trial Tr. (8/9/2012), 23:18-24:9 (Buonomo).

70 *See* Trial Tr. (9/27/2012), 96:18-21 (Ammann). A $285 million payment represented a 178% premium to market on the Notes. *See, e.g.*, Pl. Ex. 211 at 2 (email from D. Ammann dated May 18, 2009).

2. The Consent Fee Is Many Orders Of Magnitude Greater Than Any Commercially Reasonable Consent Fee

The Consent Fee was outsized compared to consent fees paid in other distressed situations. As Didric Cederholm of Elliott testified, although consent fees in distressed situations are typically somewhat higher than in non-distressed situations, consent fees in distressed scenarios are typically in the 2-3% range.[71] In this case, the Consent Fee was approximately 36% of the face amount of the Notes.[72] Prior to this deal, the largest consent fee with which Cederholm ever had experience was 8%, and Elliott had never been paid a consent fee on the order of magnitude of what it received under the Lock-Up Agreement.[73]

3. The Noteholders Released A Claim That Would Have Been Worthless In Exchange For The Lock-Up Agreement Benefits

In exchange for the Consent Fee and Old GM's other concessions under the Lock-Up Agreement, the Noteholders agreed to release all of their purported claims relating to the Intercompany Loans.[74] However, in releasing these claims, the Noteholders agreed to release claims belonging to GM Nova Scotia that were essentially worthless. The Lock-Up Noteholders were made aware during Lock-Up Agreement negotiations that GM Canada would file for bankruptcy if the parties could not reach a settlement, and that in the event of a GM Canada bankruptcy, the Intercompany Loans would be worth nothing.[75] GM Nova Scotia's only

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[71] Trial Tr. (9/6/2012), 28:21-29:1, 111:21-25 (Cederholm).

[72] *See* Gropper Decl., ¶ 52; Pl. Ex. 607 at FOR_GM002643 (email from L. Cowen to B. Truong, dated May 30, 2009). *See also* Pl. Ex. 16, ¶ 2 (executed copy of the Lock-Up Agreement) (WGM00000795), A-4 (extraordinary resolution).

[73] Trial Tr. (9/6/2012), 31:9-14, 126:19-23 (Cederholm).

[74] Pl. Ex. 16, ¶ 5(b) (WGM00000798).

[75] Trial Tr. (8/9/2012), 44:24-45:1 (Buonomo); Trial Tr. (8/8/2012), 20:5-13 (Zirinsky); Trial Tr. (9/27/2012), 103:18-104:6 (Ammann); Pl. Ex. 124 (email from D. Ammann to R. Young, dated May 16, 2009); Pl. Ex. 3 at AUR_GM021446-47, 51 (Prieto notebook).

significant assets were the Intercompany Loans;[76] thus, the Noteholders' recovery depended entirely on the extent to which GM Nova Scotia could recover on the Intercompany Loans.[77] Indeed, all of Old GM's analyses produced in litigation show that in the event of a GM Canada bankruptcy, the recovery on the Intercompany Loans would be zero.[78] The settlement under the Lock-Up Agreement therefore allowed the Noteholders to release worthless claims and, in exchange, enrich themselves at the expense of the Old GM estate.

III. THE LOCK-UP AGREEMENT IS A POSTPETITION AGREEMENT FOR WHICH COURT APPROVAL WAS REQUIRED BUT NEVER SOUGHT OR OBTAINED

A. The Lock-Up Agreement Was Finalized Postpetition

All parties to the Lock-Up Agreement always intended that any settlement would require a written agreement.[79] In connection with the Lock-Up Agreement negotiations, each Lock-Up Noteholder, Old GM and GM Nova Scotia signed a Non-Disclosure Agreement (the "**NDA**") on or before May 31, 2009.[80] This NDA was negotiated by Weil Gotshal and Greenberg Traurig[81] and provided explicitly that the parties would not be bound to any agreement unless and until there was a "definitive" agreement.[82] Each draft of the Lock-Up Agreement and the final,

[76] Trial Tr. (9/27/2012), 104:17-21, 106:5-7 (Ammann); Trial Tr. (8/9/2012), 34:7-18 (Buonomo).

[77] *See* Trial Tr. (9/27/2012), 105:24-106:4 (Ammann).

[78] Trial Tr. (8/9/2012), 34:3-6, 36:12-37:3 (Buonomo); Trial Tr. (9/27/2012), 106:22-107:5 (Ammann). *See also* Pl. Ex. 121 (email from J. Holy at GM to D. Ammann and others, dated Feb. 22, 2009, attaching analysis of projected recovery on Intercompany Loans under various scenarios); Pl. Ex. 215 at NGM00013190 (email from J. Holy to M. Sutedja, dated May 18, 2009).

[79] *See, e.g.,* Trial Tr. (9/6/2012), 64:18-22 (Cederholm); Trial Tr. (9/28/2012), 57:16-19 (Gropper); Trial Tr. (8/9/2012), 50:16-21 (Buonomo); Trial Tr. (8/8/2012), 17:17-18:3 (Zirinsky).

[80] Statement of Uncontested Facts, ¶ 22; Bolin Decl., ¶ 36 (Appaloosa signed the NDA); Gropper Decl., ¶ 37 (the Noteholders executed the NDA); Trial Tr. (8/9/2012), 43:1-4 (Buonomo) (all four funds signed the NDA).

[81] Gropper Decl., ¶ 36.

[82] Pl. Ex. 256, ¶ 11 (ELL_GM000243) (copy of NDA executed by Elliott) ("The Recipient agrees that unless and until the Parties have entered into a definitive agreement with respect to the Transaction, neither the Company nor GM will be under any legal obligation of any kind whatsoever with respect to

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executed copy of the Lock-Up Agreement contained (i) identical clauses providing that the written agreement supersedes all prior negotiations, and (ii) a clause providing that the agreement shall not become effective unless signature pages have been executed and delivered by each counterparty.[83] The only written agreement between the parties is the Lock-Up Agreement.[84] Thus, to be a valid prepetition agreement, the Lock-Up Agreement had to have been finalized and all signatures released prior to the time Old GM filed its Bankruptcy Case.

Not surprisingly, the parties to the Lock-Up Agreement insist that it was completed at some point before the petition was filed. Critically, however, the testimony of those parties as to exactly when on June 1, 2009 the agreement was completed is inconsistent.[85] And even more importantly, none of the parties has ever produced the copy of the Lock-Up Agreement that they contend was the final, executed agreement that existed prior to Old GM's bankruptcy filing. All parties instead agree that the final, executed copy of the Lock-Up Agreement is the version circulated by Weil Gotshal at 10:37 a.m. on June 1, 2009 (the "**10:37 Version**").[86] The forensic evidence, which is the only objective evidence on the timing of the Lock-Up Agreement,

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such a transaction by virtue of this or any written or oral expression with respect to such a transaction by any of the Company's or GM's respective directors, officers, employees, agents or any other representatives or their respective advisors or representatives thereof.").

[83] *See* Pl. Ex. 289, ¶¶ 10, 20 (version 16 of the Lock-Up Agreement); Pl. Ex. 290, ¶¶ 10, 20 (version 17 of the Lock-Up Agreement); Pl. Ex. 291, ¶¶ 10, 20 (version 18 of the Lock-Up Agreement); Pl. Ex. 292, ¶¶ 10, 20 (version 19 of the Lock-Up Agreement); Pl. Ex. 293, ¶¶ 10, 20 (version 20 of the Lock-Up Agreement); Pl. Ex. 16, ¶¶ 10, 20 (final, executed copy of the Lock-Up Agreement).

[84] Trial Tr. (9/28/2012), 58:12-18 (Gropper).

[85] *Compare, e.g.,* Cederholm Decl., ¶ 45 (there was an agreement on all substantive terms by 2:00 a.m.) *with* Trial Tr. (9/27/2012), 141:4-12 (Ammann) (agreement was reached around 6:00 a.m.) *with* Bolin Decl., ¶ 50 (agreement was reached at approximately 7:00 a.m.). *Compare, e.g.,* Trial Tr. (8/9/2012), 229:6-23 (Buonomo) (all parties released signature pages by 6:45 a.m. except possibly Aurelius) *with* Cederholm Decl., ¶ 52 (Elliott released its signature page between 7:00 a.m. and 7:30 a.m.).

[86] *See* Pl. Ex. 16 at WGM0000791 ("All – Please find attached the final Lock Up Agreement executed by all parties this morning."). Trial Tr. (8/8/2012), 51:10-53:22 (Zirinsky); Trial Tr. (9/20/2012), 19:15-19:3 (Truong); Trial Tr. (9/27/2012), 143:18-144:9 (Ammann).

establishes that edits to the Lock-Up Agreement continued postpetition and that the 10:37 Version of the Lock-Up Agreement was not created until well after Old GM filed its Bankruptcy Case at 7:57 a.m. on June 1, 2009.[87]

A review of the internal document metadata of each version of the Lock-Up Agreement and the metadata from Weil Gotshal's document management system ("**DMS**") shows that the version of the Lock-Up Agreement that existed as of 7:57 a.m. was version 18.[88] The 10:37 Version, which is the version the parties agree is the final, executed version of the Lock-Up Agreement, is version 20.[89] Version 20 contains significant differences from version 18[90] and was created after 9:00 a.m. on June 1, 2009.[91] The 10:37 Version was the result of edits made after 7:57 a.m. on June 1, 2009.[92] Plaintiff's Exhibit 687, which is a copy of the Lock-Up Agreement emailed between Weil Gotshal attorneys Peter Godhard and Corey Chivers at 8:43 a.m. on June 1, 2009,[93] shows that numerous changes were made after 7:57 a.m. to the Lock-Up

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87 *See* Jones Decl. (the GUC Trust's computer forensic expert), ¶¶ 6-7, Ex. A at 11 ("**Jones Report**").

88 Trial Tr. (9/4/2012), 39:25-40:4, 208:8-209:17 (Jones); Jones Report at 11. The DMS metadata log and the internal metadata for the document show that version 19 was created both as a new version on the DMS system and as a new document on a personal computer at 9:10 a.m. on June 1, 2009, more than one hour after Old GM filed its Bankruptcy Case. Trial Tr. (9/4/2012), 209:18-210:24 (Jones); Jones Report at 11, 15-19 (¶ 6).

89 Jones Report at 11, 15 (¶ 6.1.1); Jones Decl., ¶ 6. The footer on the 10:37 Version itself indicates that this final version of the Lock-Up Agreement is at least version 19. *See* Pl. Ex. 16 (footer: NY2:\1997354\19\16T6219!.DOC\72240.0637) (emphasis added). Further, at least one Lock-Up Noteholder concedes that the final version was version 19, if not some subsequent version. Trial Tr. (9/28/2012), 57:1-4 (Gropper).

90 Jones Report at 151-170 (Attach. 5) (comparison of version 18 and version 20). *See also* Pl. Ex. 687 (copy of Lock-Up Agreement as of 8:43 a.m. on June 1, 2009 showing numerous track changes).

91 The DMS metadata log and the internal metadata for the document show that version 20 was created as a new version on a computer at 9:10 a.m. and uploaded onto the DMS as a new version at 9:21 a.m. Trial Tr. (9/14/2012), 212:16-213:6 (Jones); Jones Report at 11, 15-19 (¶ 6).

92 *See* Trial Tr. (8/10/2012), 119:11-15 (Buonomo); Trial Tr. (9/4/2012), 198:16-20 (Jones); Jones Decl., ¶ 6; Pl. Ex. 687 (copy of Lock-Up Agreement as of 8:43 a.m. on June 1, 2009 showing numerous track changes).

93 *See* Pl. Ex. 451 at 1 (letter from R. Berkovich to K. Cooperman, dated July 9, 2012 describing

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Agreement, including the extraordinary resolution[94] (*i.e.*, the exhibit to the Lock-Up Agreement that was so integral that Buonomo characterized it as the "raison d'être" of the Lock-Up Agreement).[95]

The Lock-Up Noteholders' computer forensic expert, R. Christopher Racich, agrees with the GUC Trust's computer forensic expert, Keith J. Jones, that the 10:37 Version of the Lock-Up Agreement was, assuming that the internal document metadata and the DMS metadata reflects Eastern Daylight Time ("**EDT**"), created after 7:57 a.m.[96] and is the product of editing that occurred after Old GM filed its Bankruptcy Case.[97] All of the evidence in this case points to the conclusion that the internal document metadata and DMS metadata accurately reflect EDT. As both Jones and Racich testified, the internal document metadata reflects the clock times of the individual personal computers of the user of each version of the document,[98] while the DMS

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email from P. Godhard to C. Chivers sent at 8:43 a.m. (eastern time) on June 1, 2009 and attaching copy of email) and at WGM00296277 (email from P. Godhard to C. Chivers at 8:43 a.m. on June 1, 2009 attaching copy of Lock-Up Agreement). Godhard and Chivers are both Weil Gotshal attorneys. *See* Pl. Ex. 451; J. Smolinsky Depo. Tr., 12:2-9 (5/24/2012) (admitted by designation).

Pl. Ex. 687 is a copy of the Lock-Up Agreement attached to the 8:43 a.m. Godhard email showing track changes. *See* Pl. Ex. 686 at 1 (R. Berkovich letter to K. Cooperman, dated July 24, 2012).

[94] Pl. Ex. 687 is attached as Exhibit E to the Jones Declaration and shows edits made after 7:57 a.m. Trial Tr. (9/4/2012), 197:10-198:20, 219:2-225:2 (Jones). *See* Pl. Ex. 687 at WGM0029316-17 (chart showing document changes and comments).

[95] Trial Tr. (8/10/2012), 115:2-10 (Buonomo).

[96] Trial Tr. (11/27/2012), 114:13-115:7; 117:7-118:8 (Racich) (assuming that Weil Gotshal's clock times were set to EDT on June 1, 2009, Racich agrees that the version of the Lock-Up Agreement that was in existence at 7:57 a.m. was version 18, that version 19 was created at 9:10 a.m. and that version 20 was also created after 9:00 a.m. on June 1, 2009).

[97] Trial Tr. (11/27/2012), 118:24-123:12 (Racich) (assuming that the clock times were set to EDT, Pl. Ex. 687, the version of the Lock-Up Agreement emailed by Weil Gotshal at 8:43 a.m., shows that a number of changes as reflected on Pl. Ex. 687 were made to the Lock-Up Agreement after 7:57 a.m.). *See also* Trial Tr. (11/27/2012), 242:3-16 (Racich) (the postpetition changes reflected in Pl. Ex. 687 were incorporated into the 10:37 Version of the Lock-Up Agreement).

[98] Trial Tr. (9/4/2012), 202:24-206:9 (Jones); Trial Tr. (11/27/2012), 127:21-25 (Racich).

metadata reflects the times on Weil Gotshal's servers.[99] Here, the internal metadata and DMS metadata all correlate to EDT.[100] The forensic evidence, therefore, establishes that the Lock-Up Agreement was completed postpetition.[101]

B. The Lock-Up Agreement Was Implemented Through Unauthorized Postpetition Transactions

1. Old GM Amended The Trust Agreement For The $450 Million Loan After The Petition Was Filed Without Court Approval

Even after the Lock-Up Agreement was finalized, there were many important steps that remained to implement the settlement.[102] Old GM entered into two amendments to the Trust

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[99] Trial Tr. (9/4/2012), 202:24-206:9 (Jones); Trial Tr. (11/27/2012), 127:21-25 (Racich).

[100] Trial Tr. (9/4/2012), 198:21-206:9 (Jones) (Jones testified that the evidence shows that the Weil Gotshal computers and servers were synched so the times reflected in the metadata are accurate reflections of EDT).

As of June 1, 2009, EDT was in effect by several months and computer systems are generally set up to automatically switch from EST to EDT when the clock changes. Trial Tr. (11/27/2012), 134:22-135:8 (Racich). Further, circumstantial evidence such as an accurately time-stamped email can be used to determine computer clock times by matching the email time stamp to events reflected on system metadata. Trial Tr. (11/27/2012), 128:23-129:14 (Racich). Here, Pl. Ex. 451, an email from Weil Gotshal attorney Peter Godhard to Weil Gotshal attorney Cory Chivers attaching a copy of the Lock-Up Agreement emailed from the DMS system, is time stamped 8:43 a.m. on June 1, 2009. *See* Pl. Ex. 451 at 1, and at WGM00296277 (Letter from R. Berkovich to K. Cooperman dated July 9, 2012). According to Weil Gotshal, this email was indeed sent by Godhard at 8:43 a.m. on June 1, 2009, *see id.*, and the DMS metadata shows that a copy of the Lock-Up Agreement was emailed at 8:43 a.m. by Godhard. *See* Pl. Ex. 688 at WGM00296327; Trial Tr. (11/27/2012), 135:13-139:6 (Racich). Thus, even by Racich's test, the evidence establishes that Weil Gotshal's clock times were accurately set to EDT on June 1, 2009.

[101] The forensic evidence is consistent with Truong's contemporaneous email regarding the Lock-Up Agreement. Truong, at 7:55 a.m. on June 1, 2009, two minutes before Old GM filed its bankruptcy petition, sent an email stating that the "Canadian govt just approved the deal" and that he is "waiting for a copy of all executed forms." Pl. Ex. 177 at FOR_GM002899 (email chain between B. Truong and L. Cowen, dated June 1, 2009). He then wrote at 8:04 a.m., seven minutes after Old GM filed its bankruptcy petition, that the documents are "still being worked through." *See id. See also* Trial Tr. (9/20/2012), 89:6-14 (Truong) (the parties stipulate that the correct time on the top email of Pl. Ex. 177 is 8:04 a.m.). Truong's attempt to explain away this email now, *see* Truong Decl., ¶ 63, is simply not credible given his statements at the time he was negotiating the deal.

[102] *See* Pl. Ex. 260 at NGM000001078 (email from L. Buonomo to T. Chandler, dated June 1, 2009) ("Again, thanks for your help on a very difficult transaction (recognizing [that] we're not done yet)"). *See generally* Pl. Ex. 16. Sutedja noted that the Consent Fee payment technically completed the Nova Scotia bonds settlement process. Pl. Ex. 262 at NGM000015306 (email from M. Sutedja to R. Young and others, dated June 26, 2009); Pl. Ex. 16; Pl. Ex. 144 (steps list); Trial Tr. (8/9/2012), 96: 2-13 (Buonomo).

Agreement, postpetition, in connection with the $450 Million Loan, in an after-the-fact attempt to conform the Trust Agreement to the deal Old GM ultimately reached with the Lock-Up Noteholders.[103] As of May 29, the Trust Agreement between Old GM and GM Canada required that the Notes be exchanged for cash and that Noteholders representing not less than 2/3 of the principal amount of each series of Notes enter into the Lock-Up Agreement in a form attached to the Trust Agreement on or before 11:30 p.m. EST on May 31, 2009 (the "**Lock-Up Deadline**"). If these conditions were not met, GM Canada was to immediately "repay the Promissory Note" to Old GM ***with the proceeds*** that Old GM transferred on May 29.[104] None of these conditions was met. Old GM therefore entered into an amendment to the Trust Agreement backdated to May 31, 2009 (the "**First Trust Amendment**")[105] which required, as a condition of release of funds, that Noteholders representing not less than 2/3 of the principal amount of each series of Notes enter into the Lock-up Agreement in a form attached to the First Trust Amendment on or before 6:00 a.m. EST (*i.e.*, 7:00 a.m. EDT) on June 1, 2009 (the "**Amended Lock-Up Deadline**").[106] These conditions also were not satisfied.[107] Old GM then entered into a second

[103] Trial Tr. (8/9/2012), 86:25-87:6 (Buonomo). Old GM also amended the Promissory Note on June 12, 2009 to reduce the amount owed by a $78.5 million payment by GM Canada postpetition. Trial Tr. (8/9/2012), 151:6-13 (Buonomo); Statement of Uncontested Facts, ¶ 39.

[104] The Trust Agreement provides that if the conditions are not satisfied, GM Canada shall repay the $450 Million Loan to Old GM with the proceeds from the Promissory Note and that "[t]ime is of the essence." *See* Pl. Ex. 134, ¶¶ 2(a), 3(a)-(b) (NGM000000603-04) (email from J. Zhou to W. Borst and others, dated May 29, 2009, attaching, among other things, the Trust Agreement).

[105] Although the First Trust Amendment is dated "as of" May 31, 2009, the evidence supports an inference that the document was not executed by all parties prior to Old GM's bankruptcy filing. *Compare* Pl. Ex. 136 at NGM000014944-53 (email from V. Graham, dated June 5, 2009, attaching unsigned copies of the First Trust Amendment and Second Trust Amendment, with a subject line that states "housekeeping matters") *with* Pl. Ex. 135 at NGM000012428-35 (email from I. Yoo, dated June 8, 2009, attaching signed copies of the First Trust Amendment and Second Trust Amendment, with a subject line that states "signed amendment documents"). *See also* Trial Tr. (8/9/2012), 85:25-86:5 (Buonomo) (the agreement was signed by at least Old GM on June 1, 2009, but L. Buonomo does not know whether the amendment was signed by all parties prior to 7:57 a.m. on June 1, 2009).

[106] Pl. Ex. 135, ¶ 4(a)(i) (NGM000012429).

amendment to the Trust Agreement (the "**Second Trust Amendment**") after Old GM filed its Bankruptcy Case[108] to add the provision that the funds could be used to pay certain fees of the Lock-Up Noteholders.[109]

Because the release conditions of the First Trust Amendment were not satisfied[110] and the release conditions were not amended prepetition,[111] GM Canada was not entitled, as of the Petition Date, to release the proceeds of the $450 Million Loan.[112] Instead, it was required to immediately repay to Old GM the $450 million in proceeds that had been transferred. Nevertheless, on June 25, 2009, upon the passage for the extraordinary resolution, GM Canada entered into a settlement agreement with GM Nova Scotia releasing the Intercompany Loans,[113] and paid $369 million of the $450 million to GM Nova Scotia, which then used the funds to pay the Consent Fee to the Noteholders on June 26, 2009 ($367 million) and various legal fees of the Noteholders ($2 million).[114] Old GM did not seek Court approval for entry into the First Trust Amendment or the Second Trust Amendment, even though they were postpetition agreements that concerned the bankruptcy estate's rights to the $450 million.

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107 Trial Tr. (8/9/2012), 80:13-81:9 (Buonomo).

108 Buonomo does not know when the Second Trust Amendment was signed, other than it was after June 1, 2009. Trial Tr. (8/9/2012), 79:7-17; 81:24-82:1 (Buonomo).

109 *See* Pl. Ex. 135 at NGM000012427 (email from I. Yoo, dated June 8, 2009, attaching First Trust Amendment and Second Trust Amendment); Trial Tr. (8/10/2012), 18:19-24 (Buonomo).

110 Trial Tr. (8/9/2012), 80:13-81:9 (Buonomo).

111 *See* Pl. Ex. 135 (email from I. Yoo, dated June 8, 2009, attaching First Trust Amendment and Second Trust Amendment); Trial Tr. (8/9/2012), 79:7-17; 81:24-82:1 (Buonomo).

112 *See* Trial Tr. (8/9/2012), 77:14-20 (Buonomo).

113 Statement of Uncontested Facts, ¶ 34; Pl. Ex. 277 (settlement agreement between GM Nova Scotia and GM Canada).

114 Statement of Uncontested Facts, ¶¶ 33, 74; Pl. Ex. 144 at CC000135 (steps list).

2. Old GM And GM Nova Scotia Consented To The Nova Scotia Bankruptcy Case

As of June 1, 2009, GM Nova Scotia was paying its debts as they came due.[115] Nonetheless, Old GM caused GM Nova Scotia to consent to a bankruptcy order, which GM Nova Scotia delivered on June 4, 2009.[116]

3. Old GM Entered Into A $1 Billion Pension Escrow Agreement After The Petition Was Filed Without Court Approval

In July 2009, Old GM and GM Canada entered into a currency transaction pursuant to which GM Canada sold CAD $1 billion to Old GM in exchange for USD $860,511,143.62 from Old GM (the "**FX Transaction**").[117] New GM asserts that Old GM was repaid the $450 Million Loan in full through offsets to Old GM's USD $860,511,143.62 payment obligation to GM Canada under the FX Transaction.[118] However, Old GM never incurred a payment obligation to GM Canada in connection with the FX Transaction because the evidence demonstrates that the CAD $1 billion due to Old GM was never paid to Old GM. Instead, as explained below, the CAD $1 billion was paid to satisfy a pension obligation on behalf of GM Canada. Because Old GM did not validly incur any such obligation, the transfer did not in any way benefit Old GM. Therefore, any offsets to Old GM's payment obligation to GM Canada under the FX Transaction could not have fulfilled GM Canada's obligation to repay the $450 Million Loan.

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115 As of March 2, 2009, GM Nova Scotia had not missed any payments due on the Notes. Trial Tr. (9/27/2012), 27:13-16 (Bolin). As of June 1, 2009, the next payments to be made on the Notes were not due until July and December 2009. *See* Pl. Ex. 315, ¶ 3 (GHW0003641), ¶ 6 (GHW0003644) (schedule 1 to fiscal and paying agency agreement). Further, no payments were due on the Swaps until December and July 2009. *See id.*, Ex. E at GHW003738 (confirmation for the GBP 350,000,000 swap) and GHW0003743 (confirmation for the GBP 250,000,000 swap).

116 Bolin Decl., ¶ 63; Buonomo Decl., ¶ 78; Statement of Uncontested Facts, ¶ 58. *See also* Pl. Ex. 450 at NGM000004223 (email chain between J. Holy, L. Buonomo and others, dated April 20 and 21, 2010, attaching Old GM approval to GM Nova Scotia bankruptcy consent, dated "as of June 1, 2009" and faxed on June 8, 2009).

117 Lopez Decl., ¶ 5; Def. Ex. 425 (the "**Direction & Acknowledgement**").

118 Trial Tr. (3/6/2013), 53:9-25 (Lopez); Lopez Decl., ¶ 5.

While a debtor-in-possession, in July 2009, Old GM entered into a postpetition pension escrow agreement, pursuant to which Old GM seemingly agreed to fund a pension obligation of GM Canada of over CAD $1 billion.[119] Prior to this purported agreement, Old GM had no obligation whatsoever with respect to GM Canada's pension plan. No Court approval was sought or obtained for Old GM's entry into this agreement. The validity of this unauthorized, postpetition CAD $1 billion purported obligation is the lynchpin of New GM's and the Noteholders' contention that the $450 Million Loan was repaid through a series of offsetting transactions.

Tyrone Lopez of GM Canada testified that GM Canada wired the CAD $1 billion under the FX Transaction in order to fund payment of a pension obligation of GM Canada.[120] This obligation, however, was intended to be an obligation of *New GM*, as reflected in various drafts of the pension escrow agreement that were circulated prior to the entry of the Court's order approving the 363 Sale on July 5, 2009 (the "**Sale Order**").[121] An escrow account was established at CIBC as a New GM account for this transaction.[122] However, because the parties did not anticipate that the Sale Order would include a five day stay of the order,[123] Old GM was substituted at the last minute on July 6, 2009 for New GM as the counterparty to the pension

119 Pl. Ex. 717 (email from A. Hartog to A. Sundaram and others, dated July 7, 2009, attaching executed copy of the Pension Escrow Agreement); Trial Tr. (3/6/2013), 40:12-15 (Lopez).

120 Trial Tr. (3/6/2013), 40:12-15; 63:1-64:3 (Lopez).

121 *Id.* at 39:12-40:6; 42:19-43:18. *See* Pl. Ex. 707 (email from A. Hartog to A. Sundaram and others, dated July 2, 2009, attaching draft pension escrow agreement as of July 2, 2009 with General Motors Company as a party); Pl. Ex. 709 (email from A. Hartog to A. Sundaram and others, dated July 3, 2009, attaching draft escrow agreement as of July 3, 2009 that references NGMCo., Inc.).

122 *See* Pl. Ex. 708 at NGM000040485 (email from G. Krowles at CIBC, dated July 3, 2009, to A. Hartog and others sending wiring instructions for "GM Company" pension escrow account); Pl. Ex. 710 at NGM000043437 (email from A. Sundaram to T. Lopez and others, dated July 4, 2009, discussing "CIBC preferences for C$1B NewCo escrow"); Pl. Ex. 764 at NGM000040841 (email from A. Sundaram to G. Krowles at CIBC, dated July 6, 2009, discussing timing of funding for "the C$1B escrow under GM New Co").

123 *See* Sale Order, ¶ 70 [Bankr. Dkt. No. 2968].

escrow agreement.[124] Thus, without ever seeking or obtaining Court approval, Old GM purportedly incurred a postpetition pension liability of over CAD $1 billion on behalf of GM Canada that was always intended to be a New GM obligation.

While Old GM was substituted for New GM as the pension obligor, there is no evidence that Old GM was similarly substituted for New GM on the CIBC escrow account into which GM Canada paid the CAD $1 billion under the FX Transaction. Lopez testified that Old GM's usual account for foreign currency transactions was at JPMorgan, and the CIBC account was set up for the escrow transaction.[125] Lopez made no inquiry as to who owned the account and he does not know whether the account was for the benefit of New GM or Old GM.[126] The documentary evidence, on the other hand, supports an inference that the CIBC account remained a New GM account.[127] Subsequent amendments to the pension escrow agreement ensured that the return of the CAD $1 billion from the escrow account went to New GM for payment of the pension obligation and not Old GM,[128] and no funds were ever returned to Old GM.

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[124] Trial Tr. (3/6/2013), 45:21-46:10 (Lopez) (Old GM was substituted for New GM); Pl. Ex. 712 (email from A. Hartog to A. Sundaram and others, dated July 6, 2009, regarding substituting New GM for Old GM as a party and attaching revised pension escrow agreement); Pl. Ex. 764 (email from A. Sundaram to G. Krowles, dated July 6, 2009: "Due to the stay provision in the 363 Sale Order passed last night . . . we may need to have an escrow GM Old Co, which need to move to NewCo for the C$1B"). *See also* Pl. Ex. 717 (email from A. Hartog to A. Sundaram and others, dated July 7, 2009, attaching an executed copy of the pension escrow agreement).

[125] Trial Tr. (3/6/2012), 61:18-23, 63:1-14, 65:19-25, 67:19-69:5 (Lopez).

[126] *Id.* at 64:10-25, 65:1-13, 66:7-9.

[127] *See* Pl. Ex. 710 at NGM000043437 (email from A. Sundaram to T. Lopez and others, dated July 4, 2009, discussing "CIBC preferences for C$1B NewCo escrow"); Pl. Ex. 764 (email from A. Sundaram to G. Krowles at CIBC, dated July 6, 2009, discussing timing of funding for "the C$1B escrow under GM New Co"). *See also* Pl. Ex. 717 at WGM00150626-30 (the escrow account terms and conditions attached to the executed copy of the pension escrow agreement reference "General Motors Company" (*i.e.*, New GM)).

[128] *See* Pl. Ex. 720 (email, dated July 9, 2009 from S. Di Cresce to G. Krowles and others attaching a fully executed copy of the amending agreement to the pension escrow agreement); Pl. Ex. 724 (email, dated September 2, 2009, from M. Arias to A. Hartog and others attaching executed second amending agreement to the pension escrow agreement).

C. No Party Sought Court Approval For The Lock-Up Agreement

1. The Lock-Up Agreement Parties Made A Deliberate Choice Not To Seek Court Approval

Although the Lock-Up Agreement was finalized and implemented postpetition and provided for use of Old GM's property outside of the ordinary course of business, neither the Lock-Up Agreement nor the transactions thereunder were disclosed to the Court, much less presented for Court approval.[129] The parties discussed obtaining bankruptcy court approval during the Lock-Up Agreement negotiations, but decided against it.[130] Zirinsky concluded that perhaps Court approval was "not so important."[131] Prieto noted on May 30, 2009 that the deal would not require Court approval because Old GM was "not a party to the agreement"[132] as of May 30. Even though Old GM was added as a party to the Lock-Up Agreement after Prieto's May 30 note, no party ever sought Court approval for the Lock-Up Agreement. Indeed, as Buonomo testified, he is not aware of any specific effort having been made to even disclose the

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[129] New GM now contends that the Lock-Up Agreement and the transactions thereunder are outside of the review of this Court because the agreement was allegedly acquired by New GM as part of the 363 Sale. The evidence, however, establishes that the Lock-Up Agreement was not an executory contract and, even if it was, it was never assumed and assigned or otherwise transferred to New GM. In particular, the assumption and assignment procedures were not followed with respect to the Lock-Up Agreement. *See* Pl. Ex. 275, ¶ 10 (June 2, 2009 order approving the June 1, 2009 master sale and purchase agreement (the "**Sale Procedures Order**") (Bankr. Dkt. No. 274) (as a condition precedent to the assumption of an executory contract, Old GM was required to provide an assumption and assignment notice containing an objection deadline to the contracting counterparty, in the form attached as Exhibit D to the Sale Procedures Order, with instructions for how to access the assumption and assignment database); Pl. Ex. 154 (email from S. Webber to L. Buonomo, dated Nov. 19, 2009, informing Buonomo that no assumption notice was ever sent because the Lock-Up Agreement was "submitted without a mailing address"). Even if the Lock-Up Agreement was somehow transferred to New GM, such transfer does not immunize the agreement and its transactions from this Court's review.

[130] *See* Trial Tr. (8/8/2012), 22:13-21 (Zirinsky); Gropper Decl., ¶ 67; Trial Tr. (9/28/2012), 58:24-59:21 (Gropper).

[131] Pl. Ex. 4 (email from B. Zirinsky to D. Gropper and others, dated May 30, 2009, stating "perhaps court approval isn't so importnat [sic]"; Trial Tr. (8/8/2012), 30:7-31:1 (Zirinsky).

[132] *See also* Pl. Ex. 3 at AUR_GM021454 (Prieto notebook) ("GM is not a party to the agreement, do not envision this being approved by the Bankruptcy Court").

Lock-Up Agreement to the Court.[133]

2. The Lock-Up Agreement Transactions Were Structured To Evade Court Scrutiny

The Lock-Up Noteholders wanted to ensure that the Consent Fee funds were not in an Old GM account when it filed for bankruptcy.[134] Therefore, funds were transferred from Old GM on May 29 in contemplation of payment to the Noteholders, although there was no Lock-Up Agreement, and thus no deal at the time.[135] Zirinsky wanted to be comfortable that the transaction would be structured in a way to avoid potential attack.[136] On a call on May 31, 2009 with Old GM and counsel, the parties discussed how to shield the settlement from scrutiny. The plan was described as follows in Prieto's notes: "the money is in a trust account in Canada where it is being held for this deal – does not think that money will be attackable where it is now . . . the rights to this preference will be assumed by NewCO [sic] in the 363."[137]

IV. THE NOVA SCOTIA BANKRUPTCY CASE

The Lock-Up Agreement paved the way for the Lock-Up Noteholders to petition GM Nova Scotia into a bankruptcy proceeding in Canada (the "**Nova Scotia Bankruptcy Case**"), which would not be contested or otherwise challenged by Old GM, thus manufacturing the "winding up" necessary under Nova Scotia law to assert the Nova Scotia Trustee Claim. The Lock-Up Noteholders hand-picked a trustee, Green Hunt Wedlake, Inc. ("**Wedlake**" or "**Nova**

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[133] Trial Tr. (8/10/2012), 132:12-15 (Buonomo). Buonomo is also unaware of any instance in which the existence or assignment of the Swaps was specifically disclosed to the Court. *Id*. at 131:19-132:6.

[134] Trial Tr. (8/8/2012), 41:7-43:12, 44:9-14 (Zirinsky). *See also* Trial Tr. (9/28/2012), 66:9-12 (Gropper) (it was important that funds not be in a GM account at the time of GM's bankruptcy petition).

[135] Trial Tr. (8/9/2012), 69:15-70:7 (Buonomo).

[136] Trial Tr. (8/8/2012), 38:15-18 (Zirinsky) ("[W]e wanted to be comfortable that the way this transaction was going to be structured would do so, would do it in the right way so that there wouldn't be any potential attack.").

[137] *See* Pl. Ex. 3 at AUR_GM021457.

Scotia Trustee") to assert this claim,[138] impressing upon Wedlake that its "most important" activity would be to pursue the Nova Scotia Trustee Claim.[139] On October 9, 2009, GM Nova Scotia was adjudicated bankrupt and Wedlake was appointed as bankruptcy trustee.[140]

A. Wedlake Was Deeply Intertwined With And Acted For The Benefit Of The Lock-Up Noteholders

Wedlake was not a stranger to the Lock-Up Noteholders, with whom it had worked for months prior to the Petition Date, first as a proposed receiver for the assets of GM Nova Scotia in the Oppression Action,[141] and later as a proposed replacement monitor nominated by Aurelius, Appaloosa and Fortress in a potential Canadian bankruptcy proceeding for GM Nova Scotia.[142] Wedlake never disclosed to the Superintendent of Bankruptcy in Canada that it was asked to serve as interim receiver in the Oppression Action or that it was asked to serve as replacement monitor.[143] Wedlake was also represented in the Old GM Bankruptcy Case by Greenberg Traurig, who until after the Committee filed its initial objection, represented both Wedlake and the Lock-Up Noteholders simultaneously.[144] The original Rule 2019 statement filed by Greenberg Traurig did not disclose that Greenberg Traurig represented Wedlake in addition to the Lock-Up Noteholders.[145]

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[138] Wedlake Decl., ¶ 13 (Wedlake consented to being proposed as bankruptcy trustee for GM Nova Scotia).

[139] *See* Pl. Ex. 460 at GHW00003351 (email from P. Huff to P. Wedlake, dated June 24, 2009).

[140] Wedlake Decl., ¶ 19.

[141] Bolin Decl., ¶ 21; Gropper Decl., ¶ 23; Wedlake Decl., ¶¶ 7, 11.

[142] Trial Tr. (8/7/2012), 62:1-11, 65:19-66:3 (Wedlake). *See also* Pl. Ex. 202 at GHW0000751 (email from P. Huff to P. Wedlake, dated June 2, 2009) ("Looking forward to working with you, first proposed receiver, then proposed replacement monitor, now trustee in bankruptcy. I think this retainer is going to stick.").

[143] Trial Tr. (8/7/2012), 66:24-67:12 (Wedlake).

[144] Trial Tr. (8/8/2012), 119:14-21 (Zirinsky).

[145] *Compare* Pl. Ex. 386 at Ex. A and Ex. B (initial Rule 2019 statement) *with* Pl. Ex. 387 at ¶ 3 (amended Rule 2019 statement); Trial Tr. (8/8/2012), 123:24-125:15 (Zirinsky).

Wedlake continued to work with Greenberg Traurig in other cases involving Nova Scotia unlimited liability companies and U.S. parent company guarantees. Greenberg Traurig represented Wedlake in the bankruptcy cases of *In re AbitibiBowater, Inc., et al.* (Case No. 09-11296) (Bankr. D. Del.) and *In re Smurfit Stone Container Corporation, et al.,* (Case No. 09-10235) (Bankr. D. Del.) in which Wedlake, as it did in this case, acted as trustee for Nova Scotia unlimited liability companies that were subsidiaries of U.S. debtors and asserted claims under section 135 of the Companies Act against the parent-guarantors in the parents' U.S. bankruptcy cases.[146] Lock-Up Noteholder Aurelius was a noteholder in both the *Smurfit* and *AbitibiBowater* matters,[147] and Zirinsky represented both Wedlake and Aurelius in those cases.[148]

Wedlake acted, since the inception of the Nova Scotia Bankruptcy Case, to preserve the Lock-Up Noteholders' control over the Nova Scotia Bankruptcy Case and to maximize all possible benefits for the Lock-Up Noteholders. Wedlake was aware that the initiation of the Nova Scotia Bankruptcy Case was within the Lock-Up Noteholders' control from and after June 2009[149] and that the Lock-Up Noteholders purposely waited three months following receipt of the Consent Fee to initiate GM Nova Scotia's bankruptcy.[150] Wedlake knew that the reason for this was to shield the Consent Fee from preference review,[151] but Wedlake failed to act on this

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[146] Wedlake Decl., ¶ 23; Tr. (8/7/2012), 57:14-59:10 (Wedlake); Trial Tr. (9/28/2012), 46:18-47:5 (Gropper).

[147] Trial Tr. (9/28/2012), 46:18-47:5 (Gropper).

[148] Trial Tr. (8/7/2012), 58:6-14, 58:24-59:2 (Wedlake); Trial Tr. (8/8/2012), 128:23-129:1 (Zirinsky). *See also* Pl. Ex. 64 (email from D. Cederholm to Q. Koffey, dated Dec. 7, 2010) ("Bruce Zirinsky, aka Double Dip Defender of the year").

[149] Trial Tr. (8/7/2012), 63:25-64:4 (Wedlake); Pl. Ex. 202 (email from P. Huff to P. Wedlake, June 2, 2009) ("We wanted to consent in hand now, so the timing is in our control."); Wedlake Decl., ¶ 14.

[150] Wedlake Decl., ¶ 18; Trial Tr. (8/7/2012), 93:9-20 (Wedlake); Pl. Ex. 32 at GHW0003353 (email from P. Huff to P. Wedlake, Sept. 8, 2009). *See also* Trial Tr. (9/28/2012), 71:17-72:18 (Gropper) (Noteholders waited at least 90 days after the extraordinary resolution was passed before petitioning GM Nova Scotia into bankruptcy).

[151] Trial Tr. (8/7/2012), 93:18-94:19, 98:1-7 (Wedlake). *See also* Pl. Ex. 440 (email from J. Holy to

Footnote continued on next page

knowledge.[152] Further, Wedlake, against the wishes of New GM[153] and against his own judgment,[154] capitulated to the Lock-Up Noteholders' insistence that no inspectors be appointed to supervise the Nova Scotia Bankruptcy Case.[155]

B. Wedlake Failed To Investigate GM Nova Scotia's Statement Of Affairs, Despite Known Irregularities

GM Nova Scotia was a "virtual" company with no employees, and at the time of the filing of its bankruptcy case, no officers or directors.[156] To fill this void, New GM, with assistance from GM Canada employees, prepared GM Nova Scotia's Statement of Affairs, a statutorily required summary of the debtor's assets and liabilities.[157] Maurita Sutedja, a former director of GM Nova Scotia, signed and delivered the Statement of Affairs for GM Nova Scotia on or about November 23, 2009.[158] At the time she signed this statement, she was employed by New GM,[159] which purported to be a creditor of GM Nova Scotia, and she had no role at GM

Footnote continued from previous page
G. Upton, dated July 13, 2009, regarding "[b]ackground discussion on waiting to file GMNS into bankruptcy to allow the 'preference period' to run-out, presumably . . . 3 months.").

[152] Under Canadian law, Wedlake is authorized to bring claims for transfers under value. Trial Tr. (8/7/2012), 95:4-12 (Wedlake). It occurred to him that the Lock-Up Agreement and Consent Fee could be transfers under value, but he did not pursue such claims. Trial Tr. (8/7/2012), 95:13-24 (Wedlake).

[153] Trial Tr. (8/7/2012), 106:5-17 (Wedlake). *See also* Pl. Ex. 45 (email from D. Prieto to M. Brodsky, dated Nov. 12, 2009) ("GM objected to only one of the resolutions (i.e., that no Inspectors be appointed), but we outvoted them."); Trial Tr. (9/28/2012), 78:16-23 (Gropper).

[154] Trial Tr. (8/7/2012), 106:5-17 (Wedlake).

[155] Trial Tr. (9/28/2012), 78:6-13 (Gropper) (discussing Aurelius' position); Trial Tr. (9/27/2012), 45:3-18 (Bolin) (Wedlake, using Appaloosa's proxy, made a motion that no inspectors be appointed); Wedlake Decl., ¶ 43 (Aurelius seconded that motion). The Noteholders did not want inspectors appointed because they were worried about being able to continue to trade without running afoul of SEC regulations. Trial Tr. (8/7/2012), 108:3-19 (Wedlake).

[156] Trial Tr. (8/7/2012), 20:9-19, 98:22-99:13 (Wedlake).

[157] Trial Tr. (8/7/2012), 29:4-9 (Wedlake). *See also* Trial Tr. (8/9/2012), 146:21-23 (Buonomo).

[158] Wedlake Decl., ¶ 46; Trial Tr. (8/7/2012), 19:11-19 (Wedlake).

[159] M. Sutedja Depo. Tr. (5/31/2012), 10:14-16; Trial Tr. (8/7/2012), 21:2-5 (Wedlake).

Nova Scotia.[160] The Statement of Affairs should have been prepared by a current officer or director of GM Nova Scotia or by Old GM, the sole shareholder. Instead, it was prepared by a New GM employee (a former Old GM employee until the 363 Sale) in order to implement the postpetition steps required by the Lock-Up Agreement.

The Statement of Affairs as delivered did not comply with Canadian law. Under Canadian law, the Statement of Affairs was due within five days of GM Nova Scotia's bankruptcy filing.[161] The Statement of Affairs in this case was not submitted until over one month later.[162] Canadian law also requires that the Statement of Affairs list the addresses of each creditor.[163] However, the Statement of Affairs for GM Nova Scotia does not list the addresses of the Noteholders or their names.[164] The only address listed in the statement is Sutedja's address at New GM.[165]

The Nova Scotia Trustee Claim reflects debts stated in the Statement of Affairs.[166] Despite the irregularities in the statement, and the fact that a purported creditor of the debtor prepared the document, Wedlake never spoke with Sutedja about what she did to satisfy herself that the Statement of Affairs was accurate.[167] Nor did he learn what she reviewed to prepare the

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160 Trial Tr. (8/7/2012), 21:6-13 (Wedlake).

161 *Id*. at 22:21-25.

162 *Id*. at 22:21-23:7. *See* Pl. Ex. 467 at GHW0001134-35 (email chain between D. Prieto and P. Wedlake, and others, dated Oct. 28 and 29, 2009, discussing the slow pace at which information regarding GM Nova Scotia was being provided).

163 Trial Tr. (8/7/2012), 33:12-15 (Wedlake).

164 *Id*. at 33:16-21.

165 *Id*. at 34:5-9.

166 *See* Pl. Ex. 315 at Attach., ¶ 7 (GHW0003596) (Nova Scotia Trustee Claim) (". . . Claimant claims payment from the Debtor [for] the full amount of the liabilities of Finance disclosed in Exhibit B [GM Nova Scotia's Statement of Affairs]").

167 Trial Tr. (8/7/2012), 29:24-25 (Wedlake).

statement.[168] Further, he never conducted an examination of the debtor with regard to the Statement of Affairs although he has the authority to do so.[169] All of the above demonstrates that the choreographed bankruptcy of GM Nova Scotia, which the Lock-Up Noteholders controlled, was designed to benefit New GM and the Noteholders while imposing all of the costs on Old GM's creditors.

C. Wedlake Failed To Investigate The Claims Filed Against GM Nova Scotia

Wedlake consulted with the Lock-Up Noteholders and New GM (and their counsel) and assisted them in preparing their proofs of claim to be filed in the Nova Scotia Bankruptcy Case.[170] The only claims filed in the Nova Scotia Bankruptcy Case were those of the Noteholders on account of amounts due under the Notes and the claim filed by New GM on November 9, 2009 on account of New GM's alleged acquisition of Old GM's position under the Swaps (the "**New GM Swap Claim**").[171] Because under the Lock-Up Agreement, any recovery on the Swaps is subordinated to the claims of the Noteholders if any amount of the Nova Scotia Trustee Claim is disallowed,[172] all claims filed in the Nova Scotia Bankruptcy Case inure to the benefit of the Noteholders. Further, because Wedlake included in the Nova Scotia Trustee Claim all the claims filed in the Nova Scotia Bankruptcy Case,[173] the larger the claims in the Nova Scotia Bankruptcy Case, the larger the Nova Scotia Trustee Claim in the Old GM Bankruptcy

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[168] *Id*. at 30:1-2.

[169] *Id*. at 22:7-17.

[170] Wedlake Decl., ¶¶ 27-29.

[171] *See* Pl. Ex. 315 at Ex. B (GHW0003606) (creditors are the Noteholders, New GM, and Osler, Hoskin & Harcourt, LLP); Trial Tr. (8/7/2012), 186:9-17 (Wedlake) (Osler never filed a proof of claim).

New GM Filed a claim in the amount of $564,493,957 based upon alleged liability arising under the Swaps. Statement of Uncontested Facts, ¶ 64; Wedlake Decl., ¶ 29. *See* Pl. Ex. 139 (New GM Swap Claim).

[172] Pl. Ex. 16, ¶ 6(v) (WGM00000800).

[173] Trial Tr. (8/7/2012), 186:25-187:3 (Wedlake).

Case and the larger the potential recovery to the Noteholders.[174]

Wedlake, though empowered to object to claims under the Canadian Bankruptcy and Insolvency Act,[175] did not object to any claim in the Nova Scotia Bankruptcy Case.[176] Moreover, as discussed below, he did not investigate the validity of those claims prior to including them in the Nova Scotia Trustee Claim.

V. THE NOVA SCOTIA TRUSTEE CLAIM

On November 30, 2009, Wedlake filed the Nova Scotia Trustee Claim in the Old GM Bankruptcy Case, seeking not less than $1,607,647,592.49.[177] This is the largest proof of claim Wedlake has ever filed,[178] and represents the sum total of all the claims that Wedlake contends were filed in the Nova Scotia Bankruptcy Case.[179] The Nova Scotia Trustee Claim consists of (1) a claim for the unpaid principal and interest purportedly owed on the Notes as of October 9, 2009; and (2) a claim in the amount of USD $564,493,957, which purports to represent amounts owed by GM Nova Scotia to New GM under the Swaps.[180]

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174 *See* Trial Tr. (9/28/2012), 25:11-22 (Gropper) (the larger the swap claim, the more benefit the Noteholders would have).

175 Trial Tr. (8/7/2012),79:4-7 (Wedlake).

176 *Id*. at 80:16-22.

177 *Id*. at 14:2-7; Pl. Ex. 315 (Nova Scotia Trustee Claim).

178 Trial Tr. (8/7/2012), 14:8-13 (Wedlake).

179 *Id*. at 23:8-24:1; Pl. Ex. 315 at Attach., ¶ 7 (GHW0003596) (Nova Scotia Trustee Claim).

180 Pl. Ex. 315 at Attach., ¶¶ 5-7 (GHW0003594-96).

A. The Swap Claim Is Invalid

1. Wedlake Included The Swaps In The Nova Scotia Trustee Claim, Even Though Wedlake Had Not Determined The Validity Of The New GM Swap Claim

The Swaps make up more than half a billion dollars of the Nova Scotia Trustee Claim.[181] Because the Nova Scotia Trustee Claim is simply the sum total of the purported liabilities of GM Nova Scotia, the validity of the Nova Scotia Trustee Claim depends on the validity of the underlying claims against GM Nova Scotia. Wedlake, however, had not determined whether the New GM Swap Claim was valid prior to including its face amount in the Nova Scotia Trustee Claim.[182] Although Wedlake expended millions to administer the Nova Scotia Bankruptcy Case,[183] it will not make a final determination on the validity of any claim filed in the Nova Scotia Bankruptcy Case unless and until Old GM makes a distribution on the Nova Scotia Trustee Claim.[184]

There was a view at New GM that the Swaps should not be included when calculating the Nova Scotia Trustee Claim.[185] Nevertheless, Aurelius recommended that the swap liability be included,[186] and Wedlake succumbed to this request. Wedlake, having no particular familiarity with swap agreements and having never been involved with calculating liability under a swap

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181 *See* Pl. Ex. 315 at Attach., ¶¶ 5-7 (GHW0003594-96); Trial Tr. (8/7/2012), 57:7-10 (Wedlake).

182 *See* Trial Tr. (8/7/2012), 56:22-57:10 (Wedlake).

183 Wedlake Decl., ¶¶ 51-52. *See also* Trial Tr. (8/7/2012), 111:24-112:24 (Wedlake) (Wedlake recovered over $2.3 million in assets for GM Nova Scotia, which was used to pay for the administration of the GM Nova Scotia estate, including legal fees for Wedlake's counsel, Greenberg Traurig and Akin Gump.).

184 *See* Trial Tr. (8/7/2012), 79:12-80:1 (Wedlake).

185 *See* Pl. Ex. 248 at AUR_GM039690-R (05-2012) (email from D. Prieto to D. Gropper, dated July 27, 2009).

186 Trial Tr. (9/28/2012), 84:13-22 (Gropper).

contract,[187] relied on Aurelius[188] and Greenberg Traurig,[189] who prepared Wedlake's proof of claim.[190] Although a draft of the Nova Scotia Trustee Claim initially did not include a claim for the Swaps[191] and a later draft included a claim for the Swaps with the caveat that the amounts are claimed "to the extent such [s]wap [c]laim is valid" and that Wedlake has not verified the claim or the amounts due thereunder,[192] the final, filed document simply asserts a claim for $564,493,957 on account of the Swaps with no qualifying language.[193]

Wedlake had – and continues to have – reason to doubt the validity and amount of the New GM Swap Claim. Notably, Wedlake included the Swaps in the Nova Scotia Trustee Claim without ever seeing signed copies of the governing swap documents,[194] having been told that such copies could not be located.[195] Wedlake was aware there would be valuation issues with

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[187] Trial Tr. (8/7/2012), 37:8-10, 41:3-6 (Wedlake).

[188] Trial Tr. (9/28/2012), 44:12-16; 45:5-8 (Gropper); Pl. Exs. 475 and 476 (D. Prieto is copied on the emails in Nov. 2009 and the drafts reflect Prieto's input); Pl. Ex. 463 (email chain between D. Prieto and P. Wedlake in Oct. 2009, discussing the Nova Scotia Trustee Claim). In fact, Aurelius received information regarding the Swaps back in July 2009 and copies of the governing swap documents which were not publicly available. Trial Tr. (9/28/2012), 41:18-42:6 (Gropper); Pl. Ex. 248 (email from D. Prieto to D. Gropper, dated July 27, 2009, discussing Swaps); Pl. Ex. 468 (email from P. Wedlake to D. Prieto, dated Nov. 2, 2009, attaching swap documents).

[189] Trial Tr. (8/7/2012), 44:16-45:2 (Wedlake); Trial Tr. (8/8/2012), 96:21-97:16 (Zirinsky).

[190] Wedlake Decl., ¶ 53; Trial Tr. (8/7/2012), 16:10-12, 194:23-195:2 (Wedlake).

[191] *See* Pl. Ex. 476 at GHW0001402-06 (email chain between N. Mitchell of Greenberg Traurig and D. Prieto and others, forwarded to P. Wedlake, between Oct. 30 and Nov. 4, 2009, attaching draft of the Nova Scotia Trustee Claim prepared by Greenberg Traurig); Trial Tr. (8/7/2012), 49:6-14 (Wedlake).

[192] Pl. Ex. 475, ¶ 6, n.3 (GHW0002240) (Nova Scotia Trustee Claim attached to email from N. Mitchell, dated Nov. 16, 2009).

[193] *Compare* Pl. Ex. 315 at Attach., ¶ 6 (GHW0003595) *with* Pl. Ex. 475, ¶ 6, n.3 (GHW0002240). *See also* Trial Tr. (8/7/2012), 55:12-17 (Wedlake).

[194] Aurelius told Wedlake that without seeing a signed copy of the swap agreements, they could not be sure what the governing documents were. Trial Tr. (8/7/2012), 73:6-10 (Wedlake). *See also* Pl. Ex. 199 (email from D. Prieto to P. Wedlake, dated Nov. 12, 2009); Pl. Ex. 468 (email from D. Prieto to P. Wedlake, dated Nov. 3, 2009).

[195] Trial Tr. (8/9/2012), 101:25-102:2 (Buonomo); Trial Tr. (8/7/2012), 37:1-7 (Wedlake).

the Swaps,[196] and knew the Lock-Up Noteholders' Canadian counsel acknowledged that the actual amounts owed on the Swaps would be less than the amount asserted in the New GM Swap Claim.[197] Wedlake also knew that the New GM Swap Claim calculated the amount due by the mark-to-market method, contrary to the terms of the Swap Documents,[198] and was aware the Swaps had not been terminated at the time Wedlake included the Swaps in the Nova Scotia Trustee Claim.[199] Before submitting the claim, Wedlake had also seen a GM Nova Scotia balance sheet that showed a dash rather than a value for the swap liability,[200] but did not question the entry (which can only mean zero).[201]

Despite these facts, Wedlake does not recall having any conversations with Sutedja regarding the dollar amount of the New GM Swap Claim,[202] and did not consult with any outside experts prior to submitting the Nova Scotia Trustee Claim.[203] Rather, Wedlake asserts that it relied on the New GM Swap Claim itself and the Statement of Affairs to verify the amounts that were due under the Swaps and to determine who holds the Swap claim against GM Nova Scotia.[204] Both the New GM Swap Claim and the Statement of Affairs, however, were prepared

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[196] Pl. Ex. 202 (email from P. Huff to P. Wedlake, dated June 2, 2009, in which Huff states "there may be some valuation issues over that [swap] claim"); Trial Tr. (8/7/2012), 66:13-18 (Wedlake).

[197] *See* Pl. Ex. 145 at GHW0002553-54 (email from R. MacKeigan to P. Huff, dated Dec. 16, 2009) (R. MacKeigan notes that P. Huff stated that "the amount owed to [New] GM would then be somewhat less than the amount stated in its proof of claim").

[198] Trial Tr. (8/7/2012), 76:11-16 (Wedlake); Pl. Ex. 468 (email from D. Prieto to P. Wedlake, dated Nov. 3, 2009 noting that the amount of the Final Exchange is paid upon early termination of the Swaps).

[199] *See* Pl. Ex. 316 (email from S. Golick to P. Wedlake and others, dated Jan. 15, 2010, and correspondence from P. Wedlake, dated January 12, 2010, purporting to terminate the Swaps).

[200] *See* Pl. Ex. 249 at GHW0001375 (GM Nova Scotia balance sheet as of Sept. 30, 2009, with dashes inserted for the Swaps' value). "Typically a dash will represent zero." M. Sutedja Depo. Tr. (5/31/2012), 167:5-20.

[201] Trial Tr. (8/7/2012), 120:25-121:7 (Wedlake).

[202] *Id*. at 34:21-23.

[203] *Id*. at 45:3-5.

[204] *Id*. at 187:23-188:6.

by New GM,[205] the very party purporting to claim under the Swaps. Further, Wedlake knew that New GM actually revised the Statement of Affairs to conform to the New GM Swap Claim.[206]

2. The Swaps Are Not A Valid And Enforceable Claim Against Old GM

a. The Swaps Were Not Acquired By New GM

New GM has no rights under the Swaps because the Swaps were not transferred to New GM as part of the 363 Sale. The Swaps are governed by an unsigned 1992 ISDA Master Agreement, a Schedule to the ISDA Master Agreement dated October XX, 2001 and two confirmations dated July 10, 2003 (collectively, the "**Swap Documents**").[207] The only swap agreement listed in the assumption and assignment database is an "ISDA Master Agreement dated October 15, 2001."[208] There is no ISDA Master Agreement dated October 15, 2001 applicable to the Swaps.[209] Because the applicable Swap Documents were not listed in the assumption and assignment database pursuant to this Court's assumption and assignment procedures, the Swaps were not assumed and assigned to New GM.[210]

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[205] *Id*. at 43:21-44:3, 180:21-181:12.

[206] *Id*. at 188:16-189:20; Pl. Ex. 449 at NGM000016111 (email from M. Munro to P. Wedlake, dated Nov. 12, 2009).

[207] Pl. Ex. 315 at Ex. E (GHW00003705-46) (Nova Scotia Trustee Claim).

[208] Pl. Ex. 281 (email to R. Berkovich from K. Cooperman, dated May 20, 2010, attaching excerpt from assumption and assignment database) (last page).

[209] *See* Pl. Ex. 315; Trial Tr. (8/9/2012), 132:13-21 (Buonomo).

The Swaps not having been assumed and assigned is consistent with Pl. Ex. 22 (email from L. Buonomo to D. Prieto, July 30, 2009) in which Buonomo states: "I inquired with Weil Gotshal, which reminded me that inasmuch as the Swap was not assigned this decision rests with Motors Liquidation Company (Oldco), which apparently has it under review."

[210] The Swaps are also not "Purchased Assets" under the Amended and Restated Master Sale and Purchase Agreement ("**MSPA**") and were not sold to New GM as part of the 363 Sale. Under the MSPA, a "Purchased Asset" is determined as it "exist[s] as of the Closing." *See* Def. Ex. 226 at MSPA § 2.2(a) (Sale Approval Order attaching MSPA and its amendments) (Bankr. Dkt. No. 2968). An "Intercompany Obligation" is defined as one "owed or due, directly or indirectly, to" Old GM by its subsidiary. *Id*. at MSPA § 2.2(a)(iv). Thus, whether an obligation falls under the definition of "Intercompany Obligation" is determined as of the "Closing" of the 363 Sale (July 10, 2009). Here, as of July 10, 2009, there was no

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b. The Swaps Were Not Terminated

To the extent that the Swaps were acquired by New GM, which they were not, it is the termination of the Swaps that crystalizes liability and gives rise to a claim.[211] Under the ISDA Master Agreement, the bankruptcy of GM Nova Scotia constituted an event of default entitling the non-defaulting party (*i.e.*, New GM) to terminate the Swaps by issuing a notice.[212] New GM never sent any notice terminating the swaps.[213] Indeed, Aurelius believed that "[t]here may be a benefit in [the Noteholders] sending the termination notice to [New] GM rather than the other way around,"[214] and Wedlake was informed that New GM was not inclined to terminate the Swaps.[215] The idea of terminating the Swaps ultimately came from Aurelius.[216] Wedlake kept Aurelius advised as Wedlake discussed termination of the Swaps with New GM.[217] On January 12, 2010, Wedlake sent a letter to counsel for New GM stating that it was disclaiming the Swaps under three conditions: (i) that New GM will "acknowledge" that the Swaps are terminated as of October 9, 2009, the date of GM Nova Scotia's bankruptcy petition; (ii) that New GM will agree

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obligation outstanding under the Swaps. Accordingly, the Swaps are not "Intercompany Obligations" between New GM and GM Nova Scotia.

Even if the Swaps are subsumed in the definition of "Intercompany Obligations" (which they are not), they still would not be "Purchased Assets" because they are "Excluded Contracts" which are excluded from the definition of "Purchased Assets." *Id*. at MSPA § 2.2(a)(x). "Excluded Contracts" includes prepetition contracts that are not assumed contracts. *Id*. at MSPA § 2.2(b)(vii).

211 Trial Tr. (9/28/2012), 20:18-21:8, 22:2-18 (Gropper); Pl. Ex. 20 (email from D. Prieto to M. Brodsky, dated July 7, 2009).

212 *See* Pl. Ex. 315 at Ex. E, ¶¶ 5(a)(vii) (GHW0003710), 6(a) (GHW0003712) (ISDA Master Agreement attached to the Nova Scotia Trustee Claim).

213 Trial Tr. (8/7/2012), 46:25-47:2, 69:15-17 (Wedlake).

214 Pl. Ex. 28 at GHW0002044 (email from D. Prieto to P. Wedlake and others, dated Nov. 12, 2009).

215 Trial Tr. (8/7/2012), 81:19-22 (Wedlake); Wedlake Decl., ¶ 60. *See also* Pl. Ex. 145 at GHW0002553 (email from R. MacKeigan to P. Huff, dated Dec. 16, 2009).

216 Trial Tr. (8/7/2012), 82:19-23 (Wedlake).

217 *Id*. at 88:6-16. *See, e.g.,* Pl. Ex. 146 (email from R. MacKeigan to D. Prieto, dated Jan. 12, 2010).

that its claim will be calculated as of October 9, 2009; and (iii) that New GM will acknowledge that Wedlake had not, as of that time, accepted the New GM Swap Claim as filed.[218] By email dated January 15, 2010, New GM agreed to Wedlake's conditions.[219] This procedure, however, was not sufficient under the Swap Documents to terminate the Swaps.

3. The New GM Swap Claim And Nova Scotia Trustee Claim Overstate The Amount Of The Swap Claim By Over $200 Million

Even if the New GM Swap Claim and Swaps component of the Nova Scotia Trustee Claim were valid, the amount of the claim is overstated by more than $200 million. The Swaps were to terminate by their terms on December 7, 2015[220] and July 10, 2023.[221] If terminated in January 2010, the Swaps would have been terminated years before their contractual termination dates. The confirmations to the Swaps control what payments are due upon early termination.[222] In this case, the confirmations to the Swaps specified that upon early termination, "the Market Quotation Method will not hold" and instead, the parties shall pay each other the "amounts of the Final Exchange plus any accrued and unpaid amounts" (the "**Final Exchange Method**").[223] The New GM Swap Claim, however, calculated the purported swap liability using the Market Quotation Method,[224] which is the method expressly rejected by the parties to the Swaps and

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[218] Statement of Uncontested Facts, ¶ 68; Wedlake Decl., ¶¶ 63, 66; Buonomo Decl., ¶ 83; Pl. Ex. 316.

[219] Statement of Uncontested Facts, ¶ 69; Buonomo Decl., ¶ 83; Wedlake Decl., ¶ 66; Trial Tr. (8/7/2012), 81:12-18 (Wedlake); Pl. Ex. 316.

[220] Pl. Ex. 315 at Ex. E (GHW0003738) (confirmation for GBP 350,000,000 swap).

[221] *Id*. at Ex. E (GHW0003743) (confirmation for GBP 250,000,000 swap).

[222] Pl. Ex. 315 at Ex. E (GHW00003737, 3742) (Nova Scotia Trustee Claim); Overdahl Decl., Ex. A at 14 ("**Overdahl Report**").

[223] Pl. Ex. 315 at Ex. E (GHW00003737, 3742) (Nova Scotia Trustee Claim); Overdahl Report at 14.

[224] Trial Tr. (8/9/2012), 110:4-7, 116:9-14 (Buonomo). *See also* Trial Tr. (8/7/2012), 76:11-16 (Wedlake).

which yielded an amount $200 million higher than under the Final Exchange Method.[225] Although New GM's internal documents suggested a claim amount that was $200 million lower than its asserted claim,[226] New GM chose the Market Quotation methodology among the alternative methodologies suggested by New GM's Finance staff,[227] which yielded the higher claim amount.

Under the Final Exchange Method in accordance with the Swap Documents, the New GM Swap Claim would be no more than $351,192,405 assuming a termination date of October 9, 2009 (the date of GM Nova Scotia's bankruptcy filing) and $331,504,266 assuming a termination date of January 15, 2010 (the date of acknowledgement of early termination by New GM).[228]

B. The Portion Of The Nova Scotia Trustee Claim Relating To The Notes Is Duplicative Of The Guarantee Claims

On or about November 30, 2009, the Noteholders filed the Guarantee Claims in the Old GM Bankruptcy Case asserting claims on account of Old GM's guarantee of the Notes in the collective amount of $1,072,557,531.72, representing the alleged unpaid principal and interest owed on the Notes as of October 9, 2009.[229] Both the Nova Scotia Trustee Claim and the Guarantee Claims assert claims of over $1 billion for amounts due under the Notes. There is no dispute that the portion of Wedlake's claim[230] relating to the Notes is on account of the same

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[225] Trial Tr. (8/10/2012), 106:11-14 (Buonomo); Overdahl Report at 14-17.

[226] Trial Tr. (8/9/2012), 120:1-14 (Buonomo); Pl. Ex. 141 (email from L. Buonomo to S. Golick, dated Nov. 9, 2009, attaching a range of swap calculations for early termination payments from $170 million to $332 million based on different dates). *See also* Pl. Ex. 144 at CC00135 (steps list) (describing swap liability as CAD $258 million).

[227] Trial Tr. (8/9/2012), 127:6-12 (Buonomo).

[228] Overdahl Decl., ¶ 5; Overdahl Report, p. 14-17; Trial Tr. (11/26/2012), 180:6-181:2 (Shoji).

[229] Statement of Uncontested Facts, ¶ 67.

[230] Although nominally asserted by the Nova Scotia Trustee, the Nova Scotia Trustee Claim is for

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liability as the Guarantee Claims.[231] Thus, the component of the Nova Scotia Trustee Claim relating to the Notes represents an attempt to recover two times for one claim.[232] The Nova Scotia Trustee's own expert conceded at trial that the Guarantee Claims and a claim under section 135 serve the same purpose and that these claims are functional equivalents of each other.[233] Further, Old GM's books and records indicate that there is no accounting impact of the guarantee because accounting for the primary bond obligation and the guarantee would "effectively double count" the obligation.[234]

ARGUMENT

I. SECTION 502(d) OF THE BANKRUPTCY CODE REQUIRES DISALLOWANCE OF THE DISPUTED CLAIMS

Section 502(d) promotes the *pro rata* sharing of the bankruptcy estate among all creditors by precluding claimants that received avoidable transfers from sharing in the distribution of the assets of the estate.[235] Section 502(d) provides, in relevant part, that "the court *shall disallow* any claim of any entity from which property is recoverable under section . . . 550 . . . or that is a transferee of a transfer avoidable under section . . . 547, 548, [or] 549 . . . unless such entity or transferee has paid the amount, or turned over any such property. . . ." 11 U.S.C. § 502(d)

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the benefit of the creditors of GM Nova Scotia. Trial Tr. (8/7/2013), 159:18-160:1 (Wedlake). The Noteholders viewed this claim as belonging to them. *See* Pl. Ex. 17, ¶ 2 (AUR_GM020473) (draft stipulation prepared by Greenberg Traurig, which states "parties agree that the [h]olders of the Notes have . . . the deficiency claim. . . .").

[231] *Compare* Def. Ex. 290 at Attach., ¶¶ 1-2 (DEF3163) (Aurelius' Guarantee Claim) *with* Pl. Ex. 315 at Attach., ¶ 5 (GHW0003594) (Nova Scotia Trustee Claim).

[232] *See* Pl. Ex. 383 at MS&CO_GM_A_0001212 (email from D. Ammann to C. Liddell at Morgan Stanley, dated Jan. 22, 2010).

[233] Trial Tr. (11/26/2012), 57:18-58:19 (Iacobucci).

[234] Trial Tr. (8/9/2012), 141:20-142:2 (Buonomo); Pl. Ex. 152 at NGM000017558 (email from NYTO Controller's Group to file, dated July 8, 2009).

[235] *Enron Corp. v. Ave. Special Situations Fund II, LP (In re Enron Corp.)*, 340 B.R. 180, 191 (Bankr. S.D.N.Y. 2006), *vacated sub nom. on other grounds*, *Enron Corp. v. Springfield Assoc., L.L.C. (In re Enron Corp.)*, 379 B.R. 425 (S.D.N.Y. 2007).

(emphasis supplied). Thus, disallowance is mandatory if a court finds that a claimant received an avoidable transfer and has failed to return it to the estate. Because Old GM's payment of the Consent Fee is an avoidable transfer, and that property has not been returned to the estate, the Disputed Claims should be disallowed.[236]

A. Payment Of The Consent Fee Is Avoidable

1. Payment Of The Consent Fee Was An Unauthorized Postpetition Transfer Under Section 549 Of The Bankruptcy Code

A transfer of property of the estate that occurs after the petition date and is not authorized by the court is avoidable under section 549 of the Bankruptcy Code.[237] Here, the $450 million transfer is avoidable because it was an unauthorized postpetition transfer.

The $450 million transferred from Old GM to GM Canada was subject to the Trust Agreement, and that transfer was made for the sole purpose of paying the Consent Fee.[238] The

[236] We anticipate that the Defendants will argue that the GUC Trust cannot object under section 502(d) because the avoidance actions at issue were purportedly sold to New GM. This argument is misguided because the case law conclusively establishes that a claim may be disallowed under section 502(d) regardless of whether the claim for avoidance has been, or could be, brought. *See Enron Corp.*, 340 B.R. at 191 ("[T]here is no prohibition against the trustee's asserting section 502(d) as an affirmative defense to a claim of a creditor even if the trustee's claim is time-barred or otherwise nonrecoverable."). In any event, the underlying avoidance actions were not sold to New GM. First, a debtor cannot sell section 549 claims and thereby attempt to place questionable postpetition transactions beyond the supervision of the Court. New GM SJ Hr'g Tr. (7/19/2012), 83:18-22 (Court stating "[s]ection 363(b) and 549 would be renders [sic] nugatory by the simple act of assigning the right to bring the 549 action outside of the estate. That cannot be the law. Neither I, nor I think any other judge, could ever subscribe to such a suggestion."). Second, for the reasons discussed below, under the collapsing theory, payment of the Consent Fee was effectively a payment by Old GM to GM Nova Scotia for the benefit of the Noteholders. *Sullivan v. Messer (In re Corcoran)*, 246 B.R. 152, 160 (E.D.N.Y. 2000). Because GM Nova Scotia is not a "purchased subsidiary" under the MSPA, claims in connection with transfers to GM Nova Scotia were not sold to New GM.

[237] "Any entity asserting the validity of a transfer under § 549 of the Code shall have the burden of proof." Fed. R. Bankr. P. 6001; *see Manuel v. Allen (In re Allen)*, 217 B.R. 952, 955 (Bankr. MD. Fla. 1998) (noting once *prima facie* case is established, burden shifts to defendant to prove validity of transfer).

[238] Pl. Ex. 134 at NGM000000596 (Trust Agreement) ($450 Million Loan "conditioned on premise that funds be used solely to settle bond obligation of" GM Nova Scotia); *see also id.* at NGM000000602 ("GMC is desirous of providing a loan . . . the proceeds of which GM Nova Scotia shall use for the sole purpose of funding" an amendment to "the global securities representing the Notes to provide that such

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$450 million remained property of Old GM's estate because, as explained above, the conditions set forth in the Trust Agreement and the First Trust Amendment (even assuming it was a valid prepetition amendment, which it was not) were not met as of the filing of the petition.[239] *Fisher v. N.Y.C. Dep't of Hous. Pres. & Dev. (In re Pan Trading Corp. S.A.)*, 125 B.R. 869, 878 (Bankr. S.D.N.Y 1991) (if the agreed-upon escrow conditions are not satisfied, the debtor's residual interest is property of the estate). Indeed, as of the filing of the petition, it was impossible for those conditions to ever be satisfied because the Lock-Up Deadline and the Amended Lock-Up Deadline had already passed without having been further extended, and the Lock-Up Agreement was not signed and delivered by either of those deadlines. Therefore, as of the filing of Old GM's bankruptcy petition, Old GM still possessed a residual interest in the $450 million held in trust, and GM Canada's subsequent transfer of the Consent Fee to GM Nova Scotia, and all subsequent transfers of the Consent Fee thereafter, constituted unauthorized postpetition transfers of Old GM's property.[240]

Alternatively, even if the Court disregards the express conditions in the Trust Agreement (which it should not), the Court should still find that payment of the Consent Fee was an avoidable postpetition transfer by Old GM to the Noteholders. In substance, this series of transfers was a single transaction whereby Old GM paid the Consent Fee to the Noteholders.[241]

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Notes will become mandatorily exchangeable into cash").

[239] *Id*. at NGM000000602; Pl. Ex. 135 at NGM000012428-29 (Amending Agreement). *See supra* notes 103 through 114.

[240] The Bankruptcy Code expressly provides that the transfer need not be made directly by the debtor to be avoidable. 11 U.S.C. § 101(54)(D) (defining a transfer to include indirect dispositions).

[241] *HBE Leasing Corp. v. Frank*, 48 F.3d 623, 635 (2d Cir.1995); *see also Orr v. Kinderhill Corp.*, 991 F.2d 31, 35 (2d Cir.1993) ("[w]here a transfer is only a step in a general plan, the plan must be viewed as a whole with all its composite implications") (citations and quotations omitted); *In re Old CarCo L.L.C.*, 435 B.R. 169, 185 (Bankr. S.D.N.Y. 2010) (courts may look beyond the formal structure presented and labels attached to make transactions appear distinct).

In this case, collapsing this series of transfers ensures that the true substance and purpose of the transfers will not be obscured by their technical structure (which was designed to evade scrutiny), and that substantial justice will be done.[242]

The evidence at trial proves that Old GM's transfer of the $450 million to GM Canada, and the postpetition payment of the Consent Fee to the Noteholders on June 26, 2009, was intended to be part of a single integrated transaction. The sole purpose of Old GM's transfer to GM Canada was to fund the Consent Fee.[243] Significantly, the Noteholders played an integral part in structuring this transfer to obscure its true purpose: their unjust enrichment.[244]

In sum, whether due to failure to satisfy the Trust Agreement conditions or under the collapsing doctrine, payment of the Consent Fee to the Noteholders was a postpetition payment by Old GM for which there was no prior Court authorization. Thus, the Court should find that payment of the Consent Fee was an avoidable transfer.

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[242] *Bachrach Clothing, Inc. v. Bachrach (In re Bachrach Clothing, Inc.)*, 480 B.R. 820, 853 (Bankr. N.D. Ill. 2012) ("The 'collapsing' doctrine is essentially an equitable doctrine allowing a court to dispense with the structure of a transaction or a series of transactions.") (citations omitted); *Silverman v. K.E.R.U. Realty Corp. (In re Allou Distribs.)*, 379 B.R. 5, 21 (Bankr. E.D.N.Y. 2007) (stating that the Court should not "'turn a blind eye to the reality' of the substance of a series of transactions. . . .").

[243] *See* Pl. Ex. 129 at NGM000010611 ("plan where [Old GM] makes a loan to [GM Canada] which is intended for the purpose of paying down the GMNS bonds."); Pl. Ex. 396 (email from I. Yoo to N. Ramdev and A. Kibe, dated May 22, 2009, discussing "options to getting funds to [GM Canada] to pay down the loan from GMNS in order for GMNS to pay the external bondholders"); Pl. Ex. 132 ("can you send me a schematic of the related funding requirements (i.e., loan from GM to [GM Canada], [GM Canada] pay-down of NP to GMN[S], GMN[S] call of NS Bonds and payment to bonholders [sic], etc.)."); Pl. Ex. 133 (email from M. Feldman dated May 26, 2009); Pl. Ex. 138 (email from J. Stapleton to A. Mistry and M. Sutedja, dated May 27, 2009, forwarding letter to Export Development Canada stating Old GM to provide loan to GM Canada for purpose of paying bondholders).

[244] *See* Trial Tr. (8/9/2012), 86:25-87:05 (Buonomo) (Trust Agreement amended to conform to deal with Noteholders); Pl. Ex. 134 at NGM000000603 (conditions to release of funds held in trust required participation by Noteholders representing not less than 2/3 of the principal amount of each series of Notes).

2. Even If The Consent Fee Was Not A Postpetition Transfer, The Noteholders Still Received An Avoidable Transfer Under Sections 547 Or 548 Of The Bankruptcy Code

Alternatively, to the extent payment of the Consent Fee is determined to have occurred prepetition notwithstanding the evidence introduced at trial, Old GM's $450 million transfer to GM Canada for the benefit of the Noteholders is nonetheless avoidable as a preferential payment under section 547.[245] First, the $450 million transfer from Old GM to GM Canada, made for the benefit of the Noteholders on account of the Notes, satisfies each of the elements of section 547(b) of the Bankruptcy Code and is a preferential payment.[246]

The Consent Fee is also avoidable as a constructively fraudulent transfer under section 548(a)(1)(B) of the Bankruptcy Code because Old GM, while insolvent, received less than reasonably equivalent value for its transfer of the Consent Fee and the obligations it incurred under the Lock-Up Agreement. 11 U.S.C. § 548(a)(1)(B). As stated above in Factual Background Section II(B)(3), it is evident that the obligations Old GM incurred under the Lock-Up Agreement were grossly disproportionate to the worthless release Old GM received with respect to the Oppression Action.[247] Indeed, even payment of the Consent Fee alone was far in excess of what was commercially reasonable, and, when the agreement to allow the more than $2.67 billion in claims for the benefit of the Noteholders is added to the mix, there can be no doubt that Old GM did not receive anything close to reasonably equivalent value. The Consent

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[245] A preferential transfer under section 547(b) is a transfer made: (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) while the debtor was insolvent; (4) within 90 days prior to the filing for bankruptcy; and (5) that enabled the creditor to receive more than such creditor would receive in a chapter 7 liquidation. *Ames Merch. Corp. v. Revere Mills Inc. (In re Ames Dep't Stores, Inc.)*, No. 01-42217 (REG), Adv. Pro. Nos. 03-03951, 03-08325 (REG), 2010 WL 2403104, *4 (Bankr. S.D.N.Y. June 10, 2010).

[246] The Court has determined that Old GM was insolvent as of the Petition Date. *In re Gen. Motors Corp.*, 407 B.R. 463, 475 (Bankr. S.D.N.Y. 2009). Moreover, in his notebook, Prieto refers to the Consent Fee as a "preference." *See* Pl. Ex. 3 at AUR_GM021457.

[247] This release is the only consideration Old GM received under the Lock-Up Agreement.

Fee is, therefore, avoidable as a fraudulent transfer under section 548(a)(1)(B), and recoverable from the Noteholders and Wedlake as subsequent transferees under section 550.[248]

Moreover, the Consent Fee is avoidable as an actual fraudulent transfer under section 548(a)(1)(A) of the Bankruptcy Code because Old GM paid the Consent Fee with full knowledge that such payment would hinder recoveries to Old GM's other general unsecured creditors. 11 U.S.C. § 548(a)(1)(A).[249] Old GM's conduct demonstrates an intent to place $450 million of its cash beyond the reach of its unsecured creditors.[250] It was only in discovery in connection with this case that the Committee learned that the Consent Fee was paid with Old GM's money. It is obvious that Old GM and the Noteholders tried to conceal, to the disadvantage of Old GM's unsecured creditors, that Old GM was the source of the funds for the Consent Fee.[251] Accordingly, the Consent Fee is avoidable as an actual fraudulent transfer under section 548(a)(1)(A), and recoverable from the Noteholders and Wedlake as subsequent transferees under section 550.[252]

B. The Consent Fee Was Not Repaid

Section 502(d) specifically requires that the *transferee* repay the avoidable transfer to avoid claim disallowance.[253] There is no dispute in this case that the Noteholders have not

[248] 11 U.S.C. § 550(a). *See IBT Int'l, Inc. v. Ne. (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689, 708 (11th Cir. 2005); 5 Collier on Bankruptcy, ¶ 550.02[1] at 550–6 (16th ed. 2011) (noting majority view provides that "a recovery may be had from a subsequent transferee without suing the initial transferee.").

[249] *See Nisselson v. Empyrean Inv. Fund, L.P. (In re MarketXT Holdings Corp.)*, 376 B.R. 390, 403 (Bankr. S.D.N.Y. 2007) ("[I]t is well accepted that intent to hinder or delay creditors is sufficient, and intent to defraud need not be proven.").

[250] Actual intent may be inferred from the actions of Old GM and the GUC Trust is entitled to prove such intent by relying upon circumstantial evidence. *See In re Sharp Int'l Corp.*, 403 F.3d 43, 56 (2d Cir. 2005); *Salomon v. Kaiser (In re Kaiser)*, 722 F.2d 1574, 1582 (2d Cir. 1983).

[251] *See generally* Pl. Ex. 29 (June 1, 2009 8-K) (failing to disclose that Old GM funded the Consent Fee).

[252] *See supra* note 248.

[253] *Longacre Master Fund, Ltd. v. ATS Automation Tooling Sys. Inc.*, 456 B.R. 633, 640-41

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repaid the Consent Fee. The Disputed Claims should be disallowed because the Noteholders, as the direct claimants under the Guarantee Claims and the beneficiaries of the Nova Scotia Trustee Claim, have not repaid the amount of the avoidable transfer.[254] Disallowance is a personal disability of the entity that receives an avoidable transfer.[255] Thus, Defendants cannot rely on any alleged repayment by GM Canada as a defense to the GUC Trust's objection. Under section 502(d), the Defendants have the option of either keeping their avoidable transfer or surrendering their transfers and sharing ratably with other creditors – but not both.

Even if the Court finds that repayment for purposes of section 502(d) can be made by a party other than the claimant, however, the evidence does not support the contention that GM Canada repaid the $450 million to Old GM. At trial, New GM and the Noteholders contended that the transactions described in the Direction & Acknowledgment[256] demonstrated that the $450 million transferred by Old GM was repaid. This is not so.

The contention that the $450 million transfer was repaid through the internal transfers and offsets described in the Direction & Acknowledgement rests on three flawed premises. First, the Direction & Acknowledgement assumes that Old GM was obligated to contribute CAD $1 billion pursuant to the pension escrow agreement. As shown at trial, that purported obligation was supposed to be an obligation of New GM, and Old GM was only made a party to the

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(S.D.N.Y. 2011) (adopting *In re Enron Corp.*), *vacated in part on other grounds*, No. 11-3413-cv, 2012 WL 4040176 (2d Cir. Sept. 14, 2012); *Enron Corp. v. Springfield Assocs., L.L.C. (In re Enron Corp.)*, 379 B.R. 425, 443 (S.D.N.Y. 2007); *see also El Paso City of Tex. v. Am. W. Airlines, Inc. (In re Am. W. Airlines, Inc.)*, 217 F.3d 1161, 1166 (9th Cir. 2000) (upholding lower court's decision to disallow claim because claimant refused to relinquish its avoidable transfer).

[254] *See generally In re Sierra-Cal*, 210 B.R. 168, 173 (Bankr. E.D. Cal. 1997) ("The statutory language 'the court shall disallow' leaves no latitude for the court once the predicate rights are determined.").

[255] *Enron Corp.*, 379 B.R. at 443.

[256] *See* Def. Ex. 425.

agreement on July 6, 2009, the day before the escrow account was funded. The reason for this eleventh hour change was to circumvent this Court's stay of the Sale Order.[257] Old GM purportedly incurred this postpetition billion-dollar obligation without any approval from this Court. Thus, it was never a valid obligation of Old GM and cannot serve as a valid offset to the other transactions described in the Direction & Acknowledgement. Accordingly, the $450 Million Loan was not repaid through the transactions described in the Direction & Acknowledgement.

Second, the FX Transaction that is central to the argument that the $450 Million Loan was repaid is also an extraordinary transaction that was not authorized by this Court.[258] Because the FX Transaction was an unauthorized postpetition transaction, it cannot serve as a valid offset to the transactions described in the Direction & Acknowledgement, and, as a consequence, the $450 Million Loan was not repaid.

Finally, as explained above in Factual Background Section III(B)(3), the evidence shows that the account to which Old GM transferred CAD $1 billion on July 7, 2009 was a New GM account that was always intended to, and did, benefit New GM – not Old GM. Thus, the $450 Million Loan was not repaid to Old GM. In fact, adding insult to injury, as a result of the transactions described in the Direction & Acknowledgment, Old GM paid $113 million in cash

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[257] *See* Pl. Ex. 710 (emails from June 29, 2009 to July 4, 2009, discussing investment preferences for "C$1B NewCo escrow"); Pl. Ex. 764 (emails between A. Hartog, R. Burshtine, and G. Krowles, dated July 6, 2009, discussing timing of funding for the "C$1B escrow under GM New Co"); Pl. Ex. 720 and 724 (replacing New GM with Old GM in pension escrow agreement).

[258] The FX Transaction was substantially larger than any other foreign exchange transaction conducted internally between Old GM and GM Canada. Trial Tr. (3/6/2013), 59:7-61:17 (Lopez). Additionally, other than this FX Transaction, every foreign exchange between the two entities involved GM Canada wiring the Canadian proceeds to Old GM's JPMorgan London account. *Id*. at 61. In this case, however, no money was ever transferred to such account. *Id.* at 63. Rather, the proceeds were transferred directly to a "GM Company" escrow account at CIBC Mellon, which was never disclosed to the Court in either Old GM's Cash Management Motion or otherwise. *See* Pl. Ex. 750 and 751 (Cash Management Motion and Order) (Bankr. Dkt. Nos. 30 and 2542); Trial Tr. (3/6/2013), 62-64 (Lopez).

to GM Canada, in addition to paying CAD $1 billion into an escrow account owned by, and established for the benefit of, New GM.[259]

II. THE CLAIMS SHOULD BE EQUITABLY SUBORDINATED

A. Standard For Equitable Subordination

If the Court does not disallow the Disputed Claims in their entirety for the reasons set forth above in Argument Section I, then, in the alternative, it should equitably subordinate the Nova Scotia Trustee Claim and the Tainted Claims (defined below).[260] The doctrine of equitable subordination, codified in section 510(c) of the Bankruptcy Code, permits a court to consider whether, despite the "apparent legal validity" of a claim, "the conduct of the claimant in relation to other creditors . . . was such that it would be unjust or unfair to permit the claimant to share *pro rata* with the other claimants of equal status."[261] Equitable subordination is warranted where, as in this case, "(a) the claimant engaged in some type of 'inequitable conduct'; (b) the misconduct caused injury to the creditors or conferred an unfair advantage on the claimant; and

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[259] Under the terms of the Direction & Acknowledgement, after deducting various offsets that GM Canada owed to Old GM (*i.e.*, the tax refund and $450 Million Loan), Old GM owed GM Canada US $113 million for its "purchase" of CAD $1 billion. This CAD $1 billion went directly from GM Canada to the pension escrow account belonging to New GM. Eventually, the CAD $1 billion was transferred to New GM after GM Canada funded in full its own pension account (at no time was the CAD $1 billion ever deposited into an Old GM bank account).

[260] Alternatively, this Court has recognized equitable disallowance as a separate and valid basis for the expungement of claims. *See* Pre-Trial Conf. Tr. (7/17/2012); Pre-Trial Conf. Tr. (4/23/2012), 11:23-12:1 ("Even though section 510(c) of the code expressly authorizes only equitable subordination, equitable disallowance is as permissible as equitable subordination is, though it is imposed less commonly."). Like equitable subordination, equitable disallowance is appropriate where, as here, the claimant engages in inequitable conduct. *Pepper v. Litton*, 308 U.S. 295, 306 (1939). Consequently, equitable disallowance provides a basis for disallowance of the Tainted Claims as an alternative to the remedy of equitable subordination and, in this case, applying either principle will yield the same result.

[261] *See Adelphia Commc'ns Corp. v. Bank of Am., N.A. (In re Adelphia Commc'ns Corp.)*, 365 B.R. 24, 68 (Bankr. S.D.N.Y. 2007), *aff'd sub nom. Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 64 (S.D.N.Y. 2008), *adhered to on reconsideration*, Nos. 05 Civ. 9050 (LMM), 03 MDL 1529, 2008 WL 1959542 (S.D.N.Y. May 5, 2008) (citations and quotations omitted). Section 510(c) provides, in relevant part, that a "court may . . . under principles of equitable subordination, subordinate for purposes for distribution all or part of an allowed claim to all or part of another allowed claim." 11 U.S.C. § 510(c).

(c) equitable subordination of the claim is consistent with bankruptcy law."[262]

The potential range of conduct warranting the remedy of equitable subordination is broad and varied.[263] Inequitable conduct is generally viewed as conduct that "shocks one's good conscience" and includes, among other things, "a secret or open fraud, lack of faith or guardianship by a fiduciary; an unjust enrichment, not enrichment by . . . chance, astuteness or business acumen, but enrichment through another's loss brought about by one's own unconscionable, unjust, unfair, close or double dealing or foul conduct."[264]

In determining whether to equitably subordinate claims, courts subject the conduct of insiders to especially rigorous scrutiny.[265] When a claim for equitable subordination challenges a transaction entered into with an insider, the burden is on the insider to prove the good faith of the transaction and also to show its inherent fairness from the viewpoint of the debtor.[266]

B. Wedlake And The Lock-Up Noteholders Are Insiders Of Old GM

GM Nova Scotia, as an affiliate and wholly-owned subsidiary of Old GM, is an insider of Old GM.[267] By definition, Wedlake, therefore, is an insider of Old GM because Wedlake is an

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[262] *In re Adelphia Commc'ns Corp.*, 365 B.R. at 68.

[263] *See generally In re Adler, Coleman Clearing Corp.*, 277 B.R. 520, 563 (Bankr. S.D.N.Y. 2002) (citing *80 Nassau Assocs. v. Crossland Fed. Sav. Bank (In re 80 Nassau Assocs.)*, 169 B.R. 832, 837 (Bankr. S.D.N.Y. 1994)).

[264] *Id*. (quoting *In re 80 Nassau Assocs.*, 169 B.R. at 837). With regard to the first prong, "[o]ther courts have described the type of conduct that warrants equitable subordination as including: (i) fraud, illegality, or breach of fiduciary duty; (ii) undercapitalization of the debtor; and (iii) control or use of the debtor as a vehicle to benefit the creditor in preference other general creditor body." *Nisselson v. Softbank Am. Corp. (In re MarketXT Holdings Corp.)*, 361 B.R. 369, 386 (Bankr. S.D.N.Y. 2007) (citations omitted). The second prong is met where the general creditors are less likely to collect their debts as a result of the alleged inequitable conduct. *Enron Corp.*, 379 B.R. at 434. As to the third prong, "[i]f the misconduct results in harm to the entire creditor body, the [trustee] need not identify the injured creditors or quantify their injury, but need only show that the creditors were harmed in some general, concrete manner."). *Id.*

[265] *In re Adler, Coleman Clearing Corp.*, 277 B.R. at 564 (citations and quotations omitted).

[266] *Id*.

[267] Section 101(31) of the Bankruptcy Code defines an insider of a corporate debtor as including a

Footnote continued on next page

insider of Old GM's affiliate – and wholly-owned subsidiary – GM Nova Scotia. *Id*.

The Lock-Up Noteholders are also insiders of GM Nova Scotia due to the level of control they exercised over GM Nova Scotia. For example, the Lock-Up Noteholders, who were the only creditors of GM Nova Scotia,[268] controlled the entire GM Nova Scotia bankruptcy process.[269] In particular, certain Lock-Up Noteholders: (i) hand-picked a trustee they could (and did) control;[270] (ii) petitioned GM Nova Scotia into bankruptcy at a date and time designed to shield their receipt of the Consent Fee from preference review;[271] (iii) voted down the

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Footnote continued from previous page

person in control of the debtor, an affiliate of the debtor or an insider of an affiliate as if such affiliate were the debtor. 11 U.S.C. § 101(31). Section 101(2)(B) of the Bankruptcy Code defines affiliate as a corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor. A corporation is broadly defined in section 101(9) of the Bankruptcy Code to include "a wide variety of business and non-business entities." *In re Int'l Zinc Coatings & Chem. Corp.*, 355 B.R. 76, 83 (Bankr. N.D. Ill. 2006). The Bankruptcy Code's definition of corporation is "a term of art that is broader than the ordinary meaning of that word." *In re KRSM Prop. L.L.C.*, 318 B.R. 712, 717 n.5 (9th Cir. BAP 2004) (concluding that an LLC falls "comfortably" within the Bankruptcy Code's definition of "corporation"). It should be noted, however, that courts are not limited to the list set forth in section 101(31) and may consider whether one is an insider in light of the totality of the circumstances. *In re Adler, Coleman Clearing Corp.*, 277 B.R. at 564 (citations omitted). Courts have held that wholly-owned subsidiaries are insiders. *See In re La Guardia Assoc., L.P.*, Nos. 04-34512 (SR), 04-34514 (SR), 2006 WL 6601650, at *36 (Bankr. E.D. Pa. Sept. 13, 2006); *see also In re AEG Acquisition Corp.*, 161 B.R. 50, 56 n.7 (9th Cir. BAP 1993); *In re Oxford Health Investors*, L.L.C., Nos. 00–80676C–7D, 00–80677C–7D, 00–80678C–7D, 00–80679C–7D, 00–80680C–7D, 00–80681C–7D, 2002 WL 31031631, at *6 (Bankr. M.D. N.C. Sept. 3, 2002); *In re NMI Sys. Inc.*, 179 B.R. 357, 359 (Bankr. D.D.C. 1995); *In re Southmark Corp.*, 138 B.R. 831, 833 (Bankr. N.D. Tex. 1992) ("SPS, as a wholly owned subsidiary of Southmark, is an insider."), *aff'd*, 993 F.2d 117 (5th Cir. 1993).

[268] The New GM Swap Claim is subordinated to the claims of the Noteholders if even one penny of the Nova Scotia Trustee Claim is disallowed, leaving the Noteholders as the only real creditors of GM Nova Scotia.

[269] *See In re MarketXT Holdings Corp.*, 361 B.R. at 387 (noting that the term insider applies to "one who has sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at [arm's] length with the debtor.") (citations omitted). A creditor who does not deal at arm's length with debtor, but who has a special relationship with debtor through which it can compel payment of its claim, has sufficient control over debtor to be deemed an "insider," for preference-avoidance purposes.

[270] *See supra* notes 138 through 148, 170 through 176.

[271] *See supra* notes 150 through 152.

appointment of inspectors who would have had oversight over their hand-picked trustee;[272] (iv) were intimately involved with all aspects of the Nova Scotia Bankruptcy Case;[273] (v) directed Wedlake with respect to the termination and calculation of the Swaps;[274] and (vi) directed Wedlake with respect to the calculation and assertion of the Nova Scotia Trustee Claim against Old GM.[275] Further, certain Lock-Up Noteholders also had access to non-public information about GM Nova Scotia (and Old GM), including copies of the Swaps before they were ever publicly available.[276] *See Official Comm. of Unsecured Creditors v. Credit Suisse First Boston (In re Exide Techs., Inc.)*, B.R. 732, 744 (Bankr. D. Del. 2003) (finding insider status where creditor had access to material, non-public information that other creditors did not have). Because the Noteholders are insiders of GM Nova Scotia, the Noteholders are, by definition, insiders of Old GM.

C. The Tainted Claims[277] Should Be Equitably Subordinated

The Tainted Claims should be equitably subordinated because the Lock-Up Noteholders engaged in inequitable conduct that conferred an unfair advantage on them. Among other things, the Lock-Up Noteholders threatened to tie up Old GM's bankruptcy unless they received the commercially unreasonable Consent Fee, which they knew would be paid to them postpetition with funds that were property of Old GM's estate.[278] In order to receive a larger chunk of the Consent Fee and solidify total control of the Nova Scotia Bankruptcy Case, certain Lock-Up

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[272] *See supra* notes 153 through 155.

[273] *See supra* notes 156 through 170.

[274] *See supra* notes 186, 193, 214, 216 through 217.

[275] *See supra* notes 185 through 193.

[276] *See supra* note 188.

[277] The "**Tainted Claims**" constitute all Guarantee Claims asserted by the Lock-Up Noteholders, as well as all Guarantee Claims asserted by entities who acquired Notes after the Petition Date, directly or indirectly, from the Lock-Up Noteholders.

[278] *See supra* notes 55, 137.

Noteholders increased their holdings the day after they entered into the Lock-Up Agreement, before the pertinent facts were known to other creditors of Old GM.[279] Certain Lock-Up Noteholders – Fortress and Elliott – failed to disclose their trading history of CDS referencing Old GM in the Rule 2019 statements filed with this Court.[280] If the CDS had been disclosed, then other creditors would have known that Fortress and Elliott stood to profit upon Old GM's bankruptcy filing, despite their participation in a prepetition Steering Committee that was supposedly vested in the success of an out-of-court restructuring of Old GM.[281]

Moreover, by the Oppression Action, certain Lock-Up Noteholders (Fortress, Aurelius, and Appaloosa) commenced a meritless litigation in Canada to extract the rich recovery ultimately reflected in the Lock-Up Agreement.[282] The Lock-Up Noteholders also consistently misrepresented to the Court and the public that the Lock-Up Agreement was a prepetition agreement, even though they knew that the agreement was not completed until after Old GM's bankruptcy petition was filed.[283] Finally, the Lock-Up Noteholders manipulated the date by which GM Nova Scotia would be put into bankruptcy in order to insulate the Consent Fee and Lock-Up Agreement from challenge.[284]

The prepetition and postpetition actions of the Lock-Up Noteholders, which allowed

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279 *See* Pl. Exs. 38, 53, 386, 387 (Rule 2019 statements).

280 *See supra* notes 39 through 40.

281 *See supra* notes 35 through 38.

282 *See Harbert v. Calpine Canada Energy Finance II ULC*, 2005 NSSC 211 (finding that a complainant who decided to become a security holder and knew or should have known that the impugned conduct was occurring cannot be said to have had reasonable expectations to the contrary and cannot maintain that it has been oppressed) (attached hereto as Index No. 1).

283 *See supra* notes 101, 102, 116. *See, e.g., Response of Certain Noteholders in Opposition to Official Committee of Unsecured Creditors' First Amended Objection to Claims Filed by Green Hunt Wedlake, Inc. and Noteholders of General Motors Nova Scotia Finance Company and Motion for Other Relief* at 8 (Bankr. Dkt. No. 8084) ("the Lock-Up Agreement was entered into pre-petition.").

284 *See supra* notes 149 through 151.

them to enrich themselves at the expense of other general unsecured creditors of Old GM, constitute inequitable conduct by any objective measure. The Court should, therefore, subordinate the Tainted Claims to the claims of other unsecured creditors.

D. The Nova Scotia Trustee Claim Should Be Equitably Subordinated

Likewise, Wedlake's conduct warrants equitable subordination of the Nova Scotia Trustee Claim. First, Wedlake was hand-picked by certain Lock-Up Noteholders and is controlled by them, and the inequitable conduct of those Lock-Up Noteholders should therefore be imputed to Wedlake.[285]

In addition, Wedlake also acted inequitably in numerous respects including: (i) failing to adequately investigate possible "transfers at undervalue";[286] (ii) failing to have inspectors appointed for the GM Nova Scotia estate, as is customary in such a proceeding and contrary to his own best judgment;[287] (iii) knowingly consenting to the Lock-Up Noteholders' manipulation of the timing of the Nova Scotia Bankruptcy Case;[288] (iv) submitting an inflated and false claim against Old GM in reliance upon calculations performed at the direction of the Lock-Up Noteholders and without undertaking any independent investigation;[289] and (v) failing to

[285] Wedlake Decl., ¶ 13. *See also Capitol Bank & Trust Co. v. 604 Columbus Ave. Realty Trust (In re 604 Columbus Ave. Realty Trust)*, 968 F.2d 1332, 1356 (1st Cir. 1992) (applying the principle of equitable subordination and noting that "any inequity that would result from imputing bank officials' misconduct to the federal receiver would be outweighed by adoption of a federal common law rule that would entirely prevent the debtor/borrower or its creditors from benefitting from the remedy of equitable subordination.").

[286] Trial Tr. (8/7/2012), 95:13-21 (Wedlake).

[287] Trial Tr. (8/7/2012), 106:5-17 (Wedlake).

[288] *Id.* at 63:25-64:4; Pl. Ex. 202 (email from P. Huff to P. Wedlake, dated June 2, 2009); Wedlake Decl., ¶ 14. *See also* Wedlake Decl., ¶ 18; Trial Tr. (8/7/2012), 93:7-20 (Wedlake); Pl. Ex. 32 (email from P. Huff to P. Wedlake, dated Sept. 8, 2009).

[289] *See supra* notes 170 through 206; *see also In re Adler, Coleman Clearing Corp*., 277 B.R. at 567 (noting that the inflation of a claim in a situation where there is a limited pot from which to satisfy claims is prejudicial to other creditors).

investigate GM Nova Scotia's Statement of Affairs, despite Wedlake's awareness that it was riddled with irregularities.[290]

The foregoing wrongful conduct warrants equitable subordination of the Nova Scotia Trustee Claim. This inequitable conduct has prejudiced other creditors, and equitable subordination of the Nova Scotia Trustee Claim to the claims of other creditors is consistent with bankruptcy law and necessary to redress the harm that Wedlake and the Lock-Up Noteholders have inflicted upon the Old GM estate.

III. THE LOCK-UP AGREEMENT IS A POSTPETITION AGREEMENT

A. The Parties Intended To Be Bound Only By A Final Agreement

Under New York law, "if the parties intend not to be bound until they have executed a formal document embodying their agreement, they will not be bound until then."[291] To determine whether parties intended to be bound before executing a final contract, courts in this Circuit consider four factors: (i) whether any party has expressly reserved the right not to be bound absent a written agreement; (ii) partial performance of the contract; (iii) whether all terms have been agreed upon such that nothing is left to negotiate; and (iv) whether the agreement at issue is the type of contract that is generally committed to writing.[292] An analysis of these four factors based on the evidence in this case leaves no doubt that the parties did not intend to be bound by the Lock-Up Agreement before it was final.

First, the parties expressly agreed not to be bound until a completed agreement was executed. Section 11 of the NDA, signed just days before the Lock-Up Agreement, provides that

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[290] *See supra* notes 156 through 169.

[291] *See GSGSB, Inc. v. N.Y. Yankees*, 862 F. Supp. 1160, 1171-72 (S.D.N.Y. 1994) (citations omitted); *see also Chariot Grp. v. Am. Acquisition Partners*, 751 F. Supp. 1144, 1149 (S.D.N.Y. 1990), *aff'd without opinion*, 932 F.2d 956 (2d Cir. 1991).

[292] *GSGSB*, 862 F. Supp. at 1172.

Old GM will not be "under any legal obligation of any kind whatsoever" unless and until the parties have entered into a "definitive agreement."[293] Further, every draft of the Lock-Up Agreement (i) conditions the effectiveness of the parties' rights and obligations upon execution and delivery of signature pages to "[t]his Agreement"; (ii) contains a clause providing that "[t]his Agreement" supersedes all prior negotiations; and (iii) requires that all modifications be in a writing signed by all parties.[294] These provisions show that "the parties placed great importance on the formalities of execution," and that they intended not to be bound prior to the execution of a formal document.[295] The Second Circuit has recognized that this type of language, "in the context of negotiations over drafts of written agreements, indicates that the parties are working towards the goal of a written, signed contract and protects them from being bound until due execution." *Chariot Grp.*, 751 F. Supp. at 1150 (citations omitted); *see also Reprosystem, B.V. v. SCM, Corp.*, 727 F.2d 257, 262 (2d Cir. 1984) (mutual intent not to be bound prior to execution of formal documents was conclusively established when neither party took exception to provision in drafts which stated that "when executed and delivered, this . . . Agreement . . . will be a valid and binding agreement"), *cert. denied*, 469 U.S. 828 (1984).[296]

Consideration of the next relevant factor – whether all terms were agreed upon and whether anything was left to negotiate – further confirms the parties' intent not to be bound to

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[293] Pl. Ex. 256, ¶ 11 (ELL_GM 000243) (copy of NDA executed by Elliott).

[294] *See* Pl. Ex. 289, ¶¶ 10, 20 (version 16 of the Lock-Up Agreement); Pl. Ex. 290, ¶ ¶10, 20 (version 17 of the Lock-Up Agreement); Pl. Ex. 291, ¶¶ 10, 20 (version 18 of the Lock-Up Agreement); Pl. Ex. 292, ¶¶ 10, 20 (version 19 of the Lock-Up Agreement); Pl. Ex. 293, ¶¶ 10, 20 (version 20 of the Lock-Up Agreement); Pl. Ex. 16, ¶¶ 10, 20 (final, executed copy of the Lock-Up Agreement).

[295] *See id*. at 1173.

[296] *See also Ciaramella v. Reader's Digest Ass'n*., 131 F.3d 320, 324 (2d Cir. 1997) (agreement is effective at the time the parties intended to be bound); *Gucci Am., Inc. v. Gucci*, No. 07 Civ 6820 (RMB) (JCF), 2009 WL 440463, at *4 (S.D.N.Y. Feb. 20, 2009) ("[W]here the parties to a proposed contract have agreed that the contract is not to be effective or binding until certain conditions are performed or occur, no binding contract will arise until the conditions specified have occurred or been performed.") (citation omitted).

the Lock-Up Agreement until it was final.[297] Here, the parties' relentless revisions to the Lock-Up Agreement – including the extraordinary resolution described as the agreement's "raison d'être" – continued, and were not completed, until well after Old GM's bankruptcy petition was filed. For a document to be final, all revisions to the document must be complete – even if minor. *See Bear Stearns Inv. Prods., Inc. v. Hitachi Auto. Prods. (USA), Inc.*, 401 B.R. 598, 619 (S.D.N.Y. 2009). As the Second Circuit recognized in *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78, 82-83 (2d Cir. 1985), the parties' insistence on the continual redrafting of specific terms of a proposed agreement establishes that "the changes made must be deemed important enough to the parties to have delayed final execution and consummation of the agreement." *See also Chariot Grp.*, 751 F. Supp. at 1150 ("It is not for the court to determine retrospectively that at some point in the evolution of a formal document that the changes being discussed became so 'minor' or 'technical' that the contract was binding despite the parties' unwillingness to have it executed and delivered.") (citations and quotations omitted).

Finally, the Lock-Up Agreement is the type of contract that is generally committed to writing. Given the significant amount of money at stake and the parties' tireless editing of the Lock-Up Agreement, it cannot reasonably be disputed that the parties intended not to be bound until there was a completed, written agreement. *See, e.g., R.G. Grp. v. Horn & Hardart Co.*, 751 F.2d 69, 77 (2d Cir. 1984) (noting that, in evaluating the fourth factor, "most telling is the fact that the parties were talking about an initial investment of some two million dollars" and damages of "'at least' eighty million dollars"); *see also GSGSB*, 862 F. Supp. at 1175 (substantial redrafting shows that agreement was the type that required a writing).

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[297] The second factor identified above, partial performance, is not applicable here.

B. It Is Undisputed That The Final Agreement Was Created Postpetition

The document that all parties consider to be, and hold out to the public as, the final and binding version of the Lock-Up Agreement is the one identified as version 20 in Weil Gotshal's document management system (*i.e.*, the 10:37 Version). The GUC Trust's digital forensic expert confirmed that version 20 of the Lock-Up Agreement was not created until 9:21 a.m. on June 1, 2009, more than one hour after Old GM filed its bankruptcy petition.[298] This expert opinion is corroborated by the metadata associated with the Lock-Up Agreement that was produced by Weil Gotshal.

As explained in Factual Background Section III(A) above, according to that metadata, version 18 of the Lock-Up Agreement was still being edited as of and through the filing of Old GM's bankruptcy petition at 7:57 a.m. on June 1, and neither version 19 nor version 20 yet existed as of the filing of the petition. Further, a prior draft of the Lock-Up Agreement circulated among Weil Gotshal attorneys contains "track changes" and shows the corresponding time that such changes were made, many of which were subsequent to 7:57 a.m. The forensic evidence therefore establishes conclusively that the final, binding version of the Lock-Up Agreement was not even created until after the filing of Old GM's bankruptcy petition, and that as of the time of the filing, an earlier version was still being edited.[299] Thus, the Lock-Up Agreement was not complete and binding until after Old GM filed its bankruptcy petition.

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[298] Jones Report at 11, 15 (¶ 6.1.1).

[299] *See Health-Chem Corp. v. Baker*, 915 F.2d 805, 811 (2d Cir. 1990) ("[w]hen the parties to a contract enter into a new agreement that expressly supersedes the previous agreement, the previous agreement is extinguished. . . .") (citations and quotations omitted).

IV. THE LOCK-UP AGREEMENT IS VOID

A. The Lock-Up Agreement Is Void *Ab Initio* Because It Was An Extraordinary Postpetition Transaction Not Approved By This Court

The evidence demonstrates that the postpetition Lock-Up Agreement was the type of extraordinary transaction that required this Court's approval. Section 363(b)(1) of the Bankruptcy Code authorizes a debtor to "use, sell, or lease, other than in the ordinary course of business, property of the estate," but only *after* notice and a hearing. 11 U.S.C. § 363(b).

The Lock-Up Agreement and related transactions were clearly transactions outside of Old GM's "normal, daily business,"[300] and was certainly the kind of agreement that creditors ordinarily expect to be presented to the court for approval on notice.[301] Significantly, Old GM concedes that the Lock-Up Agreement was a postpetition, extraordinary event, as evidenced by Old GM's inclusion of a description of the settlement with the Noteholders in a non-public, confidential disclosure schedule to the master sale and purchase agreement, which listed exceptions from Old GM's covenant to conduct its business in the ordinary course after the filing of the petition and through the closing of the 363 Sale.[302]

Making matters worse, the Lock-Up Agreement was not only an unauthorized postpetition agreement, but also required Old GM to take various postpetition actions to implement the agreement that involved unauthorized uses of estate property outside of Old GM's ordinary course of business. These actions included Old GM's (i) execution of two postpetition

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[300] *Med. Malpractice Ins. Ass'n v. Hirsch (In re Lavigne),* 114 F.3d 379, 384 (2d Cir. 1997).

[301] *See Id.* at 384-85 ("touchstone of 'ordinariness' is interested parties' reasonable expectations of what transactions a debtor in possession is likely to enter in ordinary course of its business"). When the Committee first learned about the Lock-Up Agreement, Old GM's counsel indicated that an 8-K filed on the Petition Date "showed we were doing this," to which Mr. Mayer replied "you're telling me you expected a $2.6 billion claim settlement and a 350 million cash payment to be done with adequate notice by 8-K without actually bringing it to court for approval on notice to parties? You got to be kidding." Trial Tr. (10/13/12), 173:19-23 (Mayer).

[302] *See* Pl. Ex. 265 at CC005555-56 (disclosure schedule, section 6.2).

amendments to the Trust Agreement which, among other things, facilitated payment of the Consent Fee postpetition,[303] (ii) subordination of its claim under the Swaps and forfeiture of its right to set off the liability owed to it under the Swaps,[304] (iii) postpetition use of its corporate powers, including causing GM Nova Scotia to deliver its consent to a GM Nova Scotia bankruptcy, and (iv) postpetition use of its corporate powers to cause GM Nova Scotia to enter into a settlement that released GM Canada from its obligations under the Intercompany Loans.[305]

Accordingly, Old GM's entry into the Lock-Up Agreement, and the actions taken by Old GM to implement that agreement, were postpetition transactions outside the "ordinary course of business" that required this Court's approval. 11 U.S.C. § 363(b); *In re Lavigne*, 114 F.3d at 384.[306] The failure to seek or secure this Court's approval of the Lock-Up Agreement renders the agreement void *ab initio*.[307]

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303 The Consent Fee constitutes property of the estate because, as of the Petition Date, the conditions of the Trust Agreement had not been met. Under New York law, before an escrow can be effectuated, the agreed-upon conditions must be fulfilled. Only after the requisite conditions are satisfied will an escrow be fully transferred to a grantee. Until such time, the depositor retains the legal right to the property placed in escrow. *See, e.g.*, *In re Pan Trading Corp.*, 125 B.R. at 878; *see also In re Flannery*, 51 B.R. 697, 699-700 (Bankr. S.D. Ohio 1985).

Here, the Trust Agreement required that Noteholders representing not less than two-thirds of the principal amount of each series of Notes sign and deliver a copy of the Lock-Up Agreement by the Lock-Up Deadline. Accordingly, as of 11:31 p.m. EST on May 31 2009 when the foregoing conditions had not been met, the Consent Fee reverted back to Old GM. Assuming, arguendo, that the First Trust Amendment was executed before the Petition was filed, which it was not, the result would be the same. The First Trust Amendment extended the Lock-Up Deadline to 6:00 a.m. EST on June 1. As of 6:01 a.m., the Lock-Up Agreement had still not yet been signed and delivered, at which time the Consent Fee reverted back to Old GM. In any case, as of the filing of Old GM's bankruptcy petition, the Consent Fee constituted property of the estate.

304 *See, e.g., Harsh Inv. Corp. v. Bialac (In re Bialac)*, 712 F.2d 426, 430 (9th Cir. 1983).

305 *See In re Lavigne*, 114 F.3d at 384 (citation omitted); *see also In re Consol. Auto Recyclers, Inc.*, 123 B.R. 130, 140-41 (Bankr. D. Me. 1991) (use of debtor's shares in its wholly-owned subsidiary to authorize chapter 11 petition for a subsidiary is a "use of" estate property outside the ordinary course).

306 *See* New GM SJ Hr'g Tr. (7/19/2012), 82:2-83:2 ("[A]cquiescence to the allowance of more than $2 billion in claims, cannot be regarded as having been entered into in the ordinary course of business. . . . [I]t's at least arguably, if not plainly, a postpetition transaction that was not authorized by the Bankruptcy Court.").

307 *See In re Koneta*, 357 B.R. 540, 543-44 (Bankr. D. Ariz. 2006) ("[T]he usual effect of a sale or

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B. The Lock-Up Agreement And Related Transactions Are Violations Of The Automatic Stay

The filing of a bankruptcy petition operates as a stay, applicable to all entities, of "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). It is well settled in the Second Circuit that acts taken in violation of the stay are void and without effect.[308] Entering into a postpetition agreement that distributes estate property has been held to violate the automatic stay. *See In re Clouse*, 446 B.R. 690, 705 (Bankr. E.D. Pa. 2010) (postpetition agreement that distributed estate property was violation of automatic stay).

Here, the postpetition entry into the Lock-Up Agreement, and the implementation of its terms, violated the automatic stay because, among other things, (i) payment of the Consent Fee was a distribution of estate property,[309] and (ii) the Lock-Up Agreement required Old GM's postpetition exercise of its rights as shareholder of GM Nova Scotia, which rights are property of the estate.[310] These unauthorized postpetition actions violated the automatic stay and are thus

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lease of property of the estate, conducted outside of the ordinary course of business but without adherence to the notice and hearing requirements of section 363(b)(1), is that any sale held is rendered null and void.") (citation omitted); *see also In re NextWave Pers. Commc'ns Inc.*, 244 B.R. 253, 275 (Bankr. S.D.N.Y 2000) ("Actions which violate Section 363 are 'void.'") (citation omitted).

[308] *See, e.g., Hamm v. R.H. Macy & Co.*, No. 93 Civ. 1446, 1994 WL 507717, at *1 (S.D.N.Y. Sept. 13, 1994) ("[I]n this circuit, any proceedings or actions described in § 362 that occur after the automatic stay are void and without any effect.") (citation omitted); *see also 48th St. Steakhouse, Inc. v. Rockefeller Grp., Inc. (In re 48th St. Steakhouse, Inc.)*, 835 F.2d 427, 431 (2d Cir. 1987) (lease termination notice was in violation of automatic stay and void), *cert. denied*, 485 U.S. 1035 (1988).

[309] *See In re Clouse,* 446 B.R. at 705.

[310] *See In re Consol. Auto Recyclers, Inc.*, 123 B.R. at 140-41. It should be noted that when action taken against a non-bankrupt party would inevitably have an adverse impact on property of the bankrupt estate, such action is barred by the automatic stay. *See 48th Street Steakhouse*, 835 F.2d at 430-31; *see also Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 288 (2d Cir. 2003) (holding that the automatic stay applies to non-bankrupt entity because it is "wholly owned by [the debtor], and adjudication of the claim against [the non-bankrupt entity] will have an immediate adverse economic impact on" the debtor). Because all actions taken in furtherance of the Nova Scotia Bankruptcy Case would inevitably have an adverse impact on Old GM, as sole shareholder, such actions violate the automatic stay and are void.

void and without legal effect.[311] Because the GM Nova Scotia bankruptcy proceeding is the direct result of an automatic stay violation and the other inequitable conduct discussed above, for purposes of claim allowance in this case, the Court should refuse to recognize the GM Nova Scotia bankruptcy as a proper winding-up event, and disallow the Nova Scotia Trustee Claim in full.

C. The Lock-Up Agreement Is Void For Failure To Comply With Bankruptcy Rule 9019

As a postpetition settlement and compromise of, among other things, the Oppression Action, the Lock-Up Agreement and related transactions also required approval under Rule 9019 of the Federal Rules of Bankruptcy Procedure. Absent approval by the bankruptcy court, debtors cannot bind their estates to compromises. Fed. R. Bank. P. 9019.[312] The scope of Rule 9019 is broad, and it is intended "to prevent the making of concealed agreements which are unknown to the creditors and unevaluated by the court,"[313] and to protect creditors "against bad deals" made between a debtor and another creditor.[314]

Indeed, Rule 9019 is intended to prevent exactly what the Noteholders attempted to accomplish here. The Lock-Up Agreement involved, among other things, the worthless release of the claims asserted in the Oppression Action, which was a meritless litigation that posed no genuine risk to Old GM. That agreement further provided the Noteholders with the $367 million "consent fee" that ostensibly does not reduce the principal amount of the Notes, and gave the Noteholders claims equal to more than two-and-a-half times the face amount of the Notes.

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311 *See, e.g., Hamm*, 1994 WL 507717, at *1.

312 *See, e.g., In re Handy & Harman Ref. Grp., Inc.*, 304 B.R. 49, 53 (Bankr. D. Conn. 2004); *Saccurato v. Masters, Inc. (In re Masters, Inc.)*, 149 B.R. 289, 291 (Bankr. E.D.N.Y. 1992).

313 *In re Masters, Inc.*, 149 B.R. at 292 (citation omitted).

314 *In re Fleming Packaging Corp.*, No. 03-82408, Adv. Pro. No. 04-8166, 2008 WL 682428, at *2 (Bankr. C.D. Ill. Mar. 7, 2008).

Because no notice of the agreement was given to other creditors and no court approval was obtained, the Lock-Up Agreement is void.[315]

V. THE CONSENT FEE PAYMENT SHOULD BE APPLIED TO REDUCE THE PRINCIPAL AMOUNT OF THE NOTES

In the event that the Court does not disallow the Disputed Claims entirely for the reasons set forth in Argument Section I above, or equitably subordinate the Nova Scotia Trustee Claim and the Tainted Claims consistent with Argument Section II above, then the Court should reduce the Disputed Claims by the amount of the Consent Fee. Because the Lock-Up Agreement is void for the reasons stated above, there is no need to consider, or give any effect to, the language in that agreement stating that "the Consent Fee payment does not reduce, limit or impair the Notes, the Guarantee" Claims or the Nova Scotia Trustee Claim. Accordingly, Old GM's obligations under the Notes should be reduced by the amount of the Consent Fee and, as a result, so should the Disputed Claims, including that portion of the Nova Scotia Trustee Claim that is based on the Notes. But even if, for the sake of argument, the unauthorized postpetition entry into the Lock-Up Agreement did not render that agreement void *ab initio*, the overall circumstances, and in particular the economic substance of the payment, require that the Consent Fee be treated as a payment of principal on the Notes.[316]

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[315] *See, e.g., In re Rothewell*, 159 B.R. 374, 379 (Bankr. D. Mass. 1993) (failure to comply with Rule 9019 renders the settlement "without effect").

[316] To the extent it is even necessary to "recharacterize" the Consent Fee in this case, the Court's authority to grant such relief is firmly based on its authority to determine the allowance and amount of claims against the estate. 11 U.S.C. § 502(b); 28 U.S.C. § 157(b)(2)(A) and (B). Indeed, the allowance of claims is a fundamental power that is integral to the court's administration of the bankruptcy estate. *See Katchen v. Landy*, 382 U.S. 323, 329 (1966) (the power to allow and disallow claims is of basic importance in the administration of the bankruptcy estate); *In re Saint Vincent's Catholic Med. Ctrs.*, 445 B.R. 264, 269 (Bankr. S.D.N.Y. 2011) (citing *In re BKW Sys., Inc.*, 66 B.R. 546, 548 (Bankr. D.N.H. 1986) for the proposition that "nothing is more directly at the core of bankruptcy administration . . . than the quantification of all liabilities of the debtor.") (quotations omitted). This authority is further

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As the Supreme Court recognized in *Katchen v. Landy*, the power of a bankruptcy court to allow or disallow a claim includes "full power to inquire into the validity of any alleged debt or obligation of the bankrupt upon which a demand or a claim against the estate is based." *Katchen*, 382 U.S. at 329 (quotations omitted).[317] Accordingly, bankruptcy courts may (and do) look beyond the written terms of the parties' agreement to determine the proper characterization and allowed amounts of claims asserted against a bankruptcy estate, regardless of the labels or descriptions self-interested creditors assign to the relevant transaction.[318] For example, in *LFD Operating, Inc. v. Ames Department Stores, Inc. (In re Ames Department Stores, Inc.)*, 274 B.R. 600, 615, 631 (Bankr. S.D.N.Y. 2002), *order aff'd sub. nom.*, 2004 WL 1948754, (S.D.N.Y. Sept. 1, 2004), *judgment aff'd*, 144 F. App'x. 900, 2005 WL 1916360 (2d Cir. 2005), this Court rejected a creditor's argument that the unambiguous terms of a contract conclusively established that certain sale proceeds were property of the creditor rather than the debtor, and determined that, based on the true character of the transaction and the parties' relationship, those proceeds were property of the debtor's estate. *Id*. at 615, 631.[319]

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supplemented by the exercise of the court's equitable powers under section 105 of the Bankruptcy Code. *See Pepper,* 308 U.S. at 308-09 (equitable powers are to be exercised by bankruptcy courts regarding the allowance of claims).

[317] *See also Pepper*, 308 U.S. at 308 ("[T]he bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate."); *Spradlin v. Williams (In re Alma Energy, L.L.C.)*, No. 10-80-ART, 2010 WL 4736905, at *1 (E.D. Ky. Nov. 16, 2010) (noting that "[s]ome situations simply call for a closer look" and remanding action to uphold creditor's claim for amounts based upon prepetition settlement for further scrutiny); *In re Premier Entm't Biloxi, L.L.C.*, 413 B.R. 370, 374 (Bankr. S.D. Miss. 2009) (disallowing claim for liquidated damages).

[318] *See Bozzuto's Inc. v. Vescio*, No. 00-5040, 234 F.3d 1261 (Table), 2000 WL 1715281, at *2 (2d Cir. Nov. 13, 2000) (recharacterizing rental concessions as payments on debt); *Liona Corp. v. PCH Assocs. (In re PCH Assocs.)*, 949 F.2d 585, 597-600 (2d Cir. 1991) (recharacterizing a sale-leaseback transaction as an equitable mortgage); *see also United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609, 618 (7th Cir. 2005) (recharacterizing a purported lease as a secured loan), *cert. denied*, 547 U.S. 1003 (2006).

[319] *See also Kool, Mann, Coffee & Co. v. Coffey*, 300 F.3d 340, 364 (3d Cir. 2002) (notwithstanding
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Similarly, the Court here should look beyond the terms and labels used by the parties, consider the following relevant facts and properly characterize the $367 million Consent Fee as a payment of principal:

- The amount of the Consent Fee is approximately 36% of the face amount of the Notes,[320] far in excess of consent fees typically paid in distressed transactions.[321]
- At the time the parties entered into the Lock-Up Agreement, no payments were due under the terms of the Notes.[322]
- The Old GM Controller's office acknowledged that the Consent Fee "effectively represented an actual return on the bondholders' investment."[323]
- Old GM personnel initially understood the Consent Fee to be a settlement of GM Nova Scotia's obligations under the Notes.[324]
- The Consent Fee was paid to the Noteholders *pro rata* on the basis of their holdings regardless of whether they consented to the passage of the extraordinary resolution and even if they voted against it.[325]
- The amount of the Consent Fee exceeded by more than $82 million Old GM's own Indifference Analyses of what would be a reasonable amount to pay the Noteholders to extinguish the Notes in full.[326]

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the terms of an underlying promissory note, prepetition interest payments made by the debtor pursuant to a promissory note should be recharacterized as payments of principal because of the creditor's conduct in connection with the transaction).

[320] Gropper Decl., ¶¶ 52, 82. *See also* Pl. Ex. 16, ¶ 2 (WGM00000795) (executed copy of the Lock-Up Agreement), A-4 (WGM00000816) (extraordinary resolution).

[321] Trial Tr. (9/6/2012), 28:21-29:1, 31:9-14, 111:21-25, 126:19-23 (Cederholm).

[322] The 2015 Notes mature on December 7, 2015 with interest payable annually in arrears on December 7. Pl. Ex. 315, Ex. C ¶ 3 (GHW0003641), ¶ 6 (GHW0003644) (schedule 1 to fiscal and paying agency agreement). The 2023 Notes mature on July 10, 2023 with interest payable annually on July 10. *Id*. While the Notes had accrued interest as of June 1, 2009, no amounts were due and payable until July 10, 2009 and December 7, 2009, the next interest payment dates.

[323] Pl. Ex. 152 at NGM000017558 (email from NYTO Controller's Group to file dated July 8, 2009).

[324] Pl. Ex. 439 (email from G. Upton to H. Kiefer, dated July 8, 2009).

[325] Statement of Uncontested Facts, ¶¶ 33, 74; Buonomo Decl., ¶ 55 (extraordinary resolution was binding on all holders of Notes).

[326] Trial Tr. (8/10/2012), 108:25-109:7 (Buonomo); Trial Tr. (9/27/2012), 76:1-77:15, 79:25-80:5, 80:13-15; 83:22-84:1, 102:5-8 (Ammann); Pl. Exs. 126, 130, 133, 211.

Based on these facts, the Court should find that the true character of the Consent Fee was a payment of principal, and reduce the Noteholders' claims accordingly.

VI. THE NOVA SCOTIA TRUSTEE CLAIM IS DUPLICATIVE OF THE GUARANTEE CLAIMS

In addition to reducing the Nova Scotia Trustee Claim and the Guarantee Claims by the amount of the Consent Fee, this Court should also not allow the Noteholders' assertion of duplicate claims. Established law, in both the United States as well as Canada, recognizes that only a single distribution may be paid on account of what is, in substance, a single debt. The Nova Scotia Trustee Claim and the Guarantee Claims both seek recovery against Old GM on account of the Notes for the benefit of the Noteholders, and to that extent the claims are duplicative. Accordingly, the Nova Scotia Trustee Claim must be disallowed to the extent of its duplication of the Guarantee Claims.

Wedlake, in his Nova Scotia Trustee Claim, seeks recovery against Old GM of more than $1 billion for the unpaid principal due and interest accrued under the Notes.[327] Wedlake asserts this claim in his capacity as a fiduciary for the benefit of the creditors of GM Nova Scotia.[328] Any distribution Wedlake receives from Old GM on the Nova Scotia Trustee Claim would necessarily be distributed to the Noteholders, who are effectively the only creditors of GM Nova Scotia.[329] The Noteholders, through their Guarantee Claims, have also asserted separate claims

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[327] *See* Pl. Ex. 315 (Nova Scotia Trustee Claim).

[328] Trial Tr. (8/7/2012), 159:18-160:1 (Wedlake); Trial Tr. (9/21/2012), 141:2-8 (Khimji); Trial Tr. (11/26/2012), 67:13-68:12 (Iacobucci).

[329] New GM has asserted a claim against GM Nova Scotia for alleged liability under the Swaps. *See* Pl. Ex. 307 (New GM Swap Claim). However, under the terms of the Lock-Up Agreement, any distribution on account of the Swaps is subordinated to payment in full of the Notes should any portion of the Nova Scotia Trustee Claim be disallowed (if only one cent), effectively making the Noteholders the only creditors of GM Nova Scotia. *See* Pl. Ex. 16, ¶ 6(b)(v) (WGM00000800) (executed version of the Lock-Up Agreement).

against Old GM seeking recovery on the same liability as Wedlake, *i.e.*, more than $1 billion of unpaid principal and interest due under the Notes.[330] Thus, the Noteholders, by manufacturing the Nova Scotia Trustee Claim for their benefit and asserting the Guarantee Claims are, as one Morgan Stanley analyst described it, attempting to drink from "two straws in one milkshake."[331]

There is no dispute that the liability underlying the Nova Scotia Trustee Claim with respect to the Notes and the liability underlying the Guarantee Claims are identical: both seek recovery of the same unpaid amounts due to the Noteholders under the Notes.[332] Further, the Noteholders are the ultimate beneficiaries of any distribution by Old GM on account of the Nova Scotia Trustee Claim. It necessarily follows that if the portion of the Nova Scotia Trustee Claim that relates to the Notes and the Guarantee Claims are both allowed, the Noteholders will recover twice for a single loss, in derogation of long-established law prohibiting such a recovery, and contrary to the fundamental bankruptcy and insolvency principle of equality of distribution among creditors.[333]

Under 11 U.S.C. § 502(b)(1), a claim must be disallowed if "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law." 11 U.S.C. § 502(b)(1). The Nova Scotia Trustee Claim is based upon section 135 of the Companies Act, a

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[330] *See, e.g.,* Def. Ex. 290 (Aurelius' Guarantee Claim).

[331] *See* Pl. Ex. 383 at MS&CO_GM_A_0001212 (email from D. Ammann attaching presentation, dated Jan. 22, 2010).

[332] *Compare* Pl. Ex. 315 *with* Def. Ex. 290.

[333] *See, e.g., Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (noting that the prime bankruptcy policy is equality of distribution among creditors of the debtor); *People v. Granite State Provident Ass'n*, 15 E.H. Smith 492, 495, 161 N.Y. 492, 495, 55 N.E. 1053, 1054 (Ct. App. N.Y. 1900) ("All creditors of a corporation, wherever residing, are entitled, in cases of insolvency, to have the general assets distributed among them upon principles of perfect equality."); *Bankr of Nova Scotia v. Janzen (Trustee of)* (1989), 90 NSR (2d) 67, 230 APR 67 (NSSC) ("There is an overriding principle in bankruptcy law that creditors are to be accorded equal and fair treatment and share pro rata in the assets of the estate.") (attached hereto as Index No. 2).

Nova Scotia statute.[334] The Guarantee Claims are based upon Old GM's guarantee, which is governed by New York law.[335] The rule, however, is the same under both U.S. and Canadian law: there can be only one recovery for the same debt against the same debtor for the benefit of the same parties.[336] Accordingly, the Nova Scotia Trustee Claim, to the extent it seeks recovery of amounts owed on account of the Notes, must be disallowed.

A. The Nova Scotia Trustee Claim And Guarantee Claims Are Substitutes For Each Other

As explained in greater detail in the expert testimony of Professor Mohamed F. Khimji,[337] the Nova Scotia Trustee Claim, to the extent it seeks payment of amounts owing under the Notes, is a substitute for the contractual Guarantee Claims, and cannot be concurrently allowed with the Guarantee Claims. The Nova Scotia Trustee Claim asserts a right to payment from Old GM for GM Nova Scotia's liability under the Notes under section 135 of the Nova Scotia Companies Act. That statute provides that in the event an unlimited liability company (a "**ULC**"), such as GM Nova Scotia, is wound up, every present and past member shall, subject to section 135, "be liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges, and expenses of the winding up . . ." RSNS 1989, c. 81, s. 135.[338] Contrary to the Noteholders' assertions, section 135 does not

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[334] *See* Pl. Ex. 315 at Attach., ¶ 3 (GHW0003593) (Nova Scotia Trustee Claim).

[335] *See id*. at Ex. C ¶ 16 (GHW0003658) (Nova Scotia Trustee Claim, fiscal and paying agency agreement, schedule 1) (providing that the fiscal and paying agency agreement, the Notes, and the guarantee shall be governed and construed in accordance with the laws of the State of New York without giving effect to the principles of conflicts of laws).

[336] There is no case in which a court has allowed recovery against a member both on account of a claim under section 135 of the Nova Scotia Companies Act and on account of a claim under a separate contractual guarantee for the unlimited liability company's debt. Trial Tr. (11/26/2012), 120:17-22 (Baird).

[337] *See generally* Khimji Decl. and exhibits thereto; Trial Tr. (9/21/2012) (Khimji).

[338] A copy of section 135 of the Nova Scotia Companies Act is attached as Tab 34 of Exhibit C to the Khimji Decl. and hereto as Index No. 3.

supplant established law in both Canada and the United States that precludes creditors, such as the Noteholders here, from being paid on the basis of two claims for the same underlying loss.

Unlimited member liability under section 135 functions as a "substitute for a shareholder guarantee," K.P. McGuiness, Canadian Business Corporations Law, 2nd ed. (Markham: LexisNexis Canada, 2007) at 78 (attached hereto as Index No. 4), and members have been described as "in effect guarantors of [a ULC's] obligations without any restriction." L.C.B. Gower, Gower's Principles of Modern Company Law, 5th ed. (London: Sweet & Maxwell, 1992), at 88 (attached hereto as Index No. 5). *See also* Khimji Decl., Ex. A at n.36 (hereinafter "**Khimji Report**") (citing *Olympia & York Developments (Re),* [1994] OJ No. 1335 (Ont. Bktcy.) (attached hereto as Index No. 6)). As conceded by Wedlake's expert, Professor Edward Iacobucci, a claim under section 135 and a claim under a contractual guarantee serve the same purpose and are functional equivalents of each other.[339] Thus, where a member separately guarantees a ULC's debts, as in the present case, enforcement of the guarantee should be in lieu of, and not in addition to, enforcement of a claim under section 135. Khimji Report, ¶ 32.

While section 135 is silent on whether a member may be held liable both under section 135 and under a separate guarantee for the same debt, disallowance of the Nova Scotia Trustee Claim to the extent of the amount of the Notes is consistent with both the history and purpose of section 135 (as well as other applicable law).[340] *See* Khimji Report, ¶¶ 12-33. Section 135 does

[339] Trial Tr. (11/26/2012), 57:18-58:19 (Iacobucci).

[340] The principles of statutory construction in Canada require that, when interpreting a statute, "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense, harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament." *See Antigonish (Town) v. Antigonish (County)*, 2006 NSCA 29 (¶ 24) (citing E.A. Driedger and cases) (attached as Tab 1 to Exhibit C of the Khimji Decl. and attached hereto as Index No. 7). When interpreting a Nova Scotia statute, the Nova Scotia Interpretations Act directs that the court consider, among other things, (i) the circumstances existing at the time it was passed; (ii) the object to be attained; (iii) the former law, including other enactments upon the same or similar subjects; (iv) the consequences of a particular interpretation; and (v) the history of legislation on the subject. *See Nova Scotia*

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not create new debt. Khimji Report, ¶¶ 3, 18, 28. Rather, member contribution claims under section 135 arise as a result of the debts already owed by the ULC. The legislative intent of section 135, and its predecessor statute, section 38 of the U.K. Companies Act of 1862, is to provide a centralized mechanism for the orderly collection of member contributions to satisfy the ULC's existing debts by channeling the right to collect such contributions to a liquidator, trustee or receiver. Khimji Report, ¶¶ 18, 27. There is nothing in the statute or legislative history, or that of its predecessor statutes, to even suggest that by enacting these provisions, the legislature intended that a ULC member that contractually guaranteed a ULC's debts be liable twice. Such an outcome would overturn firmly established law that prohibits double recoveries on account of a single loss.

B. The Nova Scotia Trustee Claim And Guarantee Claims Are Not Allowable Concurrently Under U.S. Law

1. Allowance Of Both The Guarantee Claims And The Nova Scotia Trustee Claim To The Extent Of The Notes Violates The Equitable Principle That Creditors Are Entitled To Only One Recovery For One Loss

The Nova Scotia Trustee Claim and the Guarantee Claims arise under the same set of facts (the issuance and non-payment of the Notes), both allege the same damages (the amounts due under the Notes) against the same party (Old GM), and as such are duplicates of each other.[341] Allowing both claims is contrary to the bedrock principle of U.S. law that a claimant is entitled to one recovery for one loss, even if that loss can be proven under multiple legal

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Interpretation Act, RSNS 1989, c. 235, s. 9(5) (attached as Tab 33 to Exhibit C of the Khimji Decl. and attached hereto as Index No. 8).

[341] *See Sang Lan v. AOL Time Warner, Inc*., No. 11 Civ. 2870 (LBS) (JCF), 2012 WL 1633907 (S.D.N.Y. May 9, 2012) (dismissing plaintiff's breach of fiduciary duty claim because it arises from the same facts and seeks the same relief as her invasion of privacy claim and is therefore duplicative); *Netjets Aviation, Inc. v. LHC Commc'ns., L.L.C.*, 537 F.3d 168, 175 (2d Cir. 2008) (citing *Sitar v. Sitar*, 854 N.Y.S.2d 536, 538 (2d Dep't 2008), two claims are duplicative of each other if they "arise from the same facts . . . and do not allege distinct damages").

theories.[342] This principle holds even if the creditor extracts multiple promises to pay from the same debtor, because "[a]ny rule that would permit the proof of two notes for one indebtedness would permit the proof of a dozen and would substitute for pro rata distribution among real creditors, distribution in accordance with the ability of the bankrupt to make manifold obligations for single debts."[343] Applying these fundamental principles, courts disallow claims where a creditor, or a party on the creditor's behalf, asserts multiple claims against an estate on account of the same underlying debt, to prevent allowance of a double liability against the

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[342] *See, e.g., Conway v. Icahn & Co*., 16 F.3d 504, 511 (2d Cir. 1994) (citing *Wickham Contracting Co. v. Bd. of Educ*., 715 F.2d 21, 28 (2d Cir. 1983), "Where a plaintiff seeks recovery for the same damages under different legal theories, only a single recovery is allowed"); *Wickham Contracting Co., Inc. v. Bd. of Educ.*, 715 F.2d 21, 29 (2d Cir. 1983) (only a single recovery will be allowed as damages for the same illegal acts under different legal theories); *ADP Dealer Serv., Inc. v. Planet Automall, Inc.,* No. 09 Civ. 0185 (ILG) (RER), 2012 WL 95211, at *7 (E.D.N.Y. Jan. 12, 2012) (citing *Fineman v. Armstrong World Indus., Inc*., 980 F.2d 171, 218 (3d Cir. 1992), *cert. denied*, 507 U.S. 921 (1993), "Simply because [plaintiff] was able to wrap that loss into several different legal theories of recovery does not entitle it to recoup twice."); *Hettinger v. Kleinman*, 733 F. Supp. 2d 421, 449 (S.D.N.Y. 2010) (a plaintiff seeking compensation for the same injury under different legal theories is only entitled to one recovery); *Carter v. State of N.Y.*, 528 N.Y.S.2d 292 (Ct. Cl. 1988), *judgment aff'd*, 154 A.D.2d 642 (N.Y. App. Div. 1989) (the equitable principle is that a claimant may not obtain a double recovery for the same injury and damages); *Leighty v. Brunn*, 510 N.Y.S.2d 174, 175 (App. Div. 1986) ("[I]t is beyond cavil that a plaintiff is entitled to only one recovery with respect to an identical damage claim."); *Berg-Bakis Ltd. v. City of Yonkers*, 455 N.Y.S.2d 645, 646 (App. Div. 1982) ("The plaintiffs sustained a single injury and are entitled to one recovery only. Indeed, to allow the plaintiffs to recover separate damages on each of the two causes of action, or additional damages simply because they had proved both causes of action which had the same elements, would result in a proscribed double recovery."), *appeal dismissed*, 60 N.Y.2d 664 (1983), *appeal denied*, 64 N.Y.2d 603 (1985); *Zarcone v. Perry*, 434 N.Y.S.2d 437, 443 (App. Div. 1980), *aff'd*, 55 N.Y.2d. 782 (1981), *cert. denied*, 456 U.S. 979 (1982) (judicial policy forbids double recovery for one injury).

[343] *John Matthews, Inc. v. Knickerbocker Trust Co*., 192 F. 557 (2d Cir. 1911). *See, e.g., N.Y. Trust Co. v. Palmer*, 101 F.2d 1, 9 (2d Cir. 1939) (a debtor's multiple promises to pay do not give rise to allowance of multiple claims against an insolvent debtor); *Mercantile Factors Corp. v. Warner Bros. Pictures, Inc.*, 214 N.Y.S. 273 (App. Div.), *aff'd*, 244 N.Y. 504 (1926) ("[A] debtor cannot, by adding another obligation of his own to that which he is already obligated to pay, create a second obligation as collateral to the first."); *People v. E. Remington & Sons (In re Oneida Nat'l Bank)*, 54 Hun. 480, 8 N.Y.S. 31, 34 (4th Dep't 1889), *aff'd*, 121 N.Y. 675 (1890) (citing *Third Nat'l Bank of Boston v. E. Railroad Co.*, 122 Mass 240, 242 (1877), "[a] debtor's liability to his creditor, where other creditors are concerned, is not increased by increasing the number of his promises to pay the same debt, in whatever form he may make them. To hold otherwise would be to enable the debtor to incumber [sic] his assets by a new method, greatly to the prejudice of all other creditors."). *See also Union Nat'l Bank of Johnstown, P.A. v. People's Sav. & Trust Co., of Pittsburg, P.A.*, 28 F.2d 326 (3d Cir. 1928) (holding that a corporate debtor's giving of an additional note as further evidence of the original debt does not entitle the creditor to multiple claims).

estate.[344]

The case of *Curtis v. Walpole Tire & Rubber Co.,* 227 F. 698, 703 (D. Mass. 1914), is instructive. In *Curtis*, the court held that a creditor could not assert two claims against a debtor for amounts owed under a promissory note, where the creditor sought to recover from the debtor as both the indorser of the note *and* as the purchaser of the assets and liabilities of the original maker of the note. The creditor was the holder of a promissory note made by the Massachusetts Chemical Company ("**Mass. Chemical**") and indorsed by the Walpole Company ("**Walpole**"). *Id.* at 701. Walpole later acquired both the assets and liabilities of Mass. Chemical in a purchase transaction, and thereby assumed the liability of Mass. Chemical under the note. *Id.* In Walpole's receivership proceeding, the creditor asserted a claim against Walpole on account of Walpole's indorsement of the note, and on account of Mass. Chemical's primary liability on the notes, which liability Walpole separately assumed. *Id.* The court disallowed the indorsement claim because the creditor's claim on account of the primary obligation under the note had already been allowed against Walpole. The court held that to allow the indorsement claim in addition to the primary note claim would permit the creditor to receive two dividends in respect of what was in substance the same debt. *Id.* at 703.

The same conclusion is required here. Old GM is asserted to be liable for the amounts

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[344] *See, e.g., First Nat'l Bank of Beaumont v. Eason*, 149 F. 204, 204-05 (5th Cir. 1906) (a creditor may not prove two claims against a bankruptcy estate, thereby establishing "double liability" because "[t]here was only one consideration, really only one debt, and the appellant is entitled to only one satisfaction."); *In re Simetco*, *Inc.*, No. 93-61772, 1996 WL 651001, at *3 (Bankr. N.D. Ohio Feb. 15, 1996) (disallowing PBGC's minimum funding contribution claim to the extent of overlap with its unfunded benefit liability claim, because multiple recoveries for the same loss "would violate the principles of ratable distribution and offend the notions of uniform treatment for creditors."); *In re Wise Shoes*, *Inc.*, 2 F. Supp. 521, 523-24 (S.D.N.Y. 1932) (denying claim for face amount of surety bond which bankrupt failed to obtain where claim for rent accrued and unpaid was allowed because "it is evident that to allow a claim also for failure to give bond would be to permit double proof on the same debt, contrary to the settled rule."), *aff'd,* 64 F.2d 1023 (2d Cir. 1933); *In re Sterling, Ahrens & Co.*, 4 Hughes 553, 1 F. 167, 169 (D. Md. 1880) ("One sound and well established rule applicable to the settlement of insolvent estates is that the estate must never pay two dividends in respect of the same claim.").

due on the Notes under two guarantees of the same obligation: under its contractual obligation as a guarantor, and under its statutory guarantee as a member of a ULC. But these two obligations, as in *Curtis*, are for a single loss, which is the amount owed under the Notes. Because the loss for the two claims is identical, the Court must disallow the claims asserted to the extent necessary to prevent a double recovery against the Old GM estate.[345]

2. Bankruptcy Courts Have Disallowed Multiple Claims For The Same Loss By Nominally Different Parties Where The Claims Are Asserted For The Benefit Of The Same Creditor

Although the Nova Scotia Trustee Claim is nominally asserted by Wedlake and not the Noteholders, the claim is being asserted for the benefit of the Noteholders.[346] Thus, the real claimants under both the Nova Scotia Trustee Claim and the Guarantee Claims are, in equity and in substance, the Noteholders, and the fact that the Nova Scotia Trustee Claim is asserted by Wedlake on the Noteholders' behalf does not transform this claim into a non-duplicative claim. Indeed, courts considering proofs of claims in bankruptcy cases filed by individual claimants and their representatives for the same loss have consistently held that both claims cannot be allowed against the estate.[347]

345 *See also PNC Capital Recovery v. Mech. Parking Sys*., 726 N.Y.S.2d 394, 396-97 (App. Div. 2001) (noting the illogicality of interpreting a contract to make a debtor guarantee its own indebtedness), *dismissing leave to appeal*, 96 N.Y.2d 937 (2001), *appeal dismissed*, 98 N.Y.2d 763 (2002).

346 *See* Khimji Report, ¶ 27; Trial Tr. (8/7/2012), 159:18-60:1 (Wedlake); Trial Tr. (9/21/2012), 141:2-8 (Khimji); Trial Tr. (11/26/2012), 67:13-68:12 (Iacobucci). The evidence in this case also establishes that Wedlake not only acts on behalf of the Noteholders, but is controlled by the Noteholders. *See* Argument Section II(B).

347 *See, e.g., In re Nw. Airlines Corp*., No. 05-17930, 2007 WL 2682129 (Bankr. S.D.N.Y. Sept. 12, 2007) (disallowing, as duplicative, claim of individual claimant where union filed a claim with respect to the same amounts claimed); *In re Enron Corp*., No. 01-16034 (AJG), 2006 WL 1030420 (Bankr. S.D.N.Y. Apr. 6, 2006) (disallowing, as duplicative, claim of individual claimant for unpaid wages and benefits under collective bargaining agreement where claimant's union filed claim on behalf of all union members for unpaid wages and benefits); *LTV Corp. v. Pension Benefit Guar. Corp. (In re Chateaugay Corp.)*, 115 B.R. 760 (Bankr. S.D.N.Y. 1990), *aff'd* 130 B.R. 690, 698 (S.D.N.Y. 1991) (holding that claim by PBGC for unpaid contributions will be disallowed to the extent that any amount duplicated other claims allowed for unpaid contributions) *vacated by agreement of the parties,* Nos. 89 Civ. 6012, 90 Civ.

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For example, in *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey,* 160 B.R. 882 (Bankr. S.D.N.Y. 1993), this Court held that where a pension plan trustee and the Pension Benefit Guarantee Corporation ("**PBGC**") each filed claims for amounts necessary to satisfy the debtor's obligations arising under its pension plan and the Employee Retirement Income Security Act, the pension plan trustee's claim would be disallowed to the extent it duplicated the PBGC's claim. *Id.* at 893. In doing so, the Court noted that in a bankruptcy, multiple recoveries for identical injuries are not permitted, and that to allow one creditor (or multiple creditors) to assert two dollars in claims for one dollar of loss from the same debtor would violate the principles of ratable distribution and offend the notion of uniform treatment of creditors. *Id.* (citing *In re Chateaugay*, 115 B.R. at 783-84).

Similarly, the Nova Scotia Trustee Claim and the Guarantee Claims, although asserted by nominally different claimants, assert claims for the same loss for the benefit of the same claimants, the Noteholders. Allowing both claims in this case would permit assertion of two dollars in claims for every one dollar of loss against Old GM. As such, the Nova Scotia Trustee Claim should be disallowed to the extent it seeks payment of amounts owed under the Notes.

3. The Second Circuit's Holding In *Delta* Is Consistent With Disallowance Of The Nova Scotia Trustee Claim

The Second Circuit's holding in *Northwestern Mutual Life Insurance Co. v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.)*, 608 F.3d 139 (2d Cir. 2010) ("***Delta***") affirms the fundamental principle prohibiting duplicate claims against the same debtor for the same debt. The holding in *Delta*, which was based on facts very different than those presented here, does

Footnote continued from previous page
6048 (KTD), 1993 WL 388809 (S.D.N.Y. Jun. 16, 1993); *In re Brinke Transp., Inc.,* No. 87-03785, 1989 WL 233147, at *3 (Bankr. D.N.J. Jan. 23, 1989) (striking claims filed by pension fund and union based on violation of collective bargaining agreement where the claims "substantially overlap" with that filed by the NLRB for unfair labor practices on the same facts.), *aff'd*, Civ. Act. No. 89-1778, 135 L.R.R.M. 2800 (D.N.J. 1989).

not, as the Noteholders and Wedlake suggest, entitle them to a double recovery on the Noteholders' single loss.

Delta involved leveraged leases for the purchase and lease-back of aircraft and claims relating to certain payments owed in connection with lost tax benefits. *Id.* at 141. In *Delta*, the owner participants, who provided a portion of the funding for the acquisition of aircraft, filed a "TIA" claim for certain tax benefits they lost as a result of the bankruptcy filing. *Id.* at 144. The owner participants were to be reimbursed for these lost tax benefits pursuant to a prepetition contract with the debtor. *Id.* at 142. In its aircraft leases, which were assigned as security to certain lenders who provided additional funding to purchase aircraft, the debtor also agreed to pay the lenders an amount calculated by reference to the tax loss as additional security against default (the "SLV" claim). *Id.* The debtor in *Delta* objected to the claim of the owner participants, who incurred the tax loss, while allowing the claim of the lenders, who did not actually incur the tax loss. *Id.* at 143-144. The Second Circuit ruled that the objection was not valid. *Id.* at 150.

The Second Circuit's holding is premised on the unremarkable proposition that where a debtor made contractual promises to pay two different parties an amount calculated by reference to the same event, the promisor's payment to one party will not excuse the promised payment to the other. Consistent with established law, *Delta* does not implicitly or explicitly permit a creditor to recover on multiple claims for one loss.[348] Moreover, the Second Circuit

[348] The Bankruptcy Court's opinion in *Delta*, which the Second Circuit cites with approval, *see Delta*, 608 F.3d at 149, specifically addresses *Finley, Kumble* and notes "[n]ot surprisingly, the Bankruptcy Court disallowed the claims [of the PBGC and the pension plan trustee] to the extent that they sought compensation for the same underfunding of the pension plan." *In re Delta Air Lines, Inc*., 370 B.R. 552, 556-57, n.1 (Bankr. S.D.N.Y. 2007), *aff'd*, 2008 WL 4444001 (S.D.N.Y Sept. 29, 2008), *vacated and remanded*, 608 F.3d 139 (2d Cir. 2010).

acknowledged that even under the circumstances presented, the proper remedy would have been to disallow the claim of the party who did not actually incur the loss:

> To the extent that this is true [*i.e.*, that the allowance of both the TIA claim and SLV claim allowed the claimants to receive more than their pro rata share of distributions], it is Delta's own fault: the problem exists because Delta (and the creditors' committee) agreed, under the Bingham Term Sheet, the other restructured lease agreements, and Delta's plan of reorganization, to pay the Indenture Trustees [sic] more than they were entitled to – namely, their share *and* the Owner Participants' share. While Delta is correct that the aggregate amounts claimed by the Owner Participants and the Indenture Trustees exceeded their proper aggregate share to the extent of the duplication of the Owner Participants' claims under the TIAs, the proper remedy was disallowance of the claims of the Indenture Trustees to the extent they were predicated on the Owner Participants' TIA entitlements.

Id. (emphasis added).

Old GM owes only one debt – payment of the approximately $1 billion under the Notes. Unlike the debtor in *Delta*, Old GM made only one contractual promise to pay (the Guarantee). There is only one loss in this case,[349] and the Noteholders are the only ones who incurred that loss. Unlike in *Delta*, the economic beneficiaries with respect to the Nova Scotia Trustee Claim and the Guarantee Claims are the same parties (the Noteholders). Under these facts, *Delta* would not permit allowance of both the Nova Scotia Trustee Claim and the Guarantee Claims. Accordingly, the Court should disallow the Nova Scotia Trustee Claim to the extent of duplication with the Guarantee Claims, consistent with *Delta* and the existing case law in the Second Circuit, all of which consistently prohibit two recoveries for a single loss from the same entity.

[349] As explained above, section 135 of the Companies Act is simply a mechanism to enforce the existing debts of a ULC and does not create a new debt.

C. Canadian Law Prohibits Concurrent Enforcement Of The Nova Scotia Trustee Claim And The Guarantee Claims

Likewise, section 135 does not supplant established Canadian law that precludes creditors, such as the Noteholders, from being compensated on the basis of two claims for the same underlying loss.[350] The common law rule against double proof prohibits concurrent allowance against Old GM of the Guarantee Claims and the Nova Scotia Trustee Claim to the extent of the Notes. The rule against double proof is a long-standing principle of English[351] and Canadian law that is designed to ensure *pari passu* distribution to creditors by preventing the payment of claims that, although asserted under different theories or by different parties, are, in substance, on account of the same debt. Khimji Report, ¶ 35. Although the rule against double proof is often invoked in the context of bankruptcy proceedings, the rule itself is an overarching principle of Canadian law and is not limited to bankruptcy or insolvency proceedings.[352] *See* Khimji Report, ¶ 35.

The dispositive question under the rule against double proof is whether two claims are asserted on account of the same debt. *See Olympia & York Developments (Re),* [1998] OJ No. 4903, 4 CBR (4th) 189 (Ont. Bktcy.) ("**Olympia & York**") at ¶ 36 (attached hereto as Index No. 11). In determining whether two asserted claims are, in substance, for the same debt the Ontario Court of Justice in *Olympia & York* set forth the following test: "the question [is] whether two payments are being sought for a liability which, if the company were solvent, could be

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350 Khimji Report, ¶¶ 26, 34-39.

351 English law, while not binding upon Canadian courts, is persuasive authority in Canada. *See* Trial Tr. (9/21/2012), 60:12-17 (Khimji); Baird Decl. at 14, n.10.

352 *See Glen Express Ltd., Re* [2000] B.P.I.R. 456 (Ch D) at p. 4 (attached as Tab 10 to Exhibit C of the Khimji Decl. and attached hereto as Index No. 9); *Owners of Steamship Enterprises of Panama Inc. v. Owners of SS Ousel (The LiverpoolNo 2)* [1963] P 64 (CA) at p. 84 (applying the rule against double proof in an admiralty case) (attached as Tab 28 to Exhibit C of the Khimji Decl. and attached hereto as Index No. 10).

discharged as regards both claimants by one payment" (the "**O&Y Test**"). *Id.* at ¶ 45.

In *Olympia & York*, the issue was whether the claim of a syndicate of lenders on account of the parent's guarantee of a loan made to its wholly-owned subsidiary, and the claim of the subsidiary for an intercompany loan made by the subsidiary to the parent with the proceeds of the loan, should both be allowed concurrently against the parent. *Id.* at ¶¶ 2-6. In applying the O&Y Test, the court concluded that, under the facts of that case, the two claims were double proofs, and that claimants were entitled to a single dividend out of the parent's estate. The same result follows in this case, as it is undisputed that a full payment on the Guarantee Claims, assuming that Old GM is solvent, would discharge in full the amount of the Nova Scotia Trustee Claim attributable to the Notes. As such, the Nova Scotia Trustee Claim to the extent of the Notes is a double proof and would not be enforceable together with the Guarantee Claims under Canadian law.

D. The Nova Scotia Trustee Claim Must Be Disallowed Pursuant To Section 502(e) Of The Bankruptcy Code

The purpose of section 502(e)(1)(B) is "to preclude redundant recoveries on identical claims against insolvent estates in violation of the fundamental Code policy fostering equitable distribution among all creditors of the same class." *In re APCO Liquidating Trust*, 370 B.R. 625, 634 (Bankr. D. Del. 2007). Section 502(e)(1)(B) of the Bankruptcy Code therefore requires the disallowance of the Nova Scotia Trustee Claim, because it is a contingent claim that is being asserted to recover the same debt asserted under the Guarantee Claims. Specifically, section 502(e)(1)(B) precludes the allowance of the Nova Scotia Trustee Claim because it is a claim: (1) for contribution or reimbursement; (2) of an entity that is liable with the debtor for the debt; and (3) that is contingent. 11 U.S.C. § 502(e)(1)(B). Because each of these elements is satisfied, the Nova Scotia Trustee Claim must be disallowed.

First, both Old GM and GM Nova Scotia are liable for the underlying debt on the Notes. Co-liability is interpreted broadly for purposes of section 502(e), and includes any type of shared liability, regardless of its basis. *In re Drexel Burnham Lambert Grp. Inc.*, 148 B.R. 982, 986 (Bankr. S.D.N.Y. 1992); *In re Baldwin-United Corp.*, 55 B.R. 885, 890 (Bankr. S.D. Ohio 1985). The statute covers claims based on two entirely different grounds of liability, provided the underlying liability is the same. *See Norpak Corp. v. In re Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus., Inc.*), 131 F.3d 1185, 1190 (6th Cir. 1997); *In re Tri-Union Dev. Corp.*, 314 B.R. 611 (Bankr. S.D. Tex. 2004). In the present case, GM Nova Scotia issued the Notes, and Old GM guaranteed payment of the Notes, and therefore both are liable for repayment of the same debt.

Second, the Nova Scotia Trustee Claim is a claim for contribution or reimbursement. The determination of a claim's status as one for reimbursement or contribution is based on its characterization under applicable non-bankruptcy law. *In re APCO Liquidating Trust*, 370 B.R. at 631. Here, the applicable non-bankruptcy law is provided by section 135, which calls for a member of an unlimited company – such as Old GM in the present case – to "contribute to the assets of the company" under the circumstances described in the statute. N.S. Companies Act at § 135. A claim under section 135 is therefore explicitly based on a "contribution." Further, the concept of "reimbursement" under section 502(e) is broadly construed to include "whatever claims a co-debtor has which entitle him to be made whole for monies he has expended on account of a debt for which he and the debtor are both liable." *In re Wedtech Corp.*, 87 B.R. 279, 287 (Bankr. S.D.N.Y. 1988); *see also In re Lyondell Chem. Co.*, 442 B.R. 236, 256 (Bankr. S.D.N.Y. 2011). The Nova Scotia Trustee Claim therefore constitutes a claim for contribution and/or reimbursement under section 502(e).

Finally, the Nova Scotia Trustee Claim is a contingent claim. A claim is contingent if the legal duty to pay does not come into existence until triggered by the occurrence of a future event. *Mazzeo v. U.S. (In re Mazzeo)*, 131 F.3d 295, 303 (2d Cir. 1997); *In re GCO Servs., L.L.C.*, 324 B.R. 459, 466 (Bankr. S.D.N.Y. 2005); *In re Lull Corp.*, 162 B.R. 234, 239 (Bankr. D. Minn. 1993). Even where liability has been established, courts have found claims to be contingent where it is unclear whether payment will need to be made. *In re Lyondell Chem. Co.*, 442 B.R. at 250. Until such time as GM Nova Scotia pays the Notes, the Nova Scotia Trustee Claim is contingent. Because the Nova Scotia Trustee Claim is contingent, and because each of the elements of section 502(e)(1)(B) is satisfied, the Nova Scotia Trustee Claim must be disallowed.

E. The Disputed Claims, If Allowed At All, Must Be Disallowed To The Extent They Seek Recovery Of Postpetition Interest

The Disputed Claims seek recovery of principal and interest due on the Notes through October 9, 2009, the date of GM Nova Scotia's bankruptcy.[353] The Disputed Claims are unsecured claims against Old GM governed by section 502 of the Bankruptcy Code. Under section 502(b)(2) of the Bankruptcy Code, claims for unmatured interest as of June 1, 2009, Old GM's Petition Date, shall be disallowed. *See* 11 U.S.C. § 502(b)(2). Thus, the Disputed Claims, if allowed at all, should be disallowed to the extent of any interest claimed for the periods from and after Old GM's Petition Date.

F. The Nova Scotia Trustee Claim, If Allowed At All, Should Be Allowed As A "Net" Claim After Deduction Of Distributions On The Guarantee Claims

A claim under section 135 of the Companies Act is, by its nature, a net claim. If a creditor receives payment from another source on the ULC's debts, the "debts and liabilities" of the ULC are reduced, and so is the claim under section 135. *See* RSNS 1989, c. 81, s. 135. The Nova Scotia Trustee Claim asserts a section 135 claim without any deduction for the amounts the

[353] *See* Pl. Ex. 315 at Attach., ¶ 5 (GHW0003594-95).

Noteholders will recover under the Guarantee Claims. If the Nova Scotia Trustee Claim is allowed at all against Old GM, it should be allowed only as a net claim after deduction of the amounts paid to the Noteholders on account of the Guarantee Claims.

VII. THE PORTION OF THE NOVA SCOTIA TRUSTEE CLAIM THAT IS BASED ON THE SWAPS SHOULD BE DISALLOWED

A. New GM Has No Rights To The Swaps Because The Swaps Were Not Assumed And Assigned To New GM

As of the filing of the petition, Old GM owned the "in the money" side of the Swaps. In fact, as of just two months before the Petition Date, GM Nova Scotia owed Old GM approximately CAD $632 million under the Swaps.[354] Through the Lock-Up Agreement, and the postpetition machinations of the Lock-Up Noteholders acting in concert with the same conflicted Old GM employees who became employed by New GM, the Noteholders now contend that the Swaps create a $564 million claim for their benefit. For the reasons set forth herein, the portion of the Nova Scotia Trustee Claim that is based on the Swaps should be disallowed.

The Swaps mature by their terms in 2015 and 2023, respectively.[355] Old GM's bankruptcy filing constituted an "event of default" under the Swaps but did not operate to terminate the Swaps.[356] As executory contracts, the Swaps constituted property of Old GM's bankruptcy estate, subject to assumption or rejection in accordance with the Bankruptcy Code and procedures authorized by the Court. 11 U.S.C. § 365.

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[354] As disclosed by Old GM, as of March 31, 2009, GM Nova Scotia would owe a net liability of approximately CAD $632 million to Old GM under the Swaps, if the Swaps were terminated as of such date. Def. Ex. 75 at NGM000007377 (form S-4 filed on April 27, 2009).

[355] *See* Pl. Ex. 315, confirmation ¶ 2 (GHW0003743) (termination date listed as July 10, 2023), confirmation ¶ 2 (GHW0003738) (termination date listed as December 7, 2015) (Nova Scotia Trustee Claim).

[356] *See id*. at ¶ 5(a)(vii) (GHW0003710), ¶ 6(a) (GHW0003712) (Nova Scotia Trustee Claim).

The Swaps were not assumed and assigned to New GM. In the order approving the 363 Sale this Court set forth the exclusive procedures for the assumption and assignment of contracts in this case. Those procedures were not followed with respect to the Swaps.[357] In particular, notice was never sent to GM Nova Scotia, and none of the Swap Documents were listed in the assumption and assignment database.[358] Consistent with the above, New GM has acknowledged that it does not believe it has a right to the Swaps.[359]

New GM is not an assignee of, and has no rights to, the Swaps, and, therefore has no claim against GM Nova Scotia arising from the Swaps. The right to assert a claim against GM Nova Scotia for liabilities under the Swaps belongs solely to Old GM, and Old GM has not asserted that claim.[360] Accordingly, the portion of the Nova Scotia Trustee Claim that is based on the Swaps should be disallowed.

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[357] *See* Pl. Ex. 275, ¶ 10 (Sale Procedures Order) (Bankr. Dkt. No. 274) (as a condition precedent to the assumption of an executory contract, Old GM was required to provide an assumption and assignment notice containing an objection deadline to the contracting counterparty, in the form attached as Exhibit D to the Sale Procedures Order, with instructions for how to access the assumption and assignment database).

[358] Pl. Ex. 281 (Email from R. Berkovich to E. Fisher dated April 22, 2010, attaching excerpt from assumption and assignment database).

[359] The key individuals at New GM did not always believe that the Swaps had been assumed and assigned to New GM. *See* Pl. Ex. 248 ("there is a view [at GM] that [the] swap claim is not included when calculating the wind-up claim."); Pl. Ex. 22 ("I inquired with Weil Gotshal, which reminded me that inasmuch as the [Swaps were] not assigned this decision rests with Motors Liquidation Company (Oldco)"). Moreover, in the New GM Swap Claim, Buonomo certifies that New GM "acquired rights in the account as of July 10, 2009 pursuant to its acquisition of substantially all of the assets of" Old GM). Subsequently, New GM took the position that the Swaps were assumed and assigned. Trial Tr. (8/9/2012) 106:5-7 (Buonomo) ("[The Swaps] were designated for assumption according to the procedures in place. . . ."). However, when asked about the language in the New GM Swap Claim that he signed, Mr. Buonomo testified that "the date would be wrong if [the Swaps are] deemed an executory contract subject to that process. If they're deemed an executory contract, it should have been as of whatever the date [of] the assumption through that process." *Id*. at 113:11-15.

[360] The Swaps were rejected, at the latest, pursuant to *Debtors' Second Amended Joint Chapter 11 Plan* (Bankr. Dkt. No. 9836a, § 8.1).

B. Even If New GM Has Rights To The Swaps, It Has No Valid Claim

Even if the Swaps had been assigned to New GM, the portion of the Nova Scotia Trustee Claim that is based on the Swaps is, in any event, invalid because the Swaps were not terminated. Rather, GM Nova Scotia, the defaulting party upon its bankruptcy filing, purported to "disclaim" the Swaps as of October 9, 2009, by letter dated January 12, 2010. This "disclaimer," however, did not effect an early termination under the ISDA Master Agreement, which expressly requires, among other things, that the *non-defaulting party* issue a termination notice specifying the default and designating a *future* early termination date – not a date before the time such notice is effective.[361] Here, the only way that the Swaps could have been terminated in advance of the applicable maturity dates was by following the termination procedures set forth in the Swap Documents.

The termination of the Swaps is what crystalizes liability and gives rise to a claim.[362] It is undisputed that New GM has never issued a termination notice relating to the Swaps. For reasons that New GM has refused to disclose based on the assertion of privilege, it simply decided that it "was not inclined to terminate" the Swaps.[363] Absent proper termination by the non-defaulting party, no payment is due under the Swaps. The portion of the Nova Scotia Trustee Claim that is based on the Swaps should therefore be disallowed on this basis.

Finally, even if the Swaps did somehow constitute "Purchased Contracts" under the MSPA, Old GM would still have no liability to New GM (or any other entity) with respect to the

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[361] *See* Pl. Ex. 315 at Ex. E, ¶ 6(a) (GHW0003712) (ISDA Master Agreement).

[362] Trial Tr. (9/28/2012), 20:18-25; 21:1-8; 22:2-18 (Gropper); Pl. Ex. 20.

[363] Trial Tr. (8/7/2012), 81:19-22 (Wedlake); Wedlake Decl., ¶ 60; *see also* Pl. Ex. 145. The only logical explanation as to why New GM would not be inclined to terminate is that it did not believe it was legally permitted to terminate. As described above, Mr. Buonomo was reminded that the Swaps were not assigned to New GM, and he was aware of the view that the Swaps were not to be included when calculating the Nova Scotia Trustee Claim.

Swaps because, pursuant to the Sale Order, Old GM has been "forever released from any and all liability under the Purchased Contracts."[364] Thus, regardless of whether New GM has any rights in the Swaps, the portion of the Nova Scotia Trustee Claim that is based on the Swaps is invalid and should be disallowed.

C. Alternatively, The Swaps Component Of The Nova Scotia Trustee Claim Should Be Reduced

If the portion of the Nova Scotia Trustee Claim that is based on the Swaps is not disallowed in its entirety (as it should be), the claim should be reduced by at least $233 million.[365] Assuming that the January 12, 2010 letter somehow constituted a termination, it would have been an early termination because the Swaps do not mature by their terms until 2015 and 2023.[366] The confirmations to the Swaps, which dictate the payments that are due upon early termination, specify that the Final Exchange Method governs the calculation.[367] According to both the GUC Trust's swap expert and Wedlake's swap expert, the amount of the Nova Scotia Trustee Claim that is based on the Swaps (if any), applying the Final Exchange method, would be $331,504,266.[368]

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364 *See* Sale Order, ¶ GG [Bankr. Dkt. No. 2968].

365 *See supra* note 228.

366 *See supra* note 221.

367 *See supra* note 222, 223.

368 *See supra* note 228.

CONCLUSION

WHEREFORE, the GUC Trust respectfully requests entry of a judgment disallowing the Disputed Claims in full, and granting such other relief as the Court deems just and proper.

Dated: New York, New York
May 24, 2013

Respectfully submitted,

By: /s/ Eric B. Fisher

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Harbert Distressed Investment Master Fund Ltd. v. Calpine Canada Energy Finance II ULC

HARBERT DISTRESSED INVESTMENT MASTER FUND, LTD. and WILMINGTON TRUST COMPANY (Applicants) and CALPINE CANADA ENERGY FINANCE II ULC, CALPINE CANADA RESOURCES COMPANY, CALPINE EUROPEAN FUNDING (JERSEY) LIMITED, CALPINE (JERSEY) LIMITED and CALPINE CORPORATION (Respondents)

Nova Scotia Supreme Court

Smith A.C.J.S.C.

Heard: July 6-8, 27, 2005
Judgment: August 2, 2005
Docket: S.H. 245975

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Counsel: John L. Finnigan for Applicant, Harbert Distressed Investment Master Fund, Ltd.

Elizabeth Pillon for Applicant, Wilmington Trust Company

Roderick H. Rogers for Respondents

Subject: Corporate and Commercial; Civil Practice and Procedure; International

Business associations --- Powers, rights and liabilities — Corporate borrowing — Rights and obligations of security holders — General principles

Oppression remedy — H Ltd. was investment fund specializing in distressed and high yield debt securities — W Co. was securities-holding trustee — C Co. group of companies included two companies registered under Nova Scotia Companies Act, Finance II and Resources — Finance II was holder of term debenture issued by Resources — In 2001, Resources had equity interest in natural gas-fired power plant in Yorkshire, England ("S facility") — In October of 2001, Finance II issued series of bonds to W Co. as trustee for investment funds — In 2004, C Co. group of companies issued preferred shares with respect to S facility — In order to effect sale of S facility, it was necessary to cause preferred shares to be redeemed in priority to other security holders — On January 13, 2005, C Co. announced potential sale of S facility — On January 14, H Ltd. made its first purchase of Finance II bonds — At time of purchase, H Ltd. knew of issuance of preferred shares — On January 20, C Co. group of companies issued second series of preferred shares with respect to S facility — On April 13, H Ltd. sent letter to Finance II and Resources, suggesting that announcement of sale of S facility and issuance of second series of redeemable preferred shares was evidence of effort to strip value of S facility to prejudice of Finance II's bondholders — H Ltd. and W Co., as trustee on behalf of H Ltd., applied for oppression remedy un-

der s. 5 of Third Schedule of Companies Act — Application dismissed — Issuance of preferred shares was detrimental to interests of Finance II's bondholders and contravened terms of term debenture between Finance II and Resource — However, H Ltd. knew that C Co. group of companies had issued preferred shares when H Ltd. bought Finance II bonds — Consequently, H Ltd. cannot claim that conduct of C Co. group of companies was oppressive.

Judges and courts --- Jurisdiction — Territorial jurisdiction — Residence or domicile — Of corporations

Oppression remedy — H Ltd. was investment fund specializing in distressed and high yield debt securities — W Co. was securities-holding trustee — C Co. group of companies included two companies registered under Nova Scotia Companies Act, Finance II and Resources — Neither H Ltd., W Co. nor C Co. was based in Nova Scotia — Finance II and Resources were registered under Nova Scotia Companies Act — H Ltd. and W Co., as trustee on behalf of H Ltd., applied for oppression remedy under s. 5 of Third Schedule of Companies Act against C Co. group of companies — C Co. cross-applied for declaration that Nova Scotia had no jurisdiction to hear matter — Cross-application dismissed — When dealing with jurisdiction, court first determines whether forum can assume jurisdiction given relationship between case, parties and forum (jurisdiction simpliciter) — While neither H Ltd., W Co. nor C Co. was registered or had head office in Nova Scotia, Finance II and Resources were Nova Scotia companies — Finance II and Resource acknowledged jurisdiction of Nova Scotia court to deal with application against them — Businesses of Finance II, Resource and C Co. were so intermingled that it was fair to state that C Co. had real and substantial connection to Nova Scotia.

Business associations --- Specific corporate organization matters — Shareholders — Shareholders' remedies — Relief from oppression — Standing to apply

"Complainant" — H Ltd. was investment fund specializing in distressed and high yield debt securities — W Co. was securities-holding trustee — C Co. group of companies included two companies registered under Nova Scotia Companies Act, Finance II and Resources — Neither H Ltd., W Co. nor C Co. was based in Nova Scotia — Finance II and Resources were registered under Nova Scotia Companies Act — H Ltd. and W Co., as trustee on behalf of H Ltd., applied for oppression remedy under s. 5 of Third Schedule of Companies Act against C Co. group of companies — C Co. cross-applied for declaration that H Ltd. and W Co. were not "complainants" as defined in s. 7(5)(b)(i) of Companies Act — Cross-application dismissed — "Complainant" is defined in s. 7(5)(b)(i) of Act to include registered holder or beneficial owner of security of company or any of its affiliates — Term "security" is not defined in Act — Term "security" can include bond — Consequently, holders of Finance II bonds, including H Ltd. and other bond holders represented by W Co., were registered holders or beneficial owners of security of company (Finance II) and they therefore satisfied definition "complainant" in s. 7(5)(b)(i) of Act.

Business associations --- Specific corporate organization matters — Shareholders — Shareholders' remedies — Relief from oppression — Miscellaneous issues

"Affiliate" — H Ltd. was investment fund specializing in distressed and high yield debt securities — W Co. was securities-holding trustee — C Co. group of companies included two companies registered under Nova Scotia Companies Act, Finance II and Resources — Neither H Ltd., W Co. nor C Co. was based in Nova Scotia — Finance II and Resources were registered under Nova Scotia Companies Act — H Ltd. and W Co., as trustee on behalf of H Ltd., applied for oppression remedy under s. 5 of Third Schedule of Companies Act against C Co. group of companies — C Co. cross-applied for declaration that it was not "affiliate" as referred to in Act and, accordingly, oppression remedy did not apply to it — Cross-application dismissed — Section 5(2) of Act deals with conduct of company or any of its affiliates — Term "affiliate" is not specifically defined in Act — Section 2(2) of Act indicates that company shall be deemed to be affiliate of another company if one of them is subsidiary of other or if both are subsidiaries of same company or if each of them is

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controlled by same person — Broad remedial nature of oppression remedy provisions set out in Third Schedule of Act supported broad interpretation of term "affiliate" — C Co. was affiliate of Finance II and Resource — Term "affiliate" in s. 5(2) of Third Schedule of Act is not restricted to companies formed and registered in Nova Scotia or to "existing companies" as defined by Act.

Cases considered by *Smith A.C.J.S.C.*:

AMCU Credit Union Inc. v. Olympia & York Developments Ltd. (1992), 7 B.L.R. (2d) 103, 1992 CarswellOnt 145 (Ont. Gen. Div.) — considered

Ferguson v. Imax Systems Corp. (1983), 43 O.R. (2d) 128, 150 D.L.R. (3d) 718, 1983 CarswellOnt 926 (Ont. C.A.) — referred to

First Edmonton Place Ltd. v. 315888 Alberta Ltd. (1988), 40 B.C.R. 28, 60 Alta. L.R. (2d) 122, 40 B.L.R. 28, 1988 CarswellAlta 103 (Alta. Q.B.) — considered

First Edmonton Place Ltd. v. 315888 Alberta Ltd. (1989), 45 B.L.R. 110, 71 Alta. L.R. (2d) 61, [1990] 2 W.W.R. 670, 1989 CarswellAlta 181 (Alta. C.A.) — referred to

Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board) (2004), 2004 CarswellOnt 208, 2004 D.T.C. 6224, 41 B.L.R. (3d) 74 (Ont. S.C.J. [Commercial List]) — considered

Hunt v. T & N plc (1993), [1994] 1 W.W.R. 129, 21 C.P.C. (3d) 269, (sub nom. *Hunt v. Lac d'Amiante du Québec Ltée)* 37 B.C.A.C. 161, (sub nom. *Hunt v. Lac d'Amiante du Québec Ltée)* 60 W.A.C. 161, (sub nom. *Hunt v. T&N plc)* 109 D.L.R. (4th) 16, 85 B.C.L.R. (2d) 1, (sub nom. *Hunt v. Lac d'Amiante du Québec Ltée)* 161 N.R. 81, (sub nom. *Hunt v. T&N plc)* [1993] 4 S.C.R. 289, 1993 CarswellBC 1271, 1993 CarswellBC 294 (S.C.C.) — considered

Incorporated Broadcasters Ltd. v. Canwest Global Communications Corp. (2003), 2003 CarswellOnt 601, 223 D.L.R. (4th) 627, 31 B.L.R. (3d) 161, 63 O.R. (3d) 431, 30 C.P.C. (5th) 282, 169 O.A.C. 1 (Ont. C.A.) — considered

Incorporated Broadcasters Ltd. v. Canwest Global Communications Corp. (2003), 2003 CarswellOnt 5014, 2003 CarswellOnt 5015, 327 N.R. 196 (note), 195 O.A.C. 200 (note) (S.C.C.) — referred to

LSI Logic Corp. of Canada Inc. v. Logani (2001), 2001 ABQB 710, 2001 CarswellAlta 1100, 204 D.L.R. (4th) 443, [2001] 11 W.W.R. 740, 19 B.L.R. (3d) 101, 96 Alta. L.R. (3d) 162, 296 A.R. 201 (Alta. Q.B.) — considered

Morguard Investments Ltd. v. De Savoye (1990), 46 C.P.C. (2d) 1, 15 R.P.R. (2d) 1, 76 D.L.R. (4th) 256, 122 N.R. 81, [1991] 2 W.W.R. 217, 52 B.C.L.R. (2d) 160, [1990] 3 S.C.R. 1077, 1990 CarswellBC 283, 1990 CarswellBC 767 (S.C.C.) — considered

Muscutt v. Courcelles (2002), 2002 CarswellOnt 1756, 213 D.L.R. (4th) 577, 160 O.A.C. 1, 60 O.R. (3d) 20, 13 C.C.L.T. (3d) 161, 26 C.P.C. (5th) 206 (Ont. C.A.) — followed

Oakley v. Barry (1998), 1998 CarswellNS 140, 158 D.L.R. (4th) 679, 166 N.S.R. (2d) 282, 498 A.P.R. 282, 25 C.P.C. (4th) 286 (N.S. C.A.) — considered

Oakley v. Barry (1998), 233 N.R. 397 (note), 175 N.S.R. (2d) 400 (note), 534 A.P.R. 400 (note) (S.C.C.) — referred to

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O'Brien v. Canada (Attorney General) (2002), 2002 NSCA 21, 2002 CarswellNS 57, 210 D.L.R. (4th) 668, 201 N.S.R. (2d) 338, 629 A.P.R. 338 (N.S. C.A.) — considered

Palmer v. Carling O'Keefe Breweries of Canada Ltd. (1989), 41 B.L.R. 128, 67 O.R. (2d) 161, 56 D.L.R. (4th) 128, 32 O.A.C. 113, 1989 CarswellOnt 119 (Ont. Div. Ct.) — not followed

Pente Investment Management Ltd. v. Schneider Corp. (1998), 1998 CarswellOnt 4035, 113 O.A.C. 253, (sub nom. *Maple Leaf Foods Inc. v. Schneider Corp.)* 42 O.R. (3d) 177, 44 B.L.R. (2d) 115 (Ont. C.A.) — referred to

People's Department Stores Ltd. (1992) Inc., Re (2004), (sub nom. *Peoples Department Stores Inc. (Trustee of) v. Wise)* 244 D.L.R. (4th) 564, (sub nom. *Peoples Department Stores Inc. (Bankrupt) v. Wise)* 326 N.R. 267 (Eng.), (sub nom. *Peoples Department Stores Inc. (Bankrupt) v. Wise)* 326 N.R. 267 (Fr.), 4 C.B.R. (5th) 215, 49 B.L.R. (3d) 165, [2004] 3 S.C.R. 461, 2004 SCC 68, 2004 CarswellQue 2862, 2004 CarswellQue 2863 (S.C.C.) — referred to

Piller Sausages & Delicatessens Ltd. v. Cobb International Corp. (2003), 2003 CarswellOnt 2430, 35 B.L.R. (3d) 193 (Ont. S.C.J.) — considered

Piller Sausages & Delicatessens Ltd. v. Cobb International Corp. (2003), 2003 CarswellOnt 5167, 179 O.A.C. 290, 40 B.L.R. (3d) 88 (Ont. C.A.) — referred to

Richardson Greenshields of Canada Ltd. v. Kalmacoff (1995), 22 O.R. (3d) 577, 80 O.A.C. 98, 123 D.L.R. (4th) 628, 18 B.L.R. (2d) 197, 1995 CarswellOnt 324 (Ont. C.A.) — distinguished

Rizzo & Rizzo Shoes Ltd., Re (1998), 1998 CarswellOnt 1, 1998 CarswellOnt 2, 154 D.L.R. (4th) 193, 36 O.R. (3d) 418 (headnote only), (sub nom. *Rizzo & Rizzo Shoes Ltd. (Bankrupt), Re)* 221 N.R. 241, (sub nom. *Adrien v. Ontario Ministry of Labour)* 98 C.L.L.C. 210-006, 50 C.B.R. (3d) 163, (sub nom. *Rizzo & Rizzo Shoes Ltd. (Bankrupt), Re)* 106 O.A.C. 1, [1998] 1 S.C.R. 27, 33 C.C.E.L. (2d) 173 (S.C.C.) — referred to

Royal Trust Corp. of Canada v. Hordo (1993), 10 B.L.R. (2d) 86, 1993 CarswellOnt 147 (Ont. Gen. Div. [Commercial List]) — considered

SCI Systems Inc. v. Gornitzki Thompson & Little Co. (1997), 147 D.L.R. (4th) 300, 1997 CarswellOnt 1769, 36 B.L.R. (2d) 192, 1 C.B.R. (4th) 164, 29 O.T.C. 148 (Ont. Gen. Div.) — considered

SCI Systems Inc. v. Gornitzki Thompson & Little Co. (1998), 110 O.A.C. 160, 1998 CarswellOnt 2356 (Ont. Div. Ct.) — referred to

Shoom v. Great-West Lifeco Inc. (1998), (sub nom. *Shoom (in trust) v. Great-West Lifeco Inc.)* 40 O.R. (3d) 672, 1998 CarswellOnt 2192, 42 B.L.R. (2d) 25 (Ont. Gen. Div. [Commercial List]) — distinguished

Shoom v. Great-West Lifeco Inc. (1998), 1998 CarswellOnt 4993, 42 B.L.R. (2d) 40, 116 O.A.C. 278, (sub nom. *Shoom (in trust) v. Great-West Lifeco Inc.)* 42 O.R. (3d) 732 (Ont. C.A.) — distinguished

Tolofson v. Jensen (1994), [1995] 1 W.W.R. 609, 22 C.C.L.T. (2d) 173, 100 B.C.L.R. (2d) 1, 32 C.P.C. (3d) 141, 7 M.V.R. (3d) 202, 26 C.C.L.I. (2d) 1, 175 N.R. 161, 120 D.L.R. (4th) 289, (sub nom. *Lucas (Litigation Guardian of) v. Gagnon)* [1994] 3 S.C.R. 1022, 77 O.A.C. 81, 51 B.C.A.C. 241, 84 W.A.C. 241, 1994 CarswellBC 1, 1994 CarswellBC 2578 (S.C.C.) — referred to

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Westfair Foods Ltd. v. Watt (1991), 79 Alta. L.R. (2d) 363, 115 A.R. 34, [1991] 4 W.W.R. 695, 79 D.L.R. (4th) 48, 5 B.L.R. (2d) 160, 1991 CarswellAlta 63 (Alta. C.A.) — referred to

347883 Alberta Ltd. v. Producers Pipelines Inc. (1991), [1991] 4 W.W.R. 577, 80 D.L.R. (4th) 359, 3 B.L.R. (2d) 237, 92 Sask. R. 81, 1991 CarswellSask 185 (Sask. C.A.) — considered

820099 Ontario Inc. v. Harold E. Ballard Ltd. (1991), 3 B.L.R. (2d) 113, 1991 CarswellOnt 141 (Ont. Div. Ct.) — considered

Statutes considered:

Assignments and Preferences Act, R.S.N.S. 1989, c. 25

Generally — referred to

Business Corporations Act, R.S.O. 1990, c. B.16

Generally — referred to

Canada Business Corporations Act, R.S.C. 1985, c. C-44

Generally — referred to

s. 206 — referred to

Companies Act, R.S.N.S. 1989, c. 81

Generally — referred to

s. 2(1)(c) "company" — referred to

s. 2(1)(h) "existing company" — referred to

s. 2(2) — considered

Sched. 3, s. 1 — referred to

Sched. 3, s. 5 — considered

Sched. 3, s. 5(1) — referred to

Sched. 3, s. 5(2) — considered

Sched. 3, s. 5(3) — referred to

Sched. 3, s. 7(5)(b) "complainant" — considered

Sched. 3, s. 7(5)(b) "complainant" (i) — referred to

Fraudulent Conveyances Act, 1571 (13 Eliz. 1), c. 5

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Generally — referred to

Rules considered:

Civil Procedure Rules, N.S. Civ. Pro. Rules

R. 11.05 — referred to

R. 14.25 — referred to

APPLICATION by bondholder for oppression remedy under s. 5 of Third Schedule of *Companies Act*; CROSS-APPLICATION by respondents for declaration that court had no jurisdiction, that applicants were not complainants under *Act*, and that particular respondent was not affiliate under *Act*.

***Smith A.C.J.S.C.*:**

1 This case involves an application under the Nova Scotia *Companies Act* for what is commonly known as an oppression remedy. The facts of the case are somewhat complex. The ultimate issue, however, is easily understood: that is, whether the Applicants have satisfied the Court that they are entitled to relief pursuant to section 5 of the Third Schedule of the *Companies Act*.

Background

The Parties

2 The Applicant, Harbert Distressed Investment Master Fund, Ltd. (hereinafter referred to as "Harbert") is an investment fund specializing in distressed and high yield debt securities. Harbert has its registered office in the Cayman Islands and its principal office in Dublin, Ireland. Its investment team carries on business from offices in New York, New York, U.S.A.

3 Howard P. Kagan gave evidence on behalf of Harbert. He is a Vice President and Director of Investments for a Harbert affiliate and was the analyst responsible for Harbert's investment in a series of senior notes or bonds which are the subject matter of this litigation. Mr. Kagan has been an investment analyst and financial advisor for over 20 years and has spent much of that time focussing on companies in the electric power sector.

4 The Applicant, Wilmington Trust Company (hereinafter referred to as "Wilmington") is a Delaware banking corporation. Wilmington is the Trustee in relation to the bonds in question.

5 Calpine Canada Energy Finance II ULC (hereinafter referred to as "Finance II") is an unlimited liability company under and pursuant to the provisions of the Nova Scotia *Companies Act*. This company has its registered office in Halifax in the province of Nova Scotia. Finance II issued the bonds in question.

6 Calpine Canada Resources Company (hereinafter referred to as "CCRC") is also an unlimited liability company under and pursuant to the provisions of the Nova Scotia *Companies Act*. CCRC has its registered office in Halifax in the province of Nova Scotia.

7 Calpine European Funding (Jersey) Limited (hereinafter referred to as "European Funding") is a corporation organized and existing under the laws of Jersey in the Channel Islands.

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8 Calpine (Jersey) Limited (hereinafter referred to as "Jersey") is also a corporation organized and existing under the laws of Jersey in the Channel Islands.

9 The Calpine Corporation (hereinafter referred to as "Calpine") is organized and exists under the laws of the state of Delaware. Calpine has its principal executive office in San Jose in the State of California, U.S.A. According to the evidence tendered on behalf of the Respondents, Calpine was established as a corporation in 1984 and is an integrated power company operating through a variety of divisions, subsidiaries and affiliates. Calpine is a publicly traded company on the New York Stock Exchange and is included in the S & P 500 Index. Calpine guaranteed the bonds in question.

10 Michael P. Thomas gave evidence on behalf of Calpine. He is the Senior Vice President and Corporate Treasurer of Calpine. According to Mr. Thomas' evidence, Calpine is engaged in the development, acquisition, ownership and operation of power generation facilities and the sale of electricity and steam in the United States, Canada and the United Kingdom.

11 The Respondents have provided the Court with a number of organizational charts depicting their corporate holdings. These charts indicate that Calpine is the ultimate, indirect parent of CCRC and Finance II and CCRC is the ultimate, indirect parent of European Funding and Jersey.

The Transactions

12 In August of 2001, one of the companies in the Calpine group of companies purchased a natural gas-fired power plant in Yorkshire, England which is known as the Saltend facility. According to a press release issued by Calpine in January of 2005, the plant was purchased for approximately $800 million (U.S.).

13 According to Mr. Thomas, Saltend is owned by a company known as the Saltend Cogeneration Company Limited (hereinafter referred to as "Saltend Limited"). CCRC is the ultimate, indirect parent of Saltend Limited through a series of corporate holdings. At ¶ 30 of Mr. Thomas' affidavit sworn to June 13th, 2005 he confirms that Calpine indirectly owns CCRC and that CCRC indirectly owns Saltend Limited (which in turn owns the Saltend facility).

14 CCRC has an equity interest in the Saltend facility. This interest is listed as an asset on CCRC's May 31st, 2005 balance sheet having a value of $707,709,169.00 (U.S.).

15 As of August 22nd, 2001, Finance II (as borrower) had a $400 million (U.S.) bridge loan with certain commercial lending institutions. The money that was raised by this bridge loan was then loaned by Finance II to Calpine Canada Resources Ltd. (hereinafter referred to as "CCRL") which was the predecessor to CCRC. This latter loan was evidenced by a Term Debenture issued the 23rd day of August, 2001 between CCRL (as Issuer) and Finance II (as Holder). This Debenture is in the amount of £274,400,000.00 and has a due date of April 25th, 2021.

16 A complete copy of this Debenture was tendered into evidence at the time of the hearing. Appendix "A" attached hereto contains those portions of the Debenture that are most salient to this application. As will be seen from a review of Appendix "A", the advance made by Finance II to CCRL (now CCRC) was made for general corporate purposes. This Debenture included the following clauses:

4.1 Conduct of Business

The Issuer shall diligently conduct its business in a proper and efficient manner so as to preserve and protect its business and assets.

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. . . . .

4.14 Indebtedness

The Issuer shall not incur any Indebtedness unless such Indebtedness contains express terms, or is issued under a deed, indenture or other instrument which contains express terms, providing that it is unsecured and either subordinate to or ranks *pari passu* with the Indebtedness evidenced by this Debenture. The term **"Indebtedness"** means, with respect to the Issuer: (i) the principal (including redemption payments), premium, if any, interest and other payment obligations in respect of (x) indebtedness of the Issuer for money borrowed, and (y) indebtedness evidenced by securities, debentures, bonds, notes or other similar instruments issued by the Issuer, including any such securities issued under any deed, indenture or other instrument to which the Issuer is a party (including, for the avoidance of doubt, indentures pursuant to which subordinated debentures have been or may be issued), (ii) any capital, operating or other lease obligations of the Issuer, (iii) any obligations of the Issuer issued or assumed as the deferred purchase price of property, any conditional sale obligations of the Issuer, any hedging agreements and agreements of a similar nature thereto and all agreements relating to any such agreements, and all obligations of the Issuer under any title retention agreement (but excluding trade accounts payable arising in the ordinary course of business), (iv) any obligations of the Issuer for reimbursement on any letter of credit, banker's acceptance, security purchase facility or similar credit transaction, (v) all obligations of the type referred to in clauses (i) through (iv) above of other persons for the payment of which the Issuer is responsible or liable as obligor, guarantor, surety or otherwise, and (vi) all obligations of the type referred to in clauses (i) through (v) above of other persons secured by any lien on any property or asset of the Issuer (whether or not such obligation is assumed by the Issuer), in each case whether outstanding at the date of original issue of this Debenture or thereafter incurred.

17 Mr. Rogers, on behalf of the Respondents, has acknowledged that CCRC has assumed the obligations of CCRL under the terms of this Debenture.

18 In October of 2001, Finance II issued a series of bonds. The first offering was in the amount of £200 million (pounds sterling) at a rate of 8 7/8 %. The second offering was in the amount of 175 million (euros) at a rate of 8 3/8 %. Interest is payable on the bonds on April 15th and October 15th of each year. The outstanding principal amount of each series is due and payable in full on the maturity date (October 15th, 2011 for the first series in the amount of £200 million and October 15th, 2008 for the second series in the amount of 175 million). These bonds are "fully and unconditionally guaranteed" by Calpine. This guarantee is unsecured and ranks equally and ratably with all other unsecured and unsubordinated indebtedness of Calpine.

19 Calpine, Calpine Canada Energy Finance ULC (who are not a party to this application) and Finance II filed a Prospectus dated October 11, 2001 with the United States Securities and Exchange Commission (hereinafter referred to as the "SEC"). Appendix "B" attached hereto contains those portions of the Prospectus that are most salient to this application. As will be seen from a review of Appendix "B", the Prospectus indicated that Finance II is a special purpose financing subsidiary of Calpine that was formed solely as a financing vehicle for Calpine and its subsidiaries. The Prospectus further indicated that Finance II may issue a series of debt securities from time to time under one or more indentures between Finance II and Wilmington (as Trustee). These debt securities were said to be direct, unsecured obligations of the Issuer (Finance II).

20 The Prospectus disclosed that Calpine will fully and unconditionally guarantee the obligations of, *inter alia*, Finance II and the rights of holders of their debt securities. The Prospectus included the following clause:

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Almost all of Calpine's operations are conducted through Calpine's subsidiaries and other affiliates. As a result, Calpine depends almost entirely upon their earnings and cash flow to service Calpine's indebtedness, including Calpine's ability to pay the interest on and principal of Calpine's debt securities, and on the debt securities of Energy Finance and Energy Finance II under the guarantees, if the guarantees are enforced. The non-recourse project financing agreements of certain of Calpine's subsidiaries and other affiliates generally restrict their ability to pay dividends, make distributions or otherwise transfer funds to Calpine prior to the payment of other obligations, including operating expenses, debt service and reserves. Each of Energy Finance and Energy Finance II is a special purpose financing subsidiary formed solely as a financing vehicle for Calpine and its subsidiaries. Therefore, the ability of Energy Finance and Energy Finance II to pay their obligations under the debt securities is dependent upon the receipt by them of payments from Calpine and its subsidiaries to which they have made loans or otherwise under agreements with them in connection with their respective financing activities. In addition, under Canadian law, the respective direct parent companies of Energy Finance and Energy Finance II will be liable for their subsidiary's indebtedness, including any debt securities issued by such subsidiary, upon a winding-up of that subsidiary. While each of Energy Finance and Energy Finance II believes that payments made to it in connection with its financing activities will be sufficient to pay the principal of, and interest on, any debt securities it issues, if the responsible parties were not able to make such payments for any reason, the holders of such debt securities would have to rely on the enforcement of Calpine's guarantee described below.

21 The Prospectus also contained, *inter alia*, the following clause:

Use of Proceeds

Unless otherwise specified in a prospectus supplement accompanying this prospectus, we will add the net proceeds from the sale of the securities to which this prospectus and the prospectus supplement relate to our general funds, which we will use, directly or indirectly, for financing power projects under development or construction, working capital, general corporate purposes and any other purpose specified in a prospectus supplement. We may conduct concurrent or additional financings at any time. The net proceeds from the sale of debt securities by Energy Finance or Energy Finance II to which this prospectus relates will be lent to Calpine or its affiliates by Energy Finance or Energy Finance II, as applicable, pursuant to one or more intercompany loans.

22 There is a section in this Prospectus entitled "Recent Developments". Numerous business activities are described therein including the following in relation to the Saltend facility:

On July 5, 2001, we announced an agreement to acquire a 1,200-megawatt natural gas-fired power plant at Saltend near Hull, Yorkshire, England from Entergy Wholesale Operations for up to approximately £562.5 million (approximately U.S. $800 million at current exchange rates). The Saltend facility, a cogeneration facility, provides electricity and steam for BP Chemical's Hull Works plant under a 15-year agreement. The balance of the Saltend facility's electricity output is sold into the deregulated UK power market. The Saltend transaction is our first acquisition of a power facility in Europe. The acquisition closed on August 24, 2001.

23 The Prospectus refers to various risk factors involved in investing in these securities. It also contains directions for obtaining additional information including copies of documents incorporated into the prospectus by reference. While the Prospectus contained detailed financial information concerning Calpine it stated the following in relation to Finance II:

Pursuant to Rule 3-10 of Regulation S-X promulgated by the SEC, Energy Finance II is not required to file separate reports with the SEC under the Securities Exchange Act and we are not required to include separate financial state-

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ments for Energy Finance II in this prospectus because:

• all of the voting rights of Energy Finance II are owned by Calpine, either directly or through its wholly-owned subsidiaries, and Calpine files periodic and other reports with the SEC pursuant to the Securities Exchange Act;

• its sole operations are the investment of funds in Calpine and its subsidiaries; and

• Calpine will fully and unconditionally guarantee its obligations and the rights of holders under its debt securities and no subsidiary of Calpine will guarantee its obligations.

24 A Prospectus Supplement was also filed with the SEC. Appendix "C" attached hereto contains those portions of the Prospectus Supplement that are most salient to this application. Included in Appendix "C" is the following:

Description of the Senior Notes and the Guarantees

Calpine Canada Energy Finance II will issue each of the Sterling senior notes and the Euro senior notes under an indenture dated as of October 18, 2001 between Calpine Canada Energy Finance II and Wilmington Trust Company as trustee, as supplemented by the First Supplemental Indenture, dated as of October 18, 2001. The Sterling senior notes and the Euro senior notes shall each constitute a separate series of securities under the indenture. The related guarantees will be issued by Calpine under a Guarantee Agreement dated as of October 18, 2001, as supplemented by the First Amendment to Guarantee Agreement, dated as of October 18, 2001. Each series of senior notes will be issued in the form of one or more global securities registered in the name of a common depositary acting on behalf of Clearstream Banking, S.A., formerly Cedelbank ("Clearstream") and Euroclear System ("Euroclear") or its nominee.

The following description and the description in the accompanying prospectus is a summary of the material provisions of the senior notes and the guarantees and is subject to the detailed provisions of the indenture and guarantee agreement, copies of which are filed as exhibits to the Registration Statement of which this prospectus supplement is a part and are available upon request made to us. Whenever particular provisions of the indenture or guarantee agreement or terms defined therein are referred to, those provisions or definitions are incorporated by reference herein and such descriptions are qualified in their entirety by such reference. Calpine and Calpine Canada Energy Finance II urge you to read the indenture and the guarantee agreement because they, and not this description, define your rights as holders of the senior notes and the guarantees and describe every detail of the terms of the senior notes and the guarantees.

This description of the senior notes and the guarantees in this prospectus supplement replaces the description of the general provisions of the senior notes, the guarantee, the indenture and the guarantee agreement in the accompanying prospectus to the extent that it is inconsistent with the accompanying prospectus. The senior notes are "debt securities" as that term is used in the accompanying prospectus.

Principal, Maturity and Interest; Listing

The senior notes will be senior unsecured obligations of Calpine Canada Energy Finance II. Calpine will irrevocably and unconditionally guarantee the senior notes as to principal, premium, if any, interest and Additional Amounts (as defined below under "-Additional Amounts"), if any. There is no sinking fund for the senior notes.

25 This Prospectus Supplement contained detailed financial information relating to Calpine (the Guarantor of the bonds) but very little financial information relating to Finance II (the Issuer of the bonds). The following statement was

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contained in the Prospectus Supplement:

> Pursuant to Rule 3-10 of Regulation S-X promulgated by the SEC, Calpine Canada Energy Finance II is not required to file separate reports with the SEC under the Securities Exchange Act of 1934 and we are not required to include separate financial statements for Calpine Canada Energy Finance II in this prospectus supplement because:
>
> • all of the voting rights of Calpine Canada Energy Finance II are owned by Calpine, either directly or through its wholly-owned subsidiaries, and Calpine files periodic and other reports with the SEC pursuant to the Securities Exchange Act;
>
> • Calpine Canada Energy Finance II's sole operations are the investment of funds in Calpine and its subsidiaries; and
>
> • Calpine will fully and unconditionally guarantee Calpine Canada Energy Finance II's obligations and the rights of holders under the senior notes and no subsidiary of Calpine will guarantee the obligations of Calpine Canada Energy Finance II.

26 The Prospectus Supplement does indicate that the only long term debt of Finance II that will be outstanding will be the senior notes (bonds) being issued, the net proceeds of which "will have been used" to repay amounts outstanding under the $400 million (U.S.) bridge credit loan referred to in ¶15 herein.

27 The Prospectus Supplement also contained warnings about the risks involved in investing in these bonds and advised prospective investors where they could obtain copies of the documents referred to in the Prospectus Supplement.

28 There is no reference in the Prospectus Supplement to the Saltend facility.

29 As indicated in the Prospectus Supplement, the bonds were issued under an Indenture dated as of the 18th day of October, 2001 between Finance II (as Issuer) and Wilmington (as Trustee). Appendix "D" contains those portions of the Indenture that are most salient to this application. As will be seen from Appendix "D", Finance II was entitled to assign its obligations under any series of securities to the Guarantor (Calpine) or any Significant Subsidiary of the Guarantor (as defined in the Indenture) provided that certain conditions were fulfilled.

30 The Indenture was amended by a First Supplemental Indenture also dated as of the 18th day of October, 2001. Appendix "E" contains that portion of the First Supplemental Indenture that is most salient to this application. As will be seen from a review of Appendix "E", Finance II agreed to comply in all respects with its obligations under section 7.1 of the Term Debenture for the benefit of the Finance II bond holders (s. 7.1 dealt with what would occur in the event of default under the Bridge Credit Agreement or any renewal, refinancing or extension thereof or replacement therefore including default under any debt securities issued in a public offering by Finance II. The effect of this section was that in such event, Finance II would be wound up and CCRL (now CCRC) would be liable for its indebtedness including any debt securities issued by Finance II).

31 In addition to the documents referred to above, Calpine executed a Guarantee Agreement also dated as of October 18th, 2001 which was in favour of the holders of the Finance II bonds and Wilmington (as Trustee). Appendix "F" contains those portions of the Guarantee Agreement that are most salient to this application. This Guarantee Agreement includes, *inter alia*, the following clause:

> **ARTICLE THREE**

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CONSOLIDATION, MERGER, CONVEYANCE, TRANSFER OR LEASE

....

SECTION 3.03. Assignment to the Guarantor of the Company's Obligations.

It is acknowledged that, pursuant to Section 4.3 of the Indenture, the Company may assign is obligations under any Series of Securities and the Indenture to the Guarantor or any Subsidiary of the Guarantor in accordance with such Section 4.3 and, if the Company assigns its obligations to the Guarantor in accordance with such Section 4.3 with respect to any Series of Securities, all Guarantees of outstanding Securities of such Series shall automatically terminate and be discharged.

32 This Guarantee Agreement was amended by a document entitled First Amendment to Guarantee Agreement also dated as of October 18th, 2001 between Calpine (as Guarantor) and Wilmington (as Trustee). This document included, *inter alia*, the following term:

ARTICLE II

AMENDMENTS TO THE GUARANTEE AGREEMENT

Section 2.1 Amendment.

(a) Article V of the Guarantee Agreement is amended to add the following new Section

SECTION 5.06. Performance by a Subsidiary of the Guarantor of Certain Covenants under Term Debenture.

Solely for the benefit of the Holders of Sterling 8-7/8% Notes and the Holders of Euro 8-3/8% Notes, the Guarantor shall cause Calpine Canada Resources Ltd., a wholly-owned subsidiary of the Guarantor, to comply in all respects with its obligations under Section 7.1 of the Term Debenture, dated August 23, 2001, between the Company and Calpine Canada Resources Ltd.

The Sally I Transaction

33 On October 26th, 2004 Jersey issued $360 million(U.S.) of two year redeemable preferred shares. This is what has been referred to in this application and is hereinafter referred to as the "Sally I Transaction". According to the evidence of Mr. Thomas, the funds from this issuance were moved through a complex series of transactions up the Calpine corporate chain to a company known as Calpine European Finance, LLC which then returned what has been described as the "net proceeds" to CCRC by way of a return on capital. According to Mr. Thomas' evidence, CCRC utilized a portion of such net proceeds to make intercompany loans to a company known as Quintana Canada Holdings, LLC with a portion of the balance of such net proceeds used to repay intercompany debt owing by CCRC to Calpine Canada Energy Limited. According to a chart tendered into evidence by the Respondents, all of these corporations are part of the Calpine group of companies. Quintana is above CCRC in the corporate chain. Quintana gave CCRC unsecured promissory notes in relation to these intercompany loans.

34 These preferred shares must be redeemed by Jersey by October 15th, 2006 (their maturity date) if they have not already been redeemed prior to that date. According to Mr. Thomas' evidence the terms of certain loans relating to the Sally I Transaction do not permit the sale of the Saltend facility. Accordingly, in order to effect a sale of Saltend it is necessary to first prepay these loans and cause the preferred shares to be redeemed.

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35 In November of 2004, the Term Debenture between CCRL (as Issuer) and Finance II (as Holder) became available to the public.

36 On January 13th, 2005 Calpine announced the potential sale of the Saltend facility. A press release issued that day by Calpine indicated that the net proceeds of any sale of the facility would be used to redeem the existing $360 million (U.S.) Two Year Redeemable Preferred Shares (relating to the Sally I Transaction) with the remaining proceeds to be used in accordance with the asset sale provisions of Calpine's existing bond indentures.

37 On January 14th, 2005 Harbert made its first purchase of Finance II bonds. Harbert Distressed Investment Master Fund, Ltd. (as its name suggests) is in the business of purchasing or acquiring interests in distressed companies or distressed investments. Mr. Kagan confirmed that such investment generally involves acquiring interests in companies that are in part highly leveraged, may have difficulty meeting future obligations or may be in bankruptcy. Mr. Kagan also confirmed that generally Harbert is not involved in investment grade investments.

38 The evidence at the hearing establishes that on January 14th, 2005 Harbert made the following purchases of Finance II bonds:

British Pound Denominated Notes

Trade Date	Transaction Type	Master Quantity[FN1]	Price
14/01/2005	Margin Buy	1,955,000	71.0
14/01/2005	Margin Buy	2,930,000	70.75
14/01/2005	Margin Buy	1,955,000	70.75

39 Throughout this decision, the figures under the heading "Master Quantity" represent the face value of the bonds in question which is basically the initial value of the bonds. The figures under the heading "Price" represent the percentage of the face value paid by Harbert for the bonds.

40 All of the bonds referred to in this decision as having been purchased by Harbert were purchased on what is known as the secondary market (if a bond holder wishes to sell their bonds they can do so on the secondary market). As will be seen, all of the Finance II bonds acquired by Harbert were purchased below face value.

41 Mr. Kagan reviewed the January 13, 2005 Calpine press release (announcing the potential sale of Saltend and the intention to use the net proceeds therefrom to redeem the shares relating to the Sally I transaction) before Harbert made its initial purchase of the Finance II bonds. He testified that the announcement that Saltend may be sold "pushed him over the edge" in terms of wanting to purchase the Finance II bonds. He said it was his view that if Saltend was sold, the proceeds would have to be used, first, to satisfy the Term Debenture referred to above, and then, ultimately, the Finance II bonds. He said he saw this as "an opportunity to buy the debt that was in the market to be able to create a par recovery in the relatively near term". That opportunity, according to Mr. Kagan, did not exist in quite that way until the company announced that it was considering selling Saltend.

42 On January 19th, 2005 Harbert purchased the following additional Finance II bonds:

British Pound Denominated Notes

Trade Date	Transaction Type	Master Quantity	Price

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19/01/2005 Margin Buy	1,465,000	71.5

The Sally II Transaction

43 On January 20th, 2005 Calpine issued a further press release which stated, *inter alia*:

> Calpine Corporation (NYSE: CPN) today announced that Calpine European Funding (Jersey) Limited, a new, wholly owned subsidiary of Calpine, intends to commence an offering of $260 million of Redeemable Preferred Shares that will be due 180 days after issuance. This financing is a part of Calpine's recently announced plans to evaluate strategic financial alternatives for its 1,200-megawatt Saltend Energy Centre, including the potential sale of this facility.
>
> The proceeds from the offering of the Redeemable Preferred Shares will initially be loaned to a holding company, which indirectly owns Calpine's Saltend cogeneration power plant. The net proceeds from this offering will ultimately be used as permitted by Calpine's existing bond indentures.
>
> Net proceeds from any sale of the facility would be used to first redeem the existing $360 million, two-year redeemable preferred shares. And, second, to redeem the $260 million Redeemable Preferred Shares with the remaining proceeds to be used in accordance with the asset sale provisions of Calpine's existing bond indentures.

44 This preferred share issuance occurred on January 31st, 2005 and is commonly known as and is hereinafter referred to as "the Sally II Transaction". Mr. Kagan confirmed that he was aware of the intended Sally II Transaction by January 20th, 2005.

45 According to the evidence of Mr. Thomas, the net proceeds from the Sally II Transaction (after payment of applicable fees and expenses) were loaned by European Funding to a company known as Calpine European Funding (Jersey) Holdings Limited (not a party to this application) as a senior intercompany loan. That company in turn loaned the monies to Quintana Canada Holdings, LLC also as a senior intercompany loan. According to Mr. Thomas' evidence, the net proceeds of this loan (after payment of fees and expenses associated with the Sally II Transaction) were indirectly loaned and/or distributed to Calpine.

46 As part of the Sally II transaction, CCRC executed a Guarantee and Security Agreement. In addition, Finance II executed a consent and waiver form which consented to the execution of these documents by CCRC notwithstanding any provisions in the August 23rd, 2001 Term Debenture to the contrary. Mr. Thomas confirmed at the time of the hearing that clause 4.14 of the said Debenture would have prevented the execution of these documents by CCRC without the consent and waiver of Finance II. Mr. Thomas was unable to recall any benefit or consideration that Finance II received for executing this consent and waiver.

47 Mr. Thomas gave evidence that the terms of the original intercompany loan between European Funding and Calpine European Funding (Jersey) Holdings Limited provide that the sale of Saltend is not permitted unless the net proceeds of such sale are sufficient when aggregated with any cash available directly or indirectly from Calpine or any of its subsidiaries, to repay in full the amounts outstanding under the loans relating to the Sally I and Sally II Transactions, thereby causing the redemption in full of the preferred shares issued in relation thereto.

48 As indicated previously, CCRC has an equity interest in the Saltend facility. As a result of the Sally I and Sally II transactions, the flow of proceeds from these preferred share issuances and the redemption requirements upon the sale of the Saltend facility, much of CCRC's interest in the Saltend facility has flowed up out of the control of CCRC. During the course of this proceeding counsel referred to this as "upstreaming".

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49 Between January 20th, 2005 and March 29th, 2005 Harbert purchased/sold the following Finance II bonds:

British Pound Denominated Notes

Trade Date	Transaction Type	Master Quantity	Price
20/01/2005	Margin Buy	2,075,000	68.5
20/01/2005	Margin Buy	5,565,000	68.5
31/01/2005	Margin Buy	4,400,000	69
02/02/2005	Margin Buy	2,930,000	69.5
09/02/2005	Margin Buy	3,910,000	70.25
14/02/2005	Margin Buy	3,420,000	69.5
17/02/2005	Margin Buy	980,000	69
23/02/2005	Margin Buy	2,930,000	67
01/03/2005	Margin Buy	975,000	68.5
03/03/2005	Margin Buy	900,000	70.5
08/03/2005	Margin Buy	9,750,000	73.5
08/03/2005	Margin Buy	4,580,000	73.75
11/03/2005	Margin Buy	5,555,000	71.75
28/03/2005	Margin Buy	2,630,000	68.5
29/03/2005	Margin Sell	(1,950,000)	70

Euro Denominated Notes

Trade Date	Transaction Type	Master Quantity	Price
28/01/2005	Margin Buy	2,930,000	73.00
28/02/2005	Margin Buy	980,000	74.5
04/03/2005	Margin Buy	1,930,000	73
04/03/2005	Margin Buy	2,200,000	74.25

50 On April 13th, 2005 Harbert sent a letter to the Respondents suggesting that the announcement of the sale of the Saltend facility and the issuance of the $260 million in redeemable preferred shares by European Funding was "evidence of an effort to strip the value of the Saltend Facility out of Calpine Jersey and, indirectly, its parent, Calpine Canada Resources Ltd. ("Resources"), to the prejudice of Finance II's bondholders". Mr. Kagan confirmed on discovery that he thought that the decision to send this letter was made in February or March of 2005 but it took some time to prepare it.

51 On May 4th, 2005 Harbert filed an Originating Notice (Application *Inter Partes*) in the Supreme Court of Nova Scotia seeking relief pursuant to section 5 of the Third Schedule of the Nova Scotia *Companies Act* as well as an Order pursuant to the *Statute of Elizabeth* and the *Assignments and Preferences Act*.

52 Between May 5th, 2005 (after this application was commenced) and the time of the hearing, Harbert purchased/sold the following Finance II bonds:

British Pound Denominated Notes

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Trade Date	Transaction Type	Master Quantity	Price
10/05/2005	Margin Sell	(290,000)	55
24/05/2005	Margin Buy	2,230,000	56
25/05/2005	Margin Buy	970,000	58.5
25/05/2005	Margin Buy	970,000	58.5
27/05/2005	Margin Buy	970,000	60.75

Euro Denominated Notes

Trade Date	Transaction Type	Master Quantity	Price
10/5/2005	Margin Sell	(35,000)	55
3/6/2005	Margin Buy	1,940,000	69
28/6/2005	Margin Buy	1,460,000	75
29/6/2005	Margin Buy	970,000	77
29/6/2005	Margin Buy	491,000	77

53 As will be seen from the above, Harbert bought millions of dollars worth of Finance II bonds knowing of the possible sale of the Saltend facility and of the plan to use the net proceeds thereof to redeem the preferred shares relating to the Sally I and the Sally II Transactions.

54 On May 31st, 2005 Calpine issued a further press release formally announcing the sale of the Saltend facility. The sale was said to be scheduled to close on or about July 26th, 2005 pending regulatory approval and other conditions of closing. The press release indicated that the gross proceeds of sale were expected to be approximately $925 million (U.S.).

55 On June 29th, 2005 a Consent Order was issued adding Wilmington as a Co-Applicant in this proceeding. As indicated previously, Wilmington is the Trustee under the Indenture and First Supplemental Indenture pursuant to which the Finance II bonds were issued. Wilmington has joined this application on behalf of all Finance II bond holders.

56 The hearing was held July 6th, 7th and 8th, 2005. At the conclusion of the hearing, the solicitors for Harbert and Wilmington confirmed that their clients are proceeding only with their claims for relief under the Third Schedule of the *Companies Act* and are no longer relying on the *Statute of Elizabeth* or the *Assignments and Preferences Act.* They also confirmed that the Applicants were not seeking to stop the sale of the Saltend facility or the redemption of the Sally I and Sally II preferred share issuances. They have asked the Court to order that the net proceeds of the sale of the Saltend facility (after the redemption of the Sally I and Sally II shares and the transaction costs and adjustments associated with the sale) be kept in the control of CCRC. They have further requested that Calpine be ordered to place in the control of CCRC an amount, which, when added to the net proceeds referred to above, will cover the face value of all Finance II bonds.

57 Counsel for both Applicants also advised that they were discontinuing their application against European Funding and Jersey. An Order formally discontinuing the application against these Respondents was issued by consent on July 20th, 2004. Accordingly, only Finance II, CCRC and Calpine remain Respondents to this application.

58 Subsequent to the conclusion of the hearing counsel for the Respondents advised the Court that the closing of the sale of the Saltend facility had been moved to July 28th, 2005. On July 27th, 2005 the Court granted an Interim Order requiring Calpine to put in the control of CCRC the net proceeds of the sale of the Saltend facility after (1) the redemption

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of the $360 million (U.S.) preferred shares issued by Jersey on October 26th, 2004 including any interest associated with the redemption of those shares; (2) the redemption of the $260 million (U.S.) preferred shares issued by European Funding on January 31st, 2005 including any interest associated with the redemption of those shares and (3) the reasonable associated transaction costs and adjustments associated with the sale. The Court further ordered CCRC to diligently conduct its business in a proper and efficient manner so as to preserve and protect those net proceeds. The Interim Order was to remain in effect until the written release of the Court's final decision or ten days, whichever shall first occur.

Issues

59 Numerous issues have been raised by the parties. I will deal with these issues under the following general headings:

(1) Jurisdiction;

(2) Harbert's standing; and

(3) The oppression claim.

Jurisdiction

60 In the main brief filed on behalf of Harbert it is stated that "This is a case about the protection of creditors who brought [bought] publicly traded debt securities issued by a Nova Scotia Company with the expectation that certain assets were available to support the repayment obligations."

61 Finance II and CCRC have accepted the jurisdiction of the Nova Scotia Supreme Court to deal with the application against them. Calpine, however, disputes the jurisdiction of the Court on the basis of jurisdiction *simpliciter*. Calpine has made an interlocutory application pursuant to Civil Procedure Rule 11.05 to set aside the Originating Notice (Application *Inter Partes*) and has also applied under Civil Procedure Rule 14.25 to stay or dismiss the proceeding against it on the basis of jurisdiction. It was agreed by counsel that this interlocutory application would be heard at the commencement of the proceeding (recognizing that the Court would reserve its decision) followed by the hearing of the oppression remedy claim. It was further agreed that the participation of Calpine in the proceeding would not constitute submission or attornment to the jurisdiction.

62 As indicated above, Calpine takes the position that this Court does not have jurisdiction to deal with the proceeding against it on the basis of jurisdiction *simpliciter*. It submits that this Court should not assume jurisdiction over a foreign Respondent with no presence in the jurisdiction.

63 Calpine notes, *inter alia*, that neither the Applicants nor Calpine are incorporated pursuant to the Nova Scotia *Companies Act* and submit that neither the Applicants nor Calpine have business operations/offices in Nova Scotia.

64 Calpine makes reference to the fact that the majority of the documents in question indicate that they are to be governed by the laws of the state of New York or the laws of the state of New York without regard to the conflicts of laws rules thereof. The Term Debenture indicates that it shall be governed by and interpreted and enforced in accordance with the laws in force in the province of Alberta (excluding any conflict of laws rule or principle which might refer such construction to the laws of another jurisdiction). In addition, it indicates that each party thereto irrevocably submits to the non-exclusive jurisdiction of the courts of Alberta with respect to any matter arising thereunder or relating thereto.

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65 Calpine submits that the "real and substantial connection" test enunciated by the Supreme Court of Canada in *Morguard Investments Ltd. v. De Savoye*, [1990] 3 S.C.R. 1077 (S.C.C.); *Hunt v. T & N plc*, [1993] 4 S.C.R. 289 (S.C.C.) and *Tolofson v. Jensen*, [1994] 3 S.C.R. 1022 (S.C.C.) applies to the assumption of jurisdiction over a foreign Respondent and further submits that the application of this test to the case at Bar leads to the conclusion that this Court is without jurisdiction to hear this matter in relation to Calpine.

66 Capline suggests (correctly in my view) that an assumption of jurisdiction is less easily justified in an international case than in an interprovincial case. It argues that there is an insufficient connection or nexus between Nova Scotia and the claim that is being advanced to warrant an assumption of jurisdiction against Calpine.

67 It is important to note that Calpine has not argued *forum non conveniens* and bases its position solely on jurisdiction *simpliciter*.

68 Harbert and Wilmington agree that the issue of jurisdiction *simpliciter* is determined by the application of the "real and substantial connection" test which they submit is a flexible test that is guided by the requirements of order and fairness.

69 The Applicants submit that Calpine used two Nova Scotia companies (Finance II and CCRC) to raise money to pay for the Saltend facility and further submit that Calpine is now attempting to transfer the value of the Saltend facility to itself while disregarding the interests of the creditors of the Nova Scotia companies.

70 The Applicants note that there has been no objection made to the jurisdiction of the Nova Scotia Supreme Court over CCRC and Finance II and submit that in this regard, jurisdiction between Nova Scotia and the subject matter of the application has been established. They further suggest that since the application against CCRC and Finance II is proceeding regardless of the outcome of this jurisdictional challenge, the issue is more appropriately analyzed as a question of joinder rather than jurisdiction. They suggest that Calpine is a necessary and proper party to the application and accordingly, the Court should assume jurisdiction.

71 In addition, the Applicants submit that the business of Calpine and their Co-Respondent subsidiaries are inextricably intertwined and that this supports the Court assuming jurisdiction over all of the Respondents including Calpine.

72 Harbert and Wilmington submit that they should not be required to litigate in another country against Calpine when this litigation is proceeding in Nova Scotia against its subsidiaries and the evidence required for both applications would be largely the same. In addition, they noted that if jurisdiction was declined it would be impossible for them to bring a separate proceeding in another jurisdiction prior to the sale of the Saltend facility. Further, they take the position that they will lose a juridical advantage if they are not able to proceed against Capline in Nova Scotia.

73 The Applicants acknowledge that the assumption of jurisdiction is more difficult in a case with international considerations (as compared to interprovincial considerations) but suggest that this factor is minimized when the company involved is American.

74 As for the choice of law provisions in the various documents, the Applicants submit that none of the documents referred to by Calpine purport to take away, limit or curtail the Applicants' rights under the *Companies Act*. Further, they submit that these choice of law clauses merely give the party seeking to enforce the clause the right to prove, through expert evidence, the law of the territory it wishes to apply.

Analysis and Conclusions Re: Jurisdiction

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75 In the 1990's the Supreme Court of Canada dramatically altered the law of jurisdiction and enforcement. In the case of *Morguard Investments Ltd. v. De Savoye*, *supra*, the Court developed what has become known as the "real and substantial connection" test. The Court recognized that nineteenth century English rules relating to jurisdiction and enforcement were out of keeping with modern reality, including national and international commerce and mobility. It also recognized, however, that a court must have reasonable grounds for assuming jurisdiction and that there must be limits on the exercise of jurisdiction against out-of-province defendants. The Court held that jurisdiction can be assumed if there is a real and substantial connection with the jurisdiction where the action is to take place.

76 In *Hunt v. T & N plc*, *supra*, La Forest, J. referred to this test at p. 328 where he stated:

> ..... courts are required, by constitutional restraints, to assume jurisdiction only where there are real and substantial connections to that place .....

77 At p. 325 of the same decision he stated:

> In *Morguard*, a more accommodating approach to recognition and enforcement was premised on their being a 'real and substantial connection' to the forum that assumed jurisdiction and gave judgment. Contrary to the comments of some commentators and lower court judges, this was not meant to be a rigid test, but was simply intended to capture the idea that there must be some limits on the claims to jurisdiction ..... in a personal action a nexus may need to be sought between the subject-matter and the territory where the action is brought ..... The exact limits of what constitutes a reasonable assumption of jurisdiction were not defined, and I add that no test can perhaps ever be rigidly applied; no court has ever been able to anticipate all of these .....

78 At p. 326 of the same decision La Forest, J. stated:

> ..... Whatever approach is used, the assumption of and the discretion not to exercise jurisdiction must ultimately be guided by the requirements of order and fairness, not a mechanical counting of contacts or connections .....

79 See also *Tolofson v. Jensen*, *supra*.

80 The Nova Scotia Court of Appeal dealt with the "real and substantial connection" test in the case of *Oakley v. Barry* (1998), 166 N.S.R. (2d) 282 (N.S. C.A.), leave to appeal to the Supreme Court of Canada refused (1998), 175 N.S.R. (2d) 400 (note) (S.C.C.). In that case, Pugsley, J.A. concluded that the principles set out in *Morguard*, *supra*, should be applied in a flexible manner and that the concept of fairness in determining jurisdiction should be considered from the point of view of all parties to an action.

81 In *O'Brien v. Canada (Attorney General)* (2002), 201 N.S.R. (2d) 338 (N.S. C.A.) Hallett, J.A. speaking for the Nova Scotia Court of Appeal stated at p. 344:

> .... The concept of order and fairness is integral to the question of determining whether there is a real and substantial connection between the cause of action and the forum province. This Court has held in **Oakley** that it is not inappropriate for a court to consider as a component of the test, the fairness to the parties in determining if there is a real and substantial connection between the cause of action and the forum province that warrants a finding that the court has jurisdiction simpliciter.

82 In *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 (Ont. C.A.) the Ontario Court of Appeal reviewed the development of the law of jurisdiction *simpliciter*. It pointed out that when dealing with jurisdiction the Court first determines whether the forum can assume jurisdiction given the relationship between the case, the parties and the forum (jurisdiction

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simpliciter). The Court may then go on to consider the discretionary doctrine of *forum non conveniens* which recognizes that there may be more than one forum capable of assuming jurisdiction. Sharpe, J.A. stated at ¶44 of this decision that this residual discretion "provides both a significant control on assumed jurisdiction and a rationale for lowering the threshold required for the real and substantial connection test". The Court in that case then went on to identify eight factors to consider when assessing whether the real and substantial connection test has been met. They are as follows:

> (1) The connection between the forum and the plaintiff's claim;
>
> (2) The connection between the forum and the defendant;
>
> (3) Unfairness to the defendant in assuming jurisdiction;
>
> (4) Unfairness to the plaintiff in not assuming jurisdiction;
>
> (5) The involvement of other parties to the suit;
>
> (6) The Court's willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis;
>
> (7) Whether the case is interprovincial or international in nature; and
>
> (8) Comity and the standards of jurisdiction, recognition and enforcement prevailing elsewhere.

83 The Court noted that none of the above factors are determinative and that all relative factors should be considered and weighed together. In addition, the Court held at ¶ 44 that the "real and substantial connection test requires only *a* real and substantial connection, not *the most* real and substantial connection" [emphasis in the original].

84 I have carefully reviewed the case law put before me by counsel as well as the factors referred to in *Muscutt*, *supra*, and have concluded that the facts of the present case support the assumption of jurisdiction against Calpine.

85 The case before me is unusual in that neither the Applicants nor Calpine are registered or have a head office in this province. Having said that, both Finance II and CCRC (which are both part of the Calpine chain of companies) are Nova Scotia companies with head offices here in Halifax, Nova Scotia.

86 In the Prospectus filed with the SEC in relation to the bonds in question, it is stated (at page 21) that almost all of Calpine's operations are conducted through its subsidiaries and affiliates. Mr. Thomas, in his affidavit sworn to on June 13, 2005 confirmed at ¶ 26 that Calpine is the ultimate, indirect parent of both CCRC and Finance II through a series of corporate holdings. On discovery, Mr. Thomas confirmed that two senior officers and board members of Calpine are also on the board of Finance II and CCRC. He also confirmed that Finance II (a Nova Scotia company) is a "conduit" or "financing vehicle" for Calpine and its various subsidiaries and affiliates and that CCRC is a holding company or "conduit" for all of Calpine's activities "in and around that subsidiary". Further Calpine has unconditionally guaranteed the bonds in question that were issued by Finance II. All of this satisfies me that the business of Calpine, Finance II and CCRC is intertwined and that Calpine, while not being registered in this province, does have a real and substantial connection to the case, the parties and the forum, such that jurisdiction should be assumed against it.

87 As indicated previously, Finance II and CCRC have acknowledged the jurisdiction of this Court to deal with the applications against them. As a result, this case is proceeding in Nova Scotia in relation to those two Respondents regard-

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less of my conclusion in relation to jurisdiction over Calpine. I see little reason to require the Applicants to bring a separate proceeding elsewhere recognizing that the facts that would be advanced in such an application would likely be the same as those advanced in this proceeding. This would result in increased costs to all of the parties and would introduce the possibility of inconsistent results in different jurisdictions. In addition, from the Applicants' perspective it could render the application moot in relation to Calpine since they would not be able to have an application heard in California prior to the proceeds of sale of the Saltend facility being disbursed.

88 In the brief filed on behalf of Calpine reference was made to the Ontario Court of Appeal decision in *Incorporated Broadcasters Ltd. v. Canwest Global Communications Corp.* (2003), 223 D.L.R. (4th) 627 (Ont. C.A.) leave to appeal to the Supreme Court of Canada dismissed at (2003), 327 N.R. 196 (note) (S.C.C.). The Court in that case found at ¶ 38 that the dominant consideration in applying the "real and substantial connection" test was that four of the five defendants had a presence in Ontario and, subject to a *forum non conveniens* argument, the trial would take place there. It therefore served the requirements of order and fairness to try the foreign claim together with the other claims that were rooted in Ontario. In the case at Bar, the applications against two of the remaining three Respondents (Finance II and CCRC) are being dealt with in Nova Scotia. This supports the assumption of jurisdiction by this Court over Calpine.

89 It should be noted that in the case of *Incorporated Broadcasters Ltd. v. Canwest Global Communications Corp.*, *supra*, the Court went on to conclude that Manitoba was the more convenient forum to hear the matter. In the case at bar, Calpine has not relied on the doctrine of *forum non conveniens*.

90 In the brief filed by Calpine in relation to this interlocutory application, the Court was referred to a number of cases that indicate that matters relating to the internal affairs or management of a foreign corporation are subject to the law of the corporation's domicile and that the court should not, under its own laws and procedures, purport to affect the status and internal affairs of a foreign corporation. In my view, this line of authority does not prevent the Court from assuming jurisdiction in the circumstances of this case if the real and substantial connection test is satisfied.

91 Calpine's interlocutory application pursuant to Civil Procedure Rules 11.05 and 14.25 is hereby dismissed.

Harbert's Standing

92 The Indenture between Finance II and Wilmington contains a "no-action" clause which places limitations on the commencement of actions by individual security holders. The Respondents submit that Harbert has failed to meet the conditions in the Indenture which would allow it to bring this application and have requested that Harbert's application be dismissed due to a lack of standing.

93 The Applicants take the position that this issue is moot in light of the fact that the Trustee has now been joined as a party and is bringing the application on behalf of all Finance II bond holders (including Harbert).

94 In my view, it is unnecessary for the Court to decide this issue in light of the Trustee's involvement in the case on behalf of all bond holders and in light of the conclusions that I have reached in relation to the oppression remedy claim.

The Oppression Claim

95 The Applicants' claim for relief is brought pursuant to s. 5 of the Third Schedule to the Nova Scotia *Companies Act* which provides:

5(1) A complainant may apply to the court for an order under this Section.

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(2) If, upon an application under subsection (1) of this Section, the court is satisfied that in respect of a company or any of its affiliates

(a) any act or omission of the company or any of its affiliates effects a result;

(b) the business or affairs of the company or any of its affiliates are or have been carried on or conducted in a manner; or

(c) the powers of the directors of the company or any of its affiliates are or have been exercised in a manner,

that it is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

96 Section 5(3) of the Third Schedule deals with the types of relief available upon an application pursuant to s. 5(1) and indicates that the Court may make any interim or final Order that it sees fit. Section 5(3) provides:

5(3) In connection with an application under this Section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

(a) an order restraining the conduct complained of;

(b) an order appointing a receiver or receiver-manager;

(c) an order to regulate a company's affairs by amending the memorandum or articles;

(d) an order directing an issue or exchange of securities;

(e) an order appointing directors in place of or in addition to all or any of the directors then in office;

(f) an order directing a company, subject to subsection (5) of this Section, or any other person, to purchase securities of a security holder;

(g) an order directing a company, subject to subsection (5) of this Section, or any other person, to pay a security holder any part of the monies paid by him for securities;

(h) an order varying or setting aside a transaction or contract to which a company is a party and compensating the company or any other party to the transaction or contract;

(i) an order requiring a company, within a time specified by the court, to produce to the court or an interested person financial statements in the form required under the Act or an accounting in such other form as the court may determine;

(j) an order compensating an aggrieved person;

(k) an order directing rectification of the registers or other records of a company required under the Act;

(l) an order liquidating and dissolving the company;

(m) an order directing an investigation pursuant to Section 116 of the Act;

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(n) an order requiring the trial of any issue.

97 It appears from the oral submissions given at the conclusion of the hearing that the Applicants do not object *per se* to the sale of the Saltend facility or to the preferred share issuances. However, they submit that by upstreaming or permitting the upstreaming of the proceeds of the Sally I and Sally II transactions and accepting, in return, unsecured promissory notes (in relation to the Sally I transaction), CCRC is divesting itself of a hard asset (the proceeds of the Sally I and Sally II transactions, its interest in the Saltend facility or the proceeds from the sale of the Saltend facility) and getting nothing in return or an asset of questionable value (the unsecured promissory notes). The Applicants further suggest that the Respondents are removing from CCRC the only meaningful asset that it controls and that such actions will render both CCRC and Finance II insolvent and unable to meet their obligations to the holders of the Finance II bonds. The Applicants submit that these actions only benefit Calpine and provide no benefit to CCRC, Finance II or their creditors.

98 The Applicants take the position that the terms of the Debenture between CCRL (now CCRC) and Finance II were part of the documents relating to the bond issuance. In support of this suggestion they refer to the Prospectus Supplement which indicates that Finance II will comply in all respects with its obligations under s. 7.1 of the Term Debenture. They also refer to s. 3.9 of the First Supplemental Indenture which indicates that, solely for the benefit of the bond holders in question, Finance II shall comply in all respects with its obligations under s. 7.1 of the Term Debenture and to the First Amendment to Guarantee Agreement which indicates that solely for the benefit of the bond holders in question, Calpine shall cause CCRL (now CCRC) to comply in all respects with its obligations under the said section of the Term Debenture.

99 The Applicants further suggest that Finance II is failing to enforce its rights under the terms of the Debenture issued August 23rd, 2001 between Finance II and CCRL (now CCRC) and in particular under clause 4.1 (requiring CCRL to diligently conduct its business in a proper and efficient manner so as to preserve and protect its business and assets) and under clause 4.14. They take the position that these transactions are oppressive and unfairly prejudicial to the bond holders in question and unfairly disregard their interests. They therefore seek relief under the Third Schedule of the *Companies Act*.

100 Finally, the Applicants submit that Calpine's financial position has deteriorated significantly since the Finance II bonds were issued in October of 2001. They suggest that Calpine is in the midst of a liquidity crisis and note that the value of Calpine's shares has dropped significantly since the bonds were originally issued in October of 2001. (On October 12th, 2001 Calpine's shares were trading at $27.47. Accordingly to Mr. Thomas' evidence these shares were trading at $3.54 at the close of the market on June 21st, 2005.) They also refer to the fact that Calpine's corporate debt has never been rated lower than it is at the present time.

101 The Respondents dispute the allegations made by Harbert and Wilmington and state that the transactions complained of are permitted under the documents governing the issuance of the bonds. They note that these documents do not contain any negative or restrictive convenants that would prevent intercompany loans, the sale of the Saltend facility or the ability to use the proceeds from this sale as the Respondents see fit. They suggest that if any such restrictions were intended they would have been included in the bond documents.

102 The Respondents state that the bonds were sold solely on the credit of Calpine and that investors were not invited to, nor could they reasonably rely on the separate credit of CCRC, Finance II or any assets held by either of them including the Saltend facility. They note that the bond issuance documentation did not describe either Finance II or CCRC as owning any significant assets nor did they include any financial statements or statements of net worth for either

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Finance II or CCRC. In addition, they submit that none of the bond holders could have a reasonable expectation in relation to clause 4.1 of the Term Debenture as this document was not publicly disclosed until November of 2004.

103 The Respondents note that the bonds are in good standing (all interest payments have been made as required) and the outstanding principal is not due and payable until October 15, 2008 (for the euro denominated series) and October 15, 2011 (for the pound sterling series). While the Respondents appear to acknowledge facing financial challenges they deny the suggestion that they are in the midst of a liquidity crisis or that they will be unable to meet their obligations under the Finance II bonds when due.

104 The Respondents note that Harbert (who initiated this proceeding) did not begin purchasing the bonds in question until after the Sally I Transaction occurred in October of 2004 and after the possible sale of the Saltend facility was announced by Calpine on January 13, 2005 (the press release that announced the potential sale indicated that the net proceeds of any such sale would be used to redeem the preferred shares issued in the Sally I transaction with the remaining proceeds to be used in accordance with the asset sale provisions of Calpine's existing bond indentures). They further note that Harbert continued to buy the bonds in question after the Sally II Transaction was announced and it was disclosed that the net proceeds from the potential sale of Saltend would also be used to redeem the preferred shares issued in the Sally II transaction. The Respondents question the motives of Harbert and submit that it purchased the bonds in question for the express purpose of taking opportunistic advantage of the issues that have been raised in this proceeding in order to maximize profit on a short term basis.

Analysis and Conclusions Re: The Oppression Claim

105 Prior to the enactment of the oppression remedy provisions in the *Canada Business Corporations Act* and other similar provisions in provincial legislation, the rights of minority shareholders and creditors were minimal as compared to the rights of those that control a corporation. The introduction of statutory provisions which allow remedies against acts or omissions that are oppressive, unfairly prejudicial or that unfairly disregard the interests of others was a major change in corporate law and the courts involvement in corporate affairs. In relation to creditors, the oppression remedy provisions of the various statutes in Canada are said to "grant the broadest rights to creditors of any common law jurisdiction" (see: *People's Department Stores Ltd. (1992) Inc., Re* (2004), 244 D.L.R. (4th) 564 (S.C.C.) at ¶ 48).

106 While the Court has the ability, in appropriate circumstances, to grant relief from conduct that is oppressive, unfairly prejudicial or that unfairly disregards the interests of others, it must be careful not to inappropriately intrude into the legitimate conduct of a company's business.

107 Oppression cases are fact driven. Conduct that is considered oppressive, unfairly prejudicial or that unfairly disregards the interests of others in one case may not be so in the slightly different setting of another (*Ferguson v. Imax Systems Corp.* (1983), 150 D.L.R. (3d) 718 (Ont. C.A.).

108 In *Piller Sausages & Delicatessens Ltd. v. Cobb International Corp.* (2003), 35 B.L.R. (3d) 193 (Ont. S.C.J.) affirmed at (2003), 40 B.L.R. (3d) 88 (Ont. C.A.) the Court analyzed the oppression remedy and stated at ¶ 17-22:

> 17 'Oppressive' has been interpreted as meaning burdensome, harsh or wrongful: *Scottish Co-operative Wholesale Society Ltd. v. Meyer* (1958), [1959] A.C. 324 (U.K. H.L.); *Burnett v. Tsang* (1985), 29 B.L.R. 196 (Alta. Q.B.).
>
> 18 'Unfairly prejudicial' has been held to mean 'acts that are unjustly or inequitably detrimental': *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 (B.C.S.C.).

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19 'Unfairly disregards' has been held to mean 'unjustly or without cause, pay no attention to, ignore or treat as of no importance the interests of security holders, creditors, directors or officers': *Stech v. Davies* (1987), 53 Alta. L.R. (2d) 373 (Alta. Q.B.).

20 It appears that the progression from 'oppressive' to 'unfairly prejudicial' to 'unfairly disregards' involves decreasingly stringent requirements: *Journet c. Superchef Food Industries Ltd.* (1984), 29 B.L.R. 206 (Que. S.C.).

21 An applicant need not show mala fides on the part of the respondents, as it is the effect of their actions, rather than their intent, which is material: *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289 (Ont. C.A.); *Palmer v. Carling O'Keefe Breweries of Canada Ltd.* (1989), 67 O.R. (2d) 161 (Ont. Div. Ct.).

22 Jurisprudence shows that these provisions of the CBCA are remedial and should be interpreted broadly in considering a complainant's interest. Each such application is fact specific. The reasonable expectations of the parties, the nature of the acts complained of and the methods by which they were carried out must be all considered.

. . . . .

109 Fairness is an integral consideration in any oppression case. Whether conduct is unfair will be determined by a number of factors. In *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta Q.B.) appeal adjourned at (1989), 45 B.L.R. 110 (Alta C.A.) McDonald, J. stated at p. 57:

..... In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected, and general commercial practice should all be material. More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: the protection of the underlying expectation of a creditor in its arrangement with the corporation, the extent to which the acts complained of were unforeseeable or the creditor could reasonably have protected itself from such acts, and the detriment to the interests of the creditor. The elements of the formula and the list of considerations as I have stated them should not be regarded as exhaustive. Other elements and considerations may be relevant, based upon the facts of a particular case.

110 When analyzing fairness the Court considers, *inter alia*, the reasonable expectations of the parties. Whether expectations are reasonable will be determined on an objective basis (*Pente Investment Management Ltd. v. Schneider Corp.* (1998), 44 B.L.R. (2d) 115 (Ont. C.A.) at ¶ 68.)

111 In *SCI Systems Inc. v. Gornitzki Thompson & Little Co.* (1997), 36 B.L.R. (2d) 192 (Ont. Gen. Div.) affirmed at (1998), 110 O.A.C. 160 (Ont. Div. Ct.) the Court stated at ¶ 36:

I agree that the oppression remedy is designed to protect reasonable expectations. However, one of the most reasonable of all expectations of those dealing with corporations must be that the directors will manage the company in accordance with their legal obligations. Some of these obligations are specifically prescribed by statute. Others are more generally derived from the common law. However, they essentially add up to the same thing: namely, to act honestly and in good faith in the best interests of the corporation and to exercise the diligence expected of a reasonably prudent person.

The Applicants Status as "Complainants"

112 The Applicants submit that they qualify as "complainants" in relation to s. 5(1) of the Third Schedule of the *Companies Act*. Section 7(5)(b) of the Third Schedule provides as follows:

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7(5) For the purposes of Sections 4, 5, 6 and this Section

. . . . .

(b) "complainant" means

(i) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a company or any of its affiliates,

(ii) a director or an officer or a former director or officer of a company or of any of its affiliates,

(iii) the Registrar, or

(iv) any other person who, in the discretion or the court, is a proper person to make an application under this Section.

113 The term "security" is not defined in the *Act*. The Applicants note that in the *Canada Business Corporations Act* and the Ontario *Business Corporations Act* the term "security" is defined to include a "debt obligation". Further, a "debt obligation" is defined to include a bond, debenture, note or similar obligation whether secured or unsecured. The Applicants' submit that in the absence of a compelling reason to the contrary similar legislation should be interpreted harmoniously. They further submit that the oppression remedy is a remedial remedy and that these provisions should be given a broad and liberal interpretation to ensure the attainment of the objects of the *Act*.

114 The Respondents acknowledge that while in certain circumstances a creditor may be a proper complainant for the purposes of a Nova Scotia oppression claim they submit that in the circumstances of this case, the Applicants are not "proper" complainants entitled to advance such a claim.

115 I am satisfied that both Harbert and Wilmington are "complainants" as defined in s. 7(5)(b) of the Third Schedule of *Companies Act*.

116 A "complainant" is defined in s. 7(5)(b)(i) to include a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a company or any of its affiliates. As indicated above, the term "security" is not defined in the *Act*. In *Black's Law Dictionary*, seventh edition, West Group, 1999: St. Paul, Minn.) the definition of "security" includes:

..... An instrument that evidences the holder's ownership rights in a firm (e.g., a stock), the holder's creditor relationship with a firm or government (e.g., **a bond**) or the holder's other rights (e.g. an option). [emphasis added]

117 In my opinion, the term "security" can include a bond.

118 I am satisfied that the holders of the Finance II bonds (including Harbert and the other bond holders that are represented by Wilmington) are registered holders or beneficial owners of a security of a company (Finance II) and that they therefore satisfy the definition "complainant" in s. 7(5)(b)(i) of the Third Schedule of the *Act*.

Is Calpine an "Affiliate"?

119 The Respondents submit that Calpine is not an "affiliate" as referred to in the *Act* and, accordingly, the oppression remedy does not apply to that entity.

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120 Section 5(2) deals with the conduct of a company *or any of its affiliates*. Section 1 of the Third Schedule of the *Act* provides that "unless the context otherwise requires, the expressions defined in the Companies Act, or any statutory modification thereof in force at the date at which this Schedule becomes applicable to a company, shall have the meanings so defined ....."

121 The term "company" is defined in s. 2(1) of the *Act* as "a company formed and registered under this Act, or an existing company". An "existing company" is defined in s. 2(1) to mean "a company registered under Chapter 128 of the Revised Statutes, 1900, Chapter 19 of the Acts of 1921 or Chapter 174 of the Revised Statutes, 1923, and still so registered in the office of the Registrar on the first day of August, 1935". Calpine is not a "company" as defined by the Nova Scotia *Companies Act*.

122 The term "affiliate" is not specifically defined in the *Act*. However, s. 2(2) of the *Act* indicates that a company shall be deemed to be an affiliate of another company if one of them is the subsidiary of the other or if both are subsidiaries of the same company or if each of them is controlled by the same person.

123 The Respondents do not appear to dispute that Finance II and CCRC are subsidiaries of Calpine but, rather, base their argument on the fact that Calpine is not a "company" as defined by the *Act*. Counsel for the Respondents notes that s. 2(2) provides that "a *company* shall be deemed to be an affiliate of another *company* if ..." [emphasis added]. In other words they take the position that an affiliate must be a "company" (as defined in the *Act*) of another "company" (as defined in the *Act*) in order to be an "affiliate". Since Calpine is not a "company" as defined in the *Act* — they take the position that they cannot be an "affiliate".

124 In the memorandum filed on behalf of the Respondents at ¶ 134 it is stated:

> It is well-established by the jurisprudence of the Supreme Court of Canada that the preferred approach to statutory interpretation is set out by *E.A. Driedger in Construction of Statutes* (2nd Ed., 1983), at p. 87:
>
> > Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.
>
> See *Rizzo & Rizzo Shoes Ltd., Re*, 1998 CarswellOnt 1 (S.C.C.) at para. 21.

125 In my view, the broad remedial nature of the oppression remedy provisions set out in the Third Schedule of the *Companies Act* support a broad interpretation of the term "affiliate" referred to therein.

126 It is important to note that the term "affiliate" is not specifically defined in the *Act*. While s. 2(2) provides that a company shall be deemed to be an affiliate in certain circumstances, in my view, this provision does not restrict the definition of the term "affiliate".

127 In *Black's Law Dictionary*, *supra*, the definition of the term "affiliate" includes the following:

> A corporation that is related to another corporation by shareholdings or other means of control; a subsidiary, parent, or sibling corporation .....

128 I am satisfied, based on the evidence before me, that Calpine is an affiliate of Finance II and CCRC. I am further satisfied that the term "affiliate" in s. 5(2) of the Third Schedule of the *Act* is not restricted to companies formed and registered under the Nova Scotia *Companies Act* or to "existing companies" as defined by the *Act*.

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Is the Conduct in the Present Case Oppressive, Unfairly Prejudicial or Does It Unfairly Disregard the Interests of the Applicants as Bond Holders?

129 I am satisfied that the actions of Finance II, CCRC and Calpine have unfairly disregarded the interests of the Finance II bond holders.

130 When considering an application such as this it is appropriate for the Court to review the "documents of the deal" (as put by the Respondents' solicitor) to assist in determining the reasonable expectations of the parties. While in my view, these documents are not necessarily determinative of the matter, they are clearly relevant.

131 The bonds in question were issued by Finance II and are the direct unsecured obligation of Finance II. While Calpine has guaranteed the bonds (also on an unsecured basis) that does not diminish the primary obligation of Finance II under the bonds.

132 Finance II's only material balance sheet asset is the Term Debenture issued August 23rd, 2001 (between Finance II and CCRL (now CCRC)). Pursuant to clause 4.1 of that Debenture, CCRL agreed to diligently conduct its business in a proper and efficient manner so as to preserve and protect its business and assets. It also agreed pursuant to clause 4.14 not to incur any secured or higher ranking debt than the debt under the Debenture. CCRC has assumed the obligations of CCRL under the terms of the Debenture.

133 Clauses 4.1 and 4.14 were not, in my view, part of the bond issuance documentation. While the Prospectus Supplement, the First Supplemental Indenture and the First Amendment to Guarantee Agreement do make reference to s. 7.1 of the Term Debenture they do not make reference to any other terms of the Debenture including clause 4.1 and 4.14. These clauses (or for that matter the entire Term Debenture) could easily have been referred to if they were to form part of the documentation relating to the bond issuance. I also note that the Term Debenture was not made public until November of 2004, long after the bond issuance occurred.

134 The fact that clauses 4.1 and 4.14 of the Term Debenture were not part of the bond issuance documentation does not, in my view, prevent the Court from considering it when analyzing whether the acts complained of are oppressive. When dealing with oppression claims "*all* the words and deeds of the parties are relevant to an assessment of reasonable expectations, not necessarily only those consigned to paper, and not necessarily only those made when the relationship first arose" (*Westfair Foods Ltd. v. Watt* (1991), 79 D.L.R. (4th) 48 (Alta. C.A.) at p. 54 emphasis in the original). When dealing with an oppression claim the Court is not restricted solely to the documents of the deal but must consider all relevant evidence to determine the reasonable expectations of the parties on an objective basis.

135 I am satisfied from the evidence before me that CCRC has taken its interest in a valuable asset (the proceeds it received from the Sally I transaction) and is substituting therefore an asset of more dubious value (unsecured promissory notes). This, in my view, constitutes a breach of clause 4.1 of the Term Debenture. There is no evidence that Finance II has taken any action to insure that this does not occur.

136 I am further satisfied that CCRC is acquiescing in the upstreaming of the funds from the Sally II transaction out of its control despite the fact that the result will be that it will lose control of its most meaningful asset with no direct benefit to CCRC. This, in my view, also constitutes a breach of clause 4.1 of the Term Debenture. Again, there is no evidence that Finance II has taken any action to ensure that this does not occur.

137 I am also satisfied that Finance II waived clause 4.14 of the Term Debenture in order to permit the Sally II transaction. Mr. Thomas was unable to recall any benefit or consideration that Finance II received for giving this waiver.

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138 In my view, by not enforcing its rights under the Term Debenture, Finance II has unfairly disregarded the interests of the Finance II bond holders. In addition, CCRC (an affiliate of Finance II's) is unfairly disregarding the bond holders' interests (who's interests they are fully aware of) by failing to preserve and protect its assets despite the fact that it has an obligation to do so under clause 4.1 of the Term Debenture. While the Applicants are not a party to this Debenture and, accordingly, are not able to sue directly on the Debenture, I am nevertheless satisfied that the Court can consider the terms of the Debenture and CCRC's conduct in light of the Debenture when considering an oppression claim. When dealing with such a claim regard should be had to all of the surrounding circumstances (*Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board)* (2004), 41 B.L.R. (3d) 74 (Ont. S.C.J. [Commercial List]) at ¶ 219).

139 Finally, Calpine is unfairly disregarding the interests of the bond holders through its involvement in the conduct complained of. The closely held nature of these companies must be recognized. Calpine is the ultimate, indirect parent of both Finance II and CCRC. CCRC is the direct parent of Finance II. Two of the senior officers and board members of Calpine are also on the board of Finance II and CCRC.

140 I am satisfied that the bond holders in question would reasonably expect Finance II to enforce its rights under the Term Debenture. In addition, the said bond holders would reasonably expect Finance II and its affiliates not to act in a manner that unfairly disregarded the bond holders' interests.

141 The Respondents refer to the documents of the deal (including the Prospectus, the Prospectus Supplement and the Indenture) and state that the bonds were sold solely on the credit of Calpine and that investors were not invited to, nor could they reasonably rely on the separate credit of Finance II or CCRC. This argument by the Respondents ignores the fact that Finance II issued the bonds in question and that the bonds are the direct unsecured obligation of Finance II. Calpine chose to organize this bond issuance through Finance II and it cannot now ignore the very corporate structure that it elected to proceed under.

142 The evidence satisfies me that Calpine's financial condition has diminished since the bonds were originally issued in 2001. It is only reasonable that in these circumstances the bond holders would look more closely to the ability of Finance II (and possibly its parent company CCRC) to respond to the bond obligations as they become due.

143 The Respondents have referred to the section of the Indenture which allows Finance II (in certain circumstances) to assign its obligations under the bonds to Calpine or a significant subsidiary thereof without the consent of the bond holders. As a preliminary matter, it must be noted that this did not occur. Even if it had occurred, in my view, the entity that assumed the obligations of Finance II would have the same obligation that Finance II has not to unfairly disregard the interests of the bond holders.

144 During the course of this proceeding much evidence was given concerning the issue of whether Calpine is in the midst of a liquidity crisis and whether Finance II (and possibly CCRC or Calpine) will be in a position to deal with the bond obligations as they mature. In my view, it is unnecessary for the Court to make any findings in this regard. I have found that the Respondents' actions have unfairly disregarded the interests of the bond holders. These actions have resulted in the bond holders being put in a more vulnerable position than would otherwise be the case if CCRC preserved and protected its assets as required by s. 4.1 of the Term Debenture and if Finance II enforced its rights under the Term Debenture. In my view, it is unnecessary for the Applicants to prove that the Respondents will be unable to respond to the bonds in order to succeed with a remedy under s. 5 of the Third Schedule of the *Act.*

145 Finally, the Respondents argue that this application is premature. They suggest that there is no evidence that shows on a balance of probabilities or otherwise that Finance II or Calpine will be unable to repay the Finance II bonds when they mature in 2008 or 2011. Accordingly, they submit that this application is premature. They further suggest that

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s. 5 of the Third Schedule of the *Companies Act* does not allow for anticipatory claims.

146 In my view, this application is not premature or anticipatory in nature. The Respondent companies have already unfairly disregarded the interests of the Finance II bond holders. As indicated above, their actions have left the bond holders in a more vulnerable position than would otherwise be the case if CCRC preserved and protected its assets and Finance II enforced its rights under the Term Debenture. It is unnecessary to wait and see if the obligations to the bond holders are actually met when the bonds mature. The unfair conduct has already occurred.

147 That takes me to the issue of whether a remedy should be granted in the circumstances of this case.

148 Section 5(2) of the Third Schedule of the *Act* indicates that if the Court is satisfied that conduct as set out in that section is oppressive, unfairly prejudicial to or unfairly disregards the interest of a security holder the Court *may* make an Order to rectify the matters complained of. Whether relief should be granted depends on the circumstances of the case.

149 Harbert acknowledges knowing of the Sally I transaction and the possible sale of the Saltend facility prior to purchasing any of the bonds in question. However, they deny knowing of the upstreaming of the funds above or out of the control of CCRC until seeing Mr. Thomas' affidavit sworn to on June 13th, 2005. As indicated previously, the Applicants do not object *per se* to the sale of the Saltend facility. It is the upstreaming of the proceeds of the Sally I and Sally II transactions and the waiver of clause 4.14 of the Term Debenture for no or insufficient consideration that they take issue with.

150 I am satisfied from the evidence presented (including the excerpts from Mr. Kagan's examination for discovery) that prior to its initial purchase of Finance II bonds, Harbert was aware that CCRC and Calpine had upstreamed or planned to upstream the proceeds from the Sally I transaction out of the control of CCRC. I accept that they did not know the exact specifics of how the upstreaming was accomplished until reading Mr. Thomas' affidavit of June 13th, 2005. I find, however, that they had knowledge that CCRC and Calpine had upstreamed or planned to upstream the proceeds of this preferred share issuance prior to purchasing any of the bonds in question. In other words, I find that they were aware of the conduct that they now complain of prior to purchasing any Finance II bonds.

151 On January 20th, 2005 (within a week of making their first purchase) Harbert read the announcement of the Sally II transaction and of Calpine's plan to pay off the Sally II preferred share issuance from a potential sale of the Saltend Facility. In Mr. Kagan's discovery evidence he indicated that he and his boss thought it was "incredible that Calpine would be pursuing this course of action". Nevertheless, Harbert purchased more Finance II bonds.

152 As indicated previously, on April 13th, 2005 Harbert sent a letter to the Respondents suggesting there was evidence that the value of the Saltend facility was being indirectly stripped out of CCRC to the prejudice of the Finance II's bond holders. Harbert continued to purchase more Finance II bonds.

153 Harbert eventually learned from Mr. Thomas' June 13th, 2005 affidavit complete particulars of how the upstreaming occurred. Despite this knowledge, Harbert continued to buy Finance II bonds and, in fact, continued to buy bonds within days of the hearing of this matter.

154 Should the Court grant Harbert relief in these circumstances?

155 Harbert suggests that complainants are entitled to pursue an oppression claim even if they became security holders after they have knowledge of the conduct complained of. In support of this position they have referred the Court to the cases of *Palmer v. Carling O'Keefe Breweries of Canada Ltd.* (1989), 67 O.R. (2d) 161 (Ont. Div. Ct.) and *347883*

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Alberta Ltd. v. Producers Pipelines Inc. (1991), 80 D.L.R. (4th) 359 (Sask. C.A.).

156 The Respondents note that when analyzing an oppression remedy claim the Court takes into account the reasonable expectations of the parties in order to determine what is fair. They submit that an applicant that knows of the impugned conduct prior to becoming a security holder is not a proper complainant and should not be granted relief under the oppression remedy provisions of the Third Schedule of the *Companies Act*. They suggest that the date that the Applicant became a security holder is relevant in determining whether they are proper complainants and rely on the cases of *LSI Logic Corp. of Canada Inc. v. Logani*, [2001] 11 W.W.R. 740 (Alta Q.B.) and *Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board)*, *supra*, in support thereof.

157 In my view, the case law on this issue is not fully developed.

158 In *Royal Trust Corp. of Canada v. Hordo*, [1993] O.J. No. 1560 (Ont. Gen. Div. [Commercial List]) Farley, J. stated at ¶ 14:

> In my view a person who is a shareholder is not automatically ensured status to bring an oppression proceeding simply because he owns or formally owned shares in a corporation. In my opinion the court retains a discretion to deny status to such a person where the shares were purchased with a view to bringing an application under the oppression remedy or in full awareness of the circumstances alleged to constitute oppression.

159 The decision in *Hordo*, *supra*, was not followed by the Ontario Court of Appeal in the case of *Richardson Greenshields of Canada Ltd. v. Kalmacoff* (1995), 22 O.R. (3d) 577 (Ont. C.A.) which was a case involving a derivative action where the conduct complained of was alleged to be *ultra vires* the company. In that case the applicant purchased shares of the company in order to bring a derivative action. The Court of Appeal had no difficulty finding that the applicant qualified as a proper complainant to bring the action and was not concerned by the motives of the applicant in buying the shares in order to have standing. As noted, however, by Cumming, J. in *Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board)* , *supra*, "Robins, J. A.'s comments and the *ratio* of *Richardson* were directed at the derivative action before the Court of Appeal and at Farley, J.'s finding in the court below in respect of that derivative action, not at Farley, J.'s finding in *Hordo* relating to an oppression action."

160 In *Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board)*, *supra*, Cumming, J. dealt with the difference between a derivative action and an oppression claim at ¶ 240 when he stated:

> However, the situation of an oppression action is different from that of a derivative action. The latter allows the complainant to sue in the name of the corporation for a loss sustained through a wrong to the corporation. There is no requirement that the status of the complainant shareholder be contemporaneous with the impugned conduct because the court proceeding would be on behalf of the corporation, rather than being a personal action. In contrast, *an oppression action is a personal remedy premised upon there being prejudice to the interests of the complainant shareholder*.
>
> [Emphasis added]

161 In addition, there is a difference in my view between a proceeding involving a company whose actions are alleged to be illegal (*ultra vires* the company) such as in *Richardson Greenshields*, *supra*, and in a case where the actions are said to be wrong based on the reasonable expectations of the parties (an oppression claim). In the former case the impugned conduct is wrong (illegal) *per se.* In the latter situation the conduct is wrong because of the reasonable expectations of the parties.

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162 There are also cases dealing with dissenting shareholders involved in take-over bids where the Court has not been concerned by the fact that the complainant purchased the shares in question after knowing of the take-over bid. For example in *Shoom v. Great-West Lifeco Inc.* (1998), 40 O.R. (3d) 672 (Ont. Gen. Div. [Commercial List]) affirmed at (1998) 42 O.R. (3d) 732 (Ont. C.A.) the Court was not concerned by the fact that the party in question (a sophisticated arbitrageur) had purchased shares after the announcement of a take-over bid. In that case, the Court was dealing with a shareholder that had a right to a statutory remedy under s. 206 of the *Canada Business Corporations Act*. That right existed regardless of the shareholders reasonable expectations.

163 In the case at Bar, we are dealing with an oppression remedy claim. Fairness is an integral consideration in any oppression case. When analyzing fairness the Court considers the reasonable expectations of the parties. This, in my view, distinguishes cases such as *Richardson Greenshields*, *supra*, and *Shoom*, *supra*.

164 How have the Courts dealt with this issue in relation to oppression remedy claims? The two cases relied on by the Applicants (*347883 Alberta Ltd.*, *supra* and *Palmer*, *supra*) appear to support the suggestion that even in an oppression case the applicants' knowledge of the matters complained prior to becoming a security holder may not be relevant when deciding whether they are a "proper" complainant or are entitled to relief.

165 In my view, the majority decision in *347883 Alberta Ltd.*, *supra*, is distinguishable from the case at Bar in a number of ways. First, it appears that the shareholder in that case purchased its shares for the purpose of a take-over bid (page 409). In addition, the conduct complained of was said to be beyond the powers of the directors (illegal *per se*). Finally, the majority noted that the shares were purchased *prior* to the actions occurring which were found to be beyond the powers of the directors. All of these factors, in my view, distinguish that case from the case at Bar.

166 The majority in *347883 Alberta Ltd.*, *supra*, went on, however, in *obiter* to agree with the comments of Southey, J. in *Palmer v. Carling O'Keefe Breweries of Canada Ltd.*, *supra*, which indicates that an applicant's prior knowledge of the matters complained of may not preclude them from claiming relief for oppression.

167 In *Palmer v. Carling O'Keefe Breweries of Canada Ltd.*, *supra*, the Court stated at pp. 169-170:

> I am unimpressed with the argument that no relief should be given in respect of shares purchased after the intention to amalgamate became known. The submission was that, in respect of those shares, the purchasers 'bought into the oppression'. If relief is given to anyone in these proceedings, it will mean that the applicant correctly appreciated the legal rights of the preference shareholders. If the applicant and others could not take advantage of those rights with respect to the shares they were bold enough to purchase while those rights were still in dispute, it would mean that less sanguine owners would be deprived of the advantage of selling their shares during the pending litigation at prices reflecting the purchasers' estimate of the chances of success. Any such rule would place a new and, in my view, unwarranted restriction on the price of shares that are traded on a stock exchange.
>
> The conduct of the applicant and those associated in the same interest will either turn out to have provided an effective check on unlawful acts by the directors, or it will prove to have been a very expensive exercise in tilting at windmills. The owners of small numbers of shares probably could not afford to run the risks involved in providing such check.

168 As noted by Cumming, J. in *Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board)*, *supra*, it appears that in *Palmer*, *supra*, the complainants were purchasers *prior* to the act of amalgamation which was the actual impugned act of oppression. In the case at Bar, the upstreaming of the Sally I proceeds out of *CCRC* (which is part of the impugned conduct) began prior to Harbert's initial purchase of Finance II bonds.

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169 In any event, to the extent that *Palmer*, *supra*, may be at variance with my opinion in this decision, I am not prepared to follow it. In my view, a complainant who seeks equitable relief pursuant to s. 5 of the Third Schedule of the *Companies Act* must be oppressed, prejudiced or harmed by the conduct complained of. In my further view, as a general rule, a complainant that decides to become a security holder knowing that the impugned conduct was occurring cannot be said to have had reasonable expectations to the contrary and consequently, in the circumstance of the very act or conduct that was expected, maintain that it has been oppressed.

170 In *LSI Logic Corp. of Canada Inc. v. Logani*, *supra*, (which was decided after *347883 Alberta Ltd.*, *supra*, and *Palmer*, *supra*) Fruman, J. stated at ¶ 127:

> ....a shareholder who purchased LSI shares after the disposition of the Korean interests could not bring an oppression application in respect of that disposition because the shareholder could not claim to have bought the shares with the legitimate expectation that the company would not dispose of the Korean interests. The date each of the Shareholders acquired their shares is particularly relevant in determining whether they are proper complainants.

171 Further, in *Ford Motor Co. of Canada v. Ontario (Municipal Employees Retirement Board)*, *supra*, (which was also decided after *347883 Alberta Ltd.*, *supra* and *Palmer*, *supra*) Cumming, J. stated at ¶ 231:

> *In LSI*, *supra*, Fruman, J. emphasized that the date of acquiring shares is particularly relevant to determining whether a shareholder is a proper complainant. This seems appropriate and fair from a policy standpoint. The oppression remedy is protective of reasonable expectations by shareholders while considering the relevant circumstances. A shareholder should not be able to claim oppression in respect of an asserted reasonable expectation if it did not exist at the time of his or her share purchase. Arguably, the reasonable expectations of a new shareholder generally pertain to the future decision - making of management unless there are past and continuing misrepresentations, which create false expectations at the point of purchase of the shares.

172 Harbert is a very sophisticated investor. I have found that prior to their initial purchase of Finance II bonds they were aware that CCRC and Calpine had upstreamed or planned to upstream the proceeds from the Sally I transaction out of the control of CCRC. They may not have known the exact specifics of the upstreaming, but I am satisfied that they were on notice that it was occurring. I am also satisfied from the evidence presented that they were aware that this conduct may constitute a breach of the Term Debenture. Despite this knowledge, Harbert purchased Finance II bonds.

173 As indicated previously, within a week of making their first purchase of Finance II bonds Harbert read the announcement of the Sally II transaction and of Calpine's plan to pay off the Sally II preferred share issuance from a potential sale of the Saltend facility. Mr. Kagan thought it was "incredible that Calpine would be pursuing this course of action". Nevertheless, Harbert purchased more Finance II bonds.

174 Mr. Kagan testified on discovery that one of the reasons that Harbert purchased additional bonds after the press release announcing the Sally II transaction was so that Harbert would be sure they had a large enough position to pursue their rights. Section 5.6 of the Indenture dated October 18th, 2001 provides as follows:

> **SECTION 5.6 Limitation on Suits.**
>
> A Securityholder of a Series may pursue a remedy with respect to this Indenture, the Guarantee Agreement or the Securities of such Series only if:
>
>> (a) the Holder gives to the Trustee written notice of a continuing Event of Default with respect to that Series;

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(b) the Holders of at least 25% in principal amount of the Securities of such Series make a written request to the Trustee to pursue the remedy;

(c) such Holder or Holders offer to the Trustee security or indemnity reasonably satisfactory to it against any loss, liability or expense;

(d) the Trustee does not comply with the request within 60 days after receipt of the notice, request and the offer of security or indemnity; and

(e) the Holders of a majority in principal amount of the Securities of such Series do not give the Trustee a direction inconsistent with the request during such 60-day period.

A Securityholder may not use this Indenture or the Guarantee Agreement to prejudice the rights of another Securityholder or to obtain a preference or priority over another Securityholder.

175 I have difficulty accepting Mr. Kagan's suggestion that one of the reasons Harbert purchased additional bonds was to ensure that they had a large enough position to pursue their rights under the Indenture. As a preliminary matter, s. 5.6 of the governing Indenture does not require that a single bond holder hold at least 25% of the securities in question in order to make a written request to the Trustee to pursue a remedy. It is the holder*s* of at least 25% of the bonds that must make that request. Harbert could have contacted other bond holders and suggested that they collectively make such a request to the Trustee.

176 While Harbert could have been concerned about clause 5.6(e) there was no evidence that any bond holders were giving the Trustee directions which were inconsistent with Harbert's interest in pursuing the matter. In fact, it does not appear that Harbert was dealing with the Trustee in relation to this matter until May of 2005.

177 Finally, I note that after the January 20th, 2005 announcement (relating to the Sally II transaction) Harbert started to buy the euro denominated bonds. They own a very small portion of these bonds so it is unlikely that they were purchasing these bonds in order to pursue their rights.

178 Mr. Kagan was asked on discovery what other reasons Harbert had for purchasing the bonds in questions. He responded:

We thought that after speaking with counsel, that we were correct that Calpine did not have the right to do this. That it either would not occur or would not stand, at which point the value of the Canada bonds would be reflected in the market, and those bonds would become far more valuable than the market was viewing them at the time. So, we thought after reviewing all the materials that we were right and that this couldn't happen.

179 Harbert had no realistic basis to think that the Sally II transaction would not occur. Calpine announced their intention to proceed with the Sally II transaction on January 20th, 2005 and there was no evidence to suggest that an alternate intention was announced. The evidence satisfies me, on a balance of probabilities, that Harbert was of the view that it would be improper for Calpine and its subsidiaries to proceed in the manner announced but they nevertheless continued to buy Finance II bonds.

180 The oppression remedy is based on principles of equity and fairness and the reasonable expectations of the parties. It is important to note that this is not a situation where a company's conduct is alleged to be illegal such as in *Richardson Greenshields*, *supra*, (where the company's actions were alleged to be *ultra vires*) nor is this a case where a security holder is enforcing a statutory right to specific relief (such as in s. 206 of the *Canada Business Corporations Act*

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). This is a situation where a company's conduct is said to unfairly disregard the interests of a security holder based on the reasonable expectations of the parties. In my view, a security holder's knowledge of the conduct complained of and its decision to become a security holder after obtaining such knowledge is relevant when deciding whether they are a "proper" complainant or a security holder that should be granted relief.

181 The burden is upon Harbert to satisfy me that they are entitled to the relief claimed. In the circumstances of this case they have not fulfilled this burden and their application for relief is hereby dismissed.

182 In *Palmer*, *supra*, the Court referred to the fact that allowing applications by complainants who become security holders after the conduct complained of becomes known could provide an effective check on unlawful acts by directors. The Court went on to state that the owners of small numbers of shares probably could not afford to run the risks involved in providing such check. While these comments may have applicability in cases involving conduct that is wrong *per se* (illegal), in my view, they are not applicable to a claim that is based, at least in part, on the reasonable expectations of the parties.

183 That takes me to the issue of the remaining bond holders. Counsel for the Respondents submits that the only evidence before me concerning reasonable expectations relates to Harbert and another company that Harbert purchased for each time Finance II bonds were acquired by Harbert. I have no evidence about any of the other bond holders including their identity, the dates that they purchased the bonds in question, their knowledge of the matters complained of et cetera. The Respondents invite the Court to dismiss the remainder of the application based on the comments of Farley, J. in *AMCU Credit Union Inc. v. Olympia & York Developments Ltd.* (1992), 7 B.L.R. (2d) 103 (Ont. Gen. Div.) where the Court stated at ¶ 3:

> A troubling feature of this application (which being an oppression remedy application and based upon the expectations of the applicants) is that none of the applicants have provided material which directly indicates what their expectations were. Nor have they indicated what the state of their knowledge was at the time of purchasing the notes and thereafter. It would be of interest to know if they purchased directly for full value or if they acquired the notes in the aftermarket at a substantial discount. What can be said of their sophistication in the commercial paper market?............................Schroeder testified as to what he thought was the profile of a commercial paper buyer in this instance. I find this far from satisfactory. While it is true I indicated obiter in *Ballard* (1991), 3 B.L.R. (2d) 113 at 123 that shareholder expectations in a widely held corporation might have to be assumed or proxied if they are to be discerned at all, it is important not to take this comment out of context. A representative shareholder(s) applicant(s) in a multi-applicant oppression case or more especially in a derivative action situation would still have to give evidence. I also note that in the subject case, the applicants are but 26 in number and appear to be in number and dollar amount substantially all of the non-OYDL and non-bank holders of notes. One would expect that a number of this relatively small number (i.e., not widely held) would give direct evidence of expectations which would be submitted as the complete spectrum of expectations and knowledge. I would conclude that the applicants have not established any base for their claim.

184 In *820099 Ontario Inc. v. Harold E. Ballard Ltd.* [1991 CarswellOnt 141 (Ont. Div. Ct.)], *supra*, Farley, J. when dealing with an oppression remedy claim stated at ¶ 129:

> Shareholder interests would appear to be intertwined with shareholder expectations. It does not appear to me that the shareholder expectations which are to be considered are those that a shareholder has as his own individual 'wish list'. They must be expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders...........................

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185 He went on to state at ¶ 135:

> In my view, one cannot regard expectations as a static matter. Expectations may well evolve from the situation of the shareholder going into the corporation (by way of setting up the corporation or by way of gift — or by way of purchasing previously issued shares). Certainly these original expectations may strongly influence the evolutionary process. As well, in a closely held corporation, it will be much easier to consider the 'factual' expectations of the shareholders; in a widely held corporation, these expectations will have to be assumed or proxied if they are to be discerned at all. I would think that the expectations that count are those that are reasonable and which are in existence as the directors make their decisions from time to time...........................

186 In this case I have extensive evidence concerning the bond issuance, the documents of the deal, the subsequent preferred share issuances, et cetera. I am satisfied that from these documents I can determine on an objective basis the reasonable expectations of Finance II bond holders (i.e: the reasonable expectation that Finance II would enforce its rights under the Term Debenture and that the Respondent companies would not unfairly disregard their interests). I am further satisfied, however, that the dates that the bonds were purchased (prior to or after the conduct complained of) and the knowledge of the bondholders alleged to have been oppressed are relevant to the matters at issue in this proceeding. I do not have any evidence in this regard over and above the evidence provided by Harbert.

187 According to Mr. Kagan's discovery evidence the Sally I transaction and the fact that the use of the proceeds therefrom would be available to Calpine was announced to the market in September or October of 2004. A specific date was not given. The earliest date (if the announcement was made in September or October of 2004) would have been September 1st, 2004.

188 In my view, in order to determine whether a bond holder who purchased Finance II bonds after September 1st, 2004 had been oppressed, the Court would need to have evidence concerning their identity and their state of knowledge at the time of purchasing the bonds. The Trustee has not provided evidence in this regard in relation to any bond holder other than Harbert and another company that Harbert purchased for. In relation to Harbert and this other company, I am satisfied that relief should not be granted pursuant to s. 5 of the Third Schedule of the *Companies Act* due to Harbert's knowledge of the matters complained of.

189 In my view, the Trustee has failed to prove its claim in relation to any other bond holders that purchased bonds from September 1st, 2004 onward as it has failed to identify these individuals and to give evidence concerning their state of knowledge at the time of purchasing the bonds. However, I am satisfied on a balance of probabilities, that with the exception of the Respondent companies themselves (who do presently own some of the bonds in question), bond holders that purchased Finance II bonds prior to September 1st, 2004 would not have known of the conduct now complained of. Accordingly, it is not necessary for the Court to receive evidence concerning their state of knowledge.

190 In my view, a remedy should be granted for any bond holder (other than the Respondent companies) that purchased Finance II bonds prior to September 1st, 2004 and that continues to hold those bonds today. The Trustee shall have until August 31st, 2005 to provide the Respondents and the Court with a list of all Finance II bond holders that fulfil this criteria as well as the face value of the said bonds. An Order will then issue requiring Calpine to maintain in the control of CCRC sufficient proceeds from the sale of the Saltend facility to cover the said value. If there are insufficient proceeds from the said sale to fulfil this requirement then Calpine shall be obliged to place in the control of CCRC an additional amount, which, when added to the net proceeds referred to above, will cover the face value of all such bonds. The Order will further provide that CCRC shall diligently conduct its business in a proper and efficient manner so as to preserve and protect its business and assets. This Order shall remain in effect for as long as the said bonds remain out-

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standing. I hereby reserve the right to determine the specific amounts that must be placed in the control of CCRC.

191 In the meantime, a further Interim Order is hereby granted pursuant to which Calpine shall maintain in the control of CCRC the net proceeds of the sale of the Saltend facility (as defined in my Interim Order issued July 28th, 2005) until the Court's final Order is issued. Further, CCRC shall diligently conduct its business in a proper and efficient manner so as to preserve and protect its business and assets.

192 I appreciate that as a result of my decision some of the Finance II bond holders will be treated differently than other Finance II bond holders. In my view, there is nothing improper with such a result in light of the fact that the oppression remedy deals with the reasonable expectations of parties. There will be cases where some parties have different expectations than others for very good reason (beyond just a subjective "wish" or view of the matter). In those cases, different security holders may well be treated differently.

193 In my view, the parties to this application have had mixed success. I am hopeful that counsel will be able to agree on the issue of costs. If not, I am prepared to receive written submissions in this regard.

"Appendix A"

TERM DEBENTURE

CALPINE CANADA RESOURCES LTD., a corporation subsisting under the laws of the Province of Alberta, Canada (**"Issuer"**)

£274,400,000

Due: April 25, 2021

THIS DEBENTURE is issued this 23rd day of August, 2001 by the Issuer, whose principal office or place of business is located at Suite 1000, 350 — 7th Avenue S.W., Calgary, Alberta, to Calpine Canada Energy Finance II ULC, an unlimited liability company subsisting under the laws of the Province of Nova Scotia (the **"Holder"**) with a registered office at Suite 800, Purdy's Wharf Tower One, 1959 Upper Water Street, P.O. Box 997, Halifax, Nova Scotia.

WHEREAS this Debenture is issued to Calpine Canada Energy Finance II ULC, the initial Holder, as consideration for an advance made by Holder to Issuer for general corporate purposes;

AND WHEREAS it is intended that this Debenture may be used by the Holder to arrange its financing and may be held by the Holder, or sold, assigned, pledged as security from time to time by the Holder, (or otherwise used or transferred by the Holder) in connection with the Holder's financing activities;

NOW THEREFORE for good and valuable consideration (the receipt and sufficiency of which is hereby acknowledged), the Issuer covenants, acknowledges, represents and warrants as follows:

. . . . .

ARTICLE 4

COVENANTS OF THE ISSUER

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4.1 Conduct of Business

The Issuer shall diligently conduct its business in a proper and efficient manner so as to preserve and protect its business and assets.

. . . . .

4.9 General Indemnity

The Issuer will indemnify the Holder and save it fully harmless of and from all loss, cost, damage, expense, claims and liability which it may suffer or incur in connection with (i) the exercise by the Holder of its remedies and powers hereunder, (ii) any breach of the representations or warranties contained herein, or (iii) any failure by the Issuer to perform any of its covenants or obligations under this Debenture.

. . . . .

4.11 Maintain Existence

The Issuer will at all times maintain its corporate existence and carry on its business in a proper and efficient manner.

. . . . .

4.13 Use of Proceeds

The Issuer will use the proceeds of amounts borrowed pursuant to this Debenture for general corporate purposes.

4.14 Indebtedness

The Issuer shall not incur any Indebtedness unless such Indebtedness contains express terms, or is issued under a deed, indenture or other instrument which contains express terms, providing that it is unsecured and either subordinate to or ranks *pari passu* with the Indebtedness evidenced by this Debenture. The term **"Indebtedness"** means, with respect to the Issuer: (i) the principal (including redemption payments), premium, if any, interest and other payment obligations in respect of (x) indebtedness of the Issuer for money borrowed, and (y) indebtedness evidenced by securities, debentures, bonds, notes or other similar instruments issued by the Issuer, including any such securities issued under any deed, indenture or other instrument to which the Issuer is a party (including, for the avoidance of doubt, indentures pursuant to which subordinated debentures have been or may be issued), (ii) any capital, operating or other lease obligations of the Issuer, (iii) any obligations of the Issuer issued or assumed as the deferred purchase price of property, any conditional sale obligations of the Issuer, any hedging agreements and agreements of a similar nature thereto and all agreements relating to any such agreements, and all obligations of the Issuer under any title retention agreement (but excluding trade accounts payable arising in the ordinary course of business), (iv) any obligations of the Issuer for reimbursement on any letter of credit, banker's acceptance, security purchase facility or similar credit transaction, (v) all obligations of the type referred to in clauses (i) through (iv) above of other persons for the payment of which the Issuer is responsible or liable as obligor, guarantor, surety or otherwise, and (vi) all obligations of the type referred to in clauses (i) through (v) above of other persons secured by any lien on any property or asset of the Issuer (whether or not such obligation is assumed by the Issuer), in each case whether outstanding at the date of original issue of this Debenture or thereafter incurred.

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ARTICLE 7

GENERAL

7.1 Additional Covenants

The Issuer and the Holder agree, for so long as any event of default under the Bridge Credit Agreement or any renewal, refinancing or extension thereof or replacement therefore, including without limitation any debt securities issued in a public offering or private placement by the Holder, has occurred and is continuing (giving effect to all applicable grace and cure periods), as follows:

> (a) the Issuer and the Holder shall take all actions and do all things necessary within its control to ensure that the Holder remains an unlimited liability company subsisting under the laws of Nova Scotia, and shall not amend the constating documents of the Holder or enter into (or cause the Holder to enter into) any amalgamation, merger, statutory arrangement or other transaction pursuant to which the Holder would cease to be an unlimited liability company subsisting under the laws of Nova Scotia.
>
> (b) the Issuer shall remain the beneficial and record owner of 100% of the issued and outstanding shares and other equity interests in the Holder; and
>
> (c) in connection with any default or event of default that occurs or is declared pursuant to the terms of the Bridge Credit Agreement or any agreement, indenture or instrument relating to indebtedness incurred by the Holder in connection with any renewal, refinancing or extension thereof or replacement therefor (including without limitation any debt securities issued in a public offering or private placement by the Holder), the Holder, failing which, the Issuer, shall promptly take all actions and do all things necessary within their respective control to effect or cooperate with the filing of a petition for the winding-up or liquidation of the Holder under applicable law.

. . . . .

7.6 Governing Law

This Debenture shall be governed by, and interpreted and enforced in accordance with, the laws in force in the Province of Alberta (excluding any conflict of laws rule or principle which might refer such construction to the laws of another jurisdiction). Each party hereto irrevocably submits to the non-exclusive jurisdiction of the courts of Alberta with respect to any matter arising hereunder or related hereto.

7.7 Entire Agreement

There are no representations, warranties, conditions, other agreements or acknowledgments, whether direct or collateral, express or implied, (including any representation, warranty, condition, agreement or acknowledgment in any other agreement or document delivered in connection with or in any manner related to this Debenture, unless expressly otherwise provided herein), that form part of or affect this Debenture or the Obligations, other than as set forth herein.

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SCHEDULE "B"

Interest Rate Determinations

"Bridge Credit Agreement" means the Bridge Credit Agreement, dated as of August 22, 2001, among Calpine Canada Energy Finance II ULC, as Borrower, the commercial lending institutions party thereto, as Lenders, Credit Suisse First Boston, as Co-Arranger and Documentation Agent, Bayerische Landesbank Girozentrale, as Lead Arranger and Syndication Agent, and the Bank of Nova Scotia, as Lead Arranger and Administrative Agent, as amended from time to time.

"Bridge Refinancing Date" means the date on which the indebtedness outstanding under the Bridge Credit Agreement is repaid in full using the proceeds of a public offering or private placement of debt securities of Calpine Canada Energy Finance II ULC (the **"Refinancing Securities"**).

. . . . .

"Reference Rate" means (i) in respect of all Interest Periods through and including the Interest Period ending on the Bridge Refinancing Date, the rate of interest borne by loans outstanding under the Bridge Credit Agreement during each such Interest Period, which rate shall be communicated to the Issuer by the Holder promptly after each determination thereof, (ii) in respect of the Interest Period commencing on the Bridge Refinancing Date and all Interest Periods thereafter through and including the Interest Period ending on the Initial Reset Date, the rate per annum borne by the debt securities issued by Calpine Canada Energy Finance II ULC in the issuance which results in the occurrence of the Bridge Refinancing Date, which rate shall be communicated by the Holder to the Issuer promptly after the determination thereof, and (iii) in respect of the Interest Period commencing on the Initial Reset Date and all Interest Periods thereafter, until altered by an Interest Reset, the per annum interest rate established from time to time by the Holder from time to time pursuant to an Interest Reset Notice.

PROSPECTUS

Calpine Corporation

Common Stock

Preferred Stock

Debt Securities

Calpine Canada Energy Finance ULC

Debt Securities Fully and Unconditionally

Guaranteed by Calpine Corporation

Calpine Canada Energy Finance II ULC

Debt Securities Fully and Unconditionally

Guaranteed by Calpine Corporation

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ABOUT THIS PROSPECTUS

This document is called a prospectus and is part of a joint registration statement that Calpine Corporation, Calpine Canda Energy Finance ULC and Calpine Canada Energy Finance II ULC, which we refer to as "Energy Finance" and "Energy Finance II," respectively, filed with the Securities and Exchange Commission (the "SEC") using a "shelf" registration or continuous offering process. Under this shelf process, Calpine may from time to time sell any combination of its common stock, preferred stock and debt securities described in this prospectus, and Energy Finance and Energy Finance II may from time to time sell their respective debt securities fully and unconditionally guaranteed by Calpine described in this prospectus, in one or more offerings which will aggregate up to a total dollar amount of $2,775,000,000, which amount includes over-allotment options with regard to certain securities. Unless otherwise indicated, references in this prospectus to "$" are to the lawful currency of the United States.

Pursuant to Rule 3-10 of Regulation S-X promulgated by the SEC, we are not required to include separate financial statements of Energy Finance or Energy Finance II in this prospectus because:

• all of the voting rights of each of Energy Finance and Energy Finance II are owned by Calpine, either directly or through wholly-owned subsidiaries of Calpine, which files periodic and other reports with the SEC pursuant to the Securities Exchange Act of 1934, as amended;

• neither Energy Finance nor Energy Finance II has operations other than the investment of funds in Calpine or its subsidiaries; and

• Calpine will fully and unconditionally guarantee the obligations of Energy Finance and Energy Finance II, and the rights of holders of their debt securities, and no subsidiary of Calpine will guarantee the obligations of Energy Finance or Energy Finance II.

. . . . .

Unless we have indicated otherwise, in this prospectus references to 'Calpine' are to Calpine Corporation, references to 'Energy Finance' are to Calpine Canada Energy Finance ULC, references to 'Energy Finance II' are to Calpine Canada Energy Finance II ULC and references to 'we', 'us' and 'our' or similar terms are, collectively, to Calpine Corporation and its consolidated subsidiaries excluding Calpine Capital Trust III, Calpine Capital Trust II and Calpine Capital Trust

. . . . .

Recent developments

. . . . .

On July 5, 2001, we announced an agreement to acquire a 1,200-megawatt natural gas-fired power plant at Saltend near Hull, Yorkshire, England from Entergy Wholesale Operations for up to approximately £562.5 million (approximately U.S. $800 million at current exchange rates). The Saltend facility, a cogeneration facility, provides electricity and steam for BP Chemical's Hull Works plant under a 15-year agreement. The balance of the Saltend facility's electricity output is sold into the deregulated UK power market. The Saltend transaction is our first acquisition of a power facility in Europe. The acquisition closed on August 24, 2001.

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CALPINE CANADA ENERGY FINANCE II ULC

Energy Finance II is an unlimited liability company organized in July 2001 under the laws of Nova Scotia, Canada. It is an indirect wholly-owned special purpose finance subsidiary of Calpine that engages in financing activities to raise funds for the business operations of Calpine and its subsidiaries. Its direct parent company is Calpine Canada Resources Ltd., an Alberta, Canada corporation. Energy Finance II will issue debt securities, which will be fully and unconditionally guaranteed by Calpine.

Pursuant to Rule 3-10 of Regulation S-X promulgated by the SEC, Energy Finance II is not required to file separate reports with the SEC under the Securities Exchange Act and we are not required to include separate financial statements for Energy Finance II in this prospectus because:

- all of the voting rights of Energy Finance II are owned by Calpine, either directly or through its wholly-owned subsidiaries, and Calpine files periodic and other reports with the SEC pursuant to the Securities Exchange Act;

- its sole operations are the investment of funds in Calpine and its subsidiaries; and

- Calpine will fully and unconditionally guarantee its obligations and the rights of holders under its debt securities and no subsidiary of Calpine will guarantee its obligations.

The registered office of Energy Finance II is Suite 800, Purdy's Wharf, Tower 1, 1959 Upper Water Street, P.O. Box 997, Halifax, Nova Scotia B3J 3N2, telephone: (902) 420-3335.

RISK FACTORS

Investing in our securities involves risk. Please see the risk factors described in Calpine's Annual Report on Form 10-K for the year ended December 31, 2000, Calpine's Quarterly Reports on Form 10-Q for the Quarters ended March 31, 2001 and June 30, 2001 and Calpine's Current Report on Form 8-K, filed on September 10, 2001, each of which is incorporated by reference in this prospectus. Before making an investment decision, you should carefully consider these risks as well as other information contained or incorporated by reference in this prospectus. The risks and uncertainties described are not the only ones facing us. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

. . . . .

USE OF PROCEEDS

Unless otherwise specified in a prospectus supplement accompanying this prospectus, we will add the net proceeds from the sale of the securities to which this prospectus and the prospectus supplement relate to our general funds, which we will use, directly or indirectly, for financing power projects under development or construction, working capital, general corporate purposes and any other purpose specified in a prospectus supplement. We may conduct concurrent or additional financings at any time. The net proceeds from the sale of debt securities by Energy Finance or Energy Finance II to which this prospectus relates will be lent to Calpine or its affiliates by Energy Finance or Energy Finance II, as applicable, pursuant to one or more intercompany loans.

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DESCRIPTION OF THE DEBT SECURITIES

The following is a general description of the debt securities to which this prospectus and any prospectus supplement may relate. The particular terms relating to each debt security will be set forth in a prospectus supplement. Unless otherwise stated, the senior debt securities and the subordinated debt securities are together referred to as the "debt securities."

General

Calpine may issue from time to time one or more series of debt securities under one or more separate indentures between Calpine and Wilmington Trust Company, as trustee; .... and Energy Finance II may issue from time to time one or more series of debt securities under one or more indentures between Energy Finance II and Wilmington Trust Company, as trustee.

. . . . .

The debt securities will be direct, unsecured obligations of the issuer. The senior debt securities will rank equally with all other senior debt of the issuer. The indentures will not limit the amount of debt securities which the issuer may issue. The subordination provisions of any subordinated debt securities will be described in an applicable prospectus supplement.

Almost all of Calpine's operations are conducted through Calpine's subsidiaries and other affiliates. As a result, Calpine depends almost entirely upon their earnings and cash flow to service Calpine's indebtedness, including Calpine's ability to pay the interest on and principal of Calpine's debt securities, and on the debt securities of Energy Finance and Energy Finance II under the guarantees, if the guarantees are enforced. The non-recourse project financing agreements of certain of Calpine's subsidiaries and other affiliates generally restrict their ability to pay dividends, make distributions or otherwise transfer funds to Calpine prior to the payment of other obligations, including operating expenses, debt service and reserves. Each of Energy Finance and Energy Finance II is a special purpose financing subsidiary formed solely as a financing vehicle for Calpine and its subsidiaries. Therefore, the ability of Energy Finance and Energy Finance II to pay their obligations under the debt securities is dependent upon the receipt by them of payments from Calpine and its subsidiaries to which they have made loans or otherwise under agreements with them in connection with their respective financing activities. In addition, under Canadian law, the respective direct parent companies of Energy Finance and Energy Finance II will be liable for their subsidiary's indebtedness, including any debt securities issued by such subsidiary, upon a winding-up of that subsidiary. While each of Energy Finance and Energy Finance II believes that payments made to it in connection with its financing activities will be sufficient to pay the principal of, and interest on, any debt securities it issues, if the responsible parties were not able to make such payments for any reason, the holders of such debt securities would have to rely on the enforcement of Calpine's guarantee described below.

Calpine's subsidiaries and other affiliates are separate and distinct legal entities and will have no obligation to pay any amounts due on the debt securities issued by Calpine hereunder, and will not guarantee the payment of interest on or principal of the debt securities issued by Calpine hereunder. Calpine's subsidiaries and other affiliates (other than Energy Finance (in the case of debt securities issued by Energy Finance) and Energy Finance II (in the case of debt securities issued by Energy Finance II) and their direct parent companies, respectively, in the case of the winding-up of its subsidiary) will not have any obligation to pay any amounts due on the debt securities issued by Energy Finance or Energy Finance II hereunder and none of Calpine's subsidiaries or other affiliates will guarantee the payment of interest on or principal of the debt securities issued by Energy Finance or Energy Finance II hereunder. The

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right of Calpine's debt security holders to receive any assets of any of Calpine's subsidiaries or other affiliates upon Calpine's liquidation or reorganization will be subordinated to the claims of any subsidiaries' or other affiliates' creditors (including trade creditors and holders of debt issued by Calpine's subsidiaries or affiliates, including Energy Finance and Energy Finance II). Similarly, the right of holders of Energy Finance's or Energy Finance II's debt securities to receive any assets of any of Calpine's subsidiaries or other affiliates upon Calpine's liquidation or reorganization will be subordinated to the claims of any subsidiaries' or other affiliates' creditors (including trade creditors and holders of debt issued by Calpine's subsidiaries or affiliates). As of June 30, 2001, Calpine's subsidiaries had approximately $1.8 billion of project financing. Calpine intends to utilize project financing when appropriate in the future, and this financing will be effectively senior to the debt securities and the guarantees.

The following description of the debt securities is subject to the detailed provisions of each indenture, a copy of each of which is filed as an exhibit to the Registration Statement of which this prospectus is a part and is available upon request made to us. Whenever particular provisions of any indenture or terms defined therein are referred to, those provisions or definitions are incorporated by reference herein and such descriptions are qualified in their entirety by such reference. We urge you to read the forms of indentures because they, and not this description, describe every detail of the terms of the debt securities. The summary below of the general terms of the debt securities will be supplemented by the more specific terms in a prospectus supplement. Unless otherwise stated herein or in an applicable prospectus supplement, the following indenture description will apply to both senior and subordinated debt securities.

. . . . .

Ranking

. . . . .

Unless otherwise provided in the prospectus supplement relating to such securities, debt securities issued by Energy Finance or Energy Finance II will be:

- senior unsecured obligations of Energy Finance or Energy Finance II, as applicable, and will rank equally and ratably with all of its other unsecured and unsubordinated indebtedness, and

- guaranteed on a senior unsecured basis by Calpine, which guarantee will rank equally and ratably with all other unsecured and unsubordinated indebtedness of Calpine, including Calpine's indebtedness described above including the other indebtedness of its subsidiaries guaranteed by Calpine.

The subordinated debt securities issued by Calpine will be subordinate and junior in right of payment to all of Calpine's senior indebtedness, including any guarantee by Calpine of senior debt securities of Energy Finance and Energy Finance II. The subordinated debt securities of Energy Finance and Energy Finance II will be subordinate and junior in right of payment to all of their respective senior indebtedness.

Guarantees

Calpine will fully and unconditionally guarantee to each holder of a debt security issued by Energy Finance or Energy Finance II and authenticated and delivered by the trustee the due and punctual payment of the principal of, and any premium and interest on, the debt security, when and as it becomes due and payable, whether at maturity, upon acceleration, by call for redemption, repayment or otherwise in accordance with the terms of the debt securities and

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of the related indenture. The claims of holders under the guarantee by Calpine will be effectively subordinated to the claims of creditors of Calpine's subsidiaries other than Energy Finance or Energy Finance II, as applicable.

Under its guarantee agreement, Calpine will:

• agree that, if an event of default occurs under the debt securities, its obligations under the guarantees will be absolute and unconditional and will be enforceable irrespective of any invalidity, irregularity or unenforceability of any series of the debt securities or the related indenture or any supplement thereto, and

• waive its right to require the trustee or the holders to pursue or exhaust their legal or equitable remedies against Energy Finance or Energy Finance II before exercising their rights under the guarantees.

. . . . .

Actions by Holders

A holder of any series of debt securities may not pursue any remedy with respect to the indentures or the debt securities of such series (except a registered holder of a series of debt securities may bring an action for payment of overdue principal, premium, if any, or interest on that series), unless:

• the registered holder has given notice to the trustee of such series of a continuing Event of Default,

• registered holders of at least 25% in principal amount of that series of debt securities have made a written request to the trustee of such series to pursue such remedy.

• such registered holder or holders have offered the trustee of such series security or indemnity reasonably satisfactory to the trustee against any loss, liability or expense,

• the trustee of such series has not complied with such request within 60 days of such request and offer, and

• the registered holders of a majority in principal amount of that series of debt securities have not given the trustee of such series an inconsistent direction during that 60-day period.

. . . . .

Governing Law

The laws of the State of New York will govern the indentures and each series of debt securities.

Application dismissed; cross-application dismissed.

Appendix "B"

. . . . .

Appendix "C"

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Appendix "D"

Appendix "E"

Appendix "F"

[Prospectus Supplement]

. . . . .

CALPINE CORPORATION

We are a leading independent power company engaged in the development, acquisition, ownership and operation of power generation facilities and the sale of electricity and steam in the United States, Canada and the United Kingdom. We have experienced significant growth in all aspects of our business over the last five years. Currently, we own interests in 61 power plants having a net capacity of 11,085 megawatts. We also have 30 gas-fired projects under construction having a net capacity of 16,673 megawatts and have announced plans to develop 26 gas-fired projects (power plants and expansions of current facilities) with a net capacity of 14,915 megawatts. Upon completion of the projects under construction, we will have interests in 87 power plants located in 22 U.S. states, three Canadian provinces and the United Kingdom, having a net capacity of 27,758 megawatts. Of this total generating capacity, 97% will be attributable to gas-fired facilities and 3% will be attributable to geothermal facilities. As a result of our expansion program, our revenues, EBITDA, earnings and assets have grown significantly over the last five years, as shown in the table below.

. . . . .

We are a corporation organized and existing under the laws of the State of Delaware. Our principal executive office is located at 50 West San Fernando Street, San Jose, California 95113. Our registered office is located at 9 East Loockerman Street, Dover, Delaware 19901, c/o National Registered Agents, Inc.

CALPINE CANADA ENERGY FINANCE II ULC

Calpine Canada Energy Finance II is an unlimited liability company organized in July 2001 under the laws of Nova Scotia, Canada. It is an indirect wholly-owned special purpose finance subsidiary of Calpine that engages in financing activities to raise funds for the business operations of Calpine and its subsidiaries. Its direct parent company is Calpine Canada Resources Ltd., an Alberta, Canada corporation. Calpine Canada Energy Finance II will issue the senior notes, which will be fully and unconditionally guaranteed by Calpine.

The registered office of Calpine Canada Energy Finance II is Suite 800, Purdy's Wharf, Tower 1, 1959 Upper Water Street, P.O. Box 997, Halifax, Nova Scotia B3J 3N2, telephone: (902) 420-3335.

. . . . .

The net proceeds from the sale of the senior notes by Calpine Canada Energy Finance II to which this prospectus

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supplement relates will be lent to Calpine and its affiliates by Calpine Canada Energy Finance II pursuant to one or more intercompany loans. The net proceeds from the sale of the senior notes by Calpine Canada Energy Finance ULC described above will be lent to Calpine and its affiliates by Calpine Canada Energy Finance ULC pursuant to one or more intercompany loans. Calpine expects to use the net proceeds from the Concurrent Offerings as follows: (i) to refinance the $275,000,000 Bridge Credit Agreement, dated as of August 15, 2001, among Calpine, as borrower, certain commercial lending institutions parties thereto as lenders, Credit Suisse First Boston, as co-arranger and documentation agent, Bayerische Landesbank Girozentrale, as lead arranger and syndication agent, and The Bank of Nova Scotia, as lead arranger and administrative agent; (ii) to refinance the $525,000,000 Bridge Credit Agreement, dated as of August 20, 2001, among Calpine Canada Energy Finance ULC, as borrower, certain commercial lending institutions parties thereto as lenders, Credit Suisse First Boston, as co-arranger and documentation agent, Bayerische Landesbank Girozentrale, as lead arranger and syndication agent, and The Bank of Nova Scotia, as lead arranger and administrative agent; (iii) to refinance the $400,000,000 Bridge Credit Agreement, dated as of August 22, 2001, among Calpine Canada Energy Finance II, as borrower, certain commercial lending institutions parties thereto as lenders, Credit Suisse First Boston, as co-arranger and documentation agent, Bayerische Landesbank Girozentrale, as lead arranger and syndication agent, and The Bank of Nova Scotia, as lead arranger and administrative agent (the Bridge Credit Agreements referred to in clauses (i), (ii) and (iii) above are collectively referred to in this prospectus supplement as the "Bridge Credit Facilities"); and (iv) the balance for working capital and general corporate purposes, including repayment of outstanding borrowings under Calpine's construction loan credit facilities. The weighted average interest rate of outstanding advances under the Bridge Credit Facilities at October 10, 2001 was 4.89% per annum and such advances had various scheduled maturity dates. The indebtedness under the Bridge Credit Facilities was incurred to finance acquisitions recently consummated by Calpine. Each of the Bridge Credit Facilities shall terminate upon the consummation of the respective refinancings described above.

. . . . .

Pursuant to Rule 3-10 of Regulation S-X promulgated by the SEC, Calpine Canada Energy Finance II is not required to file separate reports with the SEC under the Securities Exchange Act of 1934 and we are not required to include separate financial statements for Calpine Canada Energy Finance II in this prospectus supplement because:

• all of the voting rights of Calpine Canada Energy Finance II are owned by Calpine, either directly or through its wholly-owned subsidiaries, and Calpine files periodic and other reports with the SEC pursuant to the Securities Exchange Act;

• Calpine Canada Energy Finance II's sole operations are the investment of funds in Calpine and its subsidiaries; and

• Calpine will fully and unconditionally guarantee Calpine Canada Energy Finance II's obligations and the rights of holders under the senior notes and no subsidiary of Calpine will guarantee the obligations of Calpine Canada Energy Finance II.

. . . . .

Calpine Canada Energy Finance II

As of the date of this prospectus supplement: (i) Calpine Canada Energy Finance II has 500,000,000 shares of common stock of no par value authorized and 1,000 shares of common stock outstanding; (ii) Calpine Canada Energy

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Finance II's paid-in capital is $1,000; (iii) no shares of preferred stock are authorized or outstanding; (iv) Calpine Canada Energy Finance II has incurred no short-term debt or medium-term debt; and (v) the only long-term debt of Calpine Canada Energy Finance II that will be outstanding will be the senior notes being issued hereunder, the net proceeds of which will have been used to repay amounts outstanding under the $400,000,000 Bridge Credit Agreement, dated as of August 22, 2001, among Calpine Canada Energy Finance II, as borrower, certain commercial lending institutions parties thereto as lenders, Credit Suisse First Boston, as co-arranger and documentation agent, Bayerische Landesbank Girozentrale, as lead arranger and syndication agent, and The Bank of Nova Scotia, as lead arranger and administrative agent.

DESCRIPTION OF THE SENIOR NOTES AND THE GUARANTEES

Calpine Canada Energy Finance II will issue each of the Sterling senior notes and the Euro senior notes under an indenture dated as of October 18, 2001 between Calpine Canada Energy Finance II and Wilmington Trust Company as trustee, as supplemented by the First Supplemental Indenture, dated as of October 18, 2001. The Sterling senior notes and the Euro senior notes shall each constitute a separate series of securities under the indenture. The related guarantees will be issued by Calpine under a Guarantee Agreement dated as of October 18, 2001, as supplemented by the First Amendment to Guarantee Agreement, dated as of October 18, 2001. Each series of senior notes will be issued in the form of one or more global securities registered in the name of a common depositary acting on behalf of Clearstream Banking, S.A., formerly Cedelbank ("Clearstream") and Euroclear System ("Euroclear") or its nominee.

The following description and the description in the accompanying prospectus is a summary of the material provisions of the senior notes and the guarantees and is subject to the detailed provisions of the indenture and guarantee agreement, copies of which are filed as exhibits to the Registration Statement of which this prospectus supplement is a part and are available upon request made to us. Whenever particular provisions of the indenture or guarantee agreement or terms defined therein are referred to, those provisions or definitions are incorporated by reference herein and such descriptions are qualified in their entirety by such reference. Calpine and Calpine Canada Energy Finance II urge you to read the indenture and the guarantee agreement because they, and not this description, define your rights as holders of the senior notes and the guarantees and describe every detail of the terms of the senior notes and the guarantees.

This description of the senior notes and the guarantees in this prospectus supplement replaces the description of the general provisions of the senior notes, the guarantee, the indenture and the guarantee agreement in the accompanying prospectus to the extent that it is inconsistent with the accompanying prospectus. The senior notes are "debt securities" as that term is used in the accompanying prospectus.

Principal, Maturity and Interest; Listing

The senior notes will be senior unsecured obligations of Calpine Canada Energy Finance II. Calpine will irrevocably and unconditionally guarantee the senior notes as to principal, premium, if any, interest and Additional Amounts (as defined below under "-Additional Amounts"), if any. There is no sinking fund for the senior notes.

. . . . .

Compliance with Term Debenture

Calpine Canada Energy Finance II will comply in all respects with its obligations under Section 7.1 of the term

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debenture between Calpine Canada Energy Finance II and Calpine Canada Resources Ltd. Calpine will cause Calpine Canada Resources Ltd. to comply in all respects with its obligations under Section 7.1 of the same term debenture. If Calpine Canada Energy Finance II or Calpine defaults in the performance of their respective convenant regarding the term debenture and the default continues for 30 days after notice of such default, such default will constitute an Event of Default (as described under the caption "Description of the Debt Securities — Events of Default" in the accompanying prospectus) under the indenture.

. . . . .

CALPINE CANADA ENERGY FINANCE II ULC

and

WILMINGTON TRUST COMPANY, Trustee

Indenture

Dated as of October 18, 2001

Debt Securities

Fully and Unconditionally Guaranteed

by Calpine Corporation

INDENTURE, dated as of October 18, 2001, between Calpine Canada Energy II Finance ULC, an unlimited liability company organized under the laws of Nova Scotia, Canada (the"Company"), and Wilmington Trust Company, a Delaware banking corporation (the "Trustee").

. . . . .

WHEREAS, Calpine Corporation, the parent corporation of the Company, has agreed to fully and unconditionally guarantee the debt securities issued by the Company hereunder; and

WHEREAS, the Trustee desires to act as Trustee with respect to such securities;

. . . . .

ARTICLE I

DEFINITIONS AND INCORPORATION BY REFERENCE

. . . . .

"Guarantee" means, as applied to any obligation, contingent or otherwise, of any Person, (i) a guarantee, direct or indirect, in any manner, of any part or all of such obligation (other than by endorsement of negotiable instruments for collection in the ordinary course of business) and (ii) an agreement, direct or indirect, contingent or otherwise, the practical effect of which is to insure in any way the payment or performance (or payment of damages in the event of nonperformance) of any part or all of such obligation, including the payment of amounts drawn down under letters of

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credit. With respect to the Guarantor, "Guarantee" shall include the guarantee by the Guarantor of the Securities pursuant to the Guarantee Agreement.

"Guarantee Agreement" means the guarantee agreement made by the Guarantor and accepted and agreed to by the Trustee, in substantially the form annexed hereto as Exhibit D, as the same may be amended or supplemented from time to time in accordance with the applicable provisions thereof.

"Guarantor" means Calpine Corporation, a Delaware corporation until a successor replaces it pursuant to the terms and conditions of the Guarantee Agreement and thereafter means the successor.

"Holder" or "Securityholder" means the Person in whose name a Security is registered on the Registrar's books.

. . . . .

ARTICLE II

THE SECURITIES

SECTION 2.1 Securities Issuable in Series.

Securities may be issued hereunder in one or more series, the Securities of each series (a "Series") having identical terms but for authentication date and public offering price. Securities of any one Series need not be issued at the same time and, unless specifically provided otherwise, a Series may be reopened, without the consent of the Holders, for issuances of additional Securities of such Series. All Securities shall be fully and unconditionally guaranteed by the Guarantor pursuant to the Guarantee Agreement. Initial Securities of a Series shall be treated as a single class and series with Exchange Securities issued in exchange for such Initial Securities.

. . . . .

ARTICLE III

COVENANTS

SECTION 3.1 Payment of Securities.

The Company shall pay the principal of, and interest on the Securities of each Series on the dates and in the manner provided in such Securities. The Company shall pay interest on overdue principal at the rate borne by or provided for in such Securities; it shall pay interest on overdue installments of interest at the rate borne by or provided for in such Securities to the extent lawful. Principal and interest shall be considered paid on the date due if the Trustee or the Paying Agent (other than the Company or a Subsidiary or an Affiliate of the Company) has received from or on behalf of the Company money sufficient to pay all principal and interest then due in accordance with Section 2.5.

. . . . .

ARTICLE IV

CONSOLIDATION, MERGER, SALE AND LEASE

. . . . .

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SECTION 4.3 Assignment by the Company to the Guarantor or Its Significant Subsidiaries.

(a) The Company may assign its obligations under any series of Securities to the Guarantor or any Significant Subsidiary of the Guarantor (the "Affiliate Assignee") and such Affiliate Assignee shall be treated as the successor to the Company with respect to such series of Securities; provided that: (i) the Affiliate Assignee expressly assumes in an assumption agreement or supplemental indenture hereto, executed and delivered to the Trustee, the due and punctual payment of the principal of and any premium and interest on such Securities and the performance or observance of every convenant of this Indenture on the part of the Company to be performed or observed with respect to such Series; (ii) immediately after giving effect to such assignment and assumption, no Event of Default with respect to such Series and no event which, after notice or lapse of time or both, would become an Event of Default with respect to such Series, shall have occurred and be continuing; (iii) the Affiliate Assignee shall deliver to the Trustee an opinion of an independent counsel or a tax consultant of recognized standing that the Holders will not recognize income, gain or loss for United States federal income tax purposes as a result of such assignment and assumption; and (iv) the Affiliate Assignee shall have delivered to the Trustee an Officers' Certificate and an Opinion of Counsel stating that such assignment and assumption and such assumption agreement comply with this Article and that all conditions precedent herein provided for relating to such assignment and assumption have been complied with.

(b) Upon any assignment and assumption of Securities pursuant to Section 4.3(a) above, the Affiliate Assignee shall succeed to, and be substituted for, and may exercise every right and power of, the Company under such Securities and this Indenture with respect to such Series with the same effect as if the Affiliate Assignee has been named as the Company herein, and the Company shall be released from its liability as obligor upon such Securities and under this Indenture with respect to such Securities and, if the Affiliate Assignee is the Guarantor and the Guarantor has assumed the obligations of the Company under an outstanding series of Securities and the Indenture with respect to such Securities in accordance with (a) above, all outstanding Guarantees of such series of Securities shall automatically terminate and be discharged.

ARTICLE V

DEFAULTS AND REMEDIES

. . . . .

SECTION 5.6 Limitation on Suits.

A Securityholder of a Series may pursue a remedy with respect to this Indenture, the Guarantee Agreement or the Securities of such Series only if:

(a) the Holder gives to the Trustee written notice of a continuing Event of Default with respect to that Series;

(b) the Holders of at least 25% in principal amount of the Securities of such Series make a written request to the Trustee to pursue the remedy;

(c) such Holder or Holders offer to the Trustee security or indemnity reasonably satisfactory to it against any loss, liability or expense;

(d) the Trustee does not comply with the request within 60 days after receipt of the notice, request and the offer of security or indemnity; and

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(e) the Holders of a majority in principal amount of the Securities of such Series do not give the Trustee a direction inconsistent with the request during such 60-day period.

A Securityholder may not use this Indenture or the Guarantee Agreement to prejudice the rights of another Securityholder or to obtain a preference or priority over another Securityholder.

SECTION 5.7 Rights of Holders to Receive Payment.

Notwithstanding any other provision of this Indenture or the Guarantee Agreement, the right of any Holder of a Security to receive payment of principal and interest on the Security, on or after the respective due dates expressed or provided for in the Security, or to bring suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of the Holder.

. . . . .

ARTICLE X

MISCELLANEOUS

. . . . .

SECTION 10.11 Governing Law.

The laws of the State of New York govern this Indenture and the Securities, without regard to the conflicts of laws rules thereof.

. . . . .

FIRST SUPPLEMENTAL INDENTURE

Dated as of October 18, 2001

Between

CALPINE CANADA ENERGY FINANCE II ULC,

AS ISSUER

and

WILMINGTON TRUST COMPANY,

AS TRUSTEE

Supplementing the Indenture

Dated as of October 18, 2001

. . . . .

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ARTICLE II

AMENDMENTS TO THE INDENTURE

Section 2.1 Amendments.

. . . . .

(d) Article III of the Indenture is amended to insert the following as new Section 3.9:

SECTION 3.9 Performance by the Company of Certain Convenants under Term Debenture.

Solely for the benefit of the Holders of Sterling 8-7/8% Notes and the Holders of Euro 8-3/8% Notes, the Company shall comply in all respects with its obligations under Section 7.1 of the Term Debenture, dated August 23, 2001, between the Company and Calpine Canada Resources Ltd.

GUARANTEE AGREEMENT

made by

CALPINE CORPORATION

as Guarantor of Debt Securities Issued by

CALPINE CANADA ENERGY FINANCE II ULC

dated as of

October 18, 2001

. . . . .

ARTICLE TWO

GUARANTEE

SECTION 2.01 Unconditional Guarantee.

The Guarantor hereby unconditionally guarantees to each Holder of a Security authenticated by the Trustee and to the Trustee and its successors and assigns that: the principal of, premium thereon (if any) and interest on the Securities of each Series will be promptly paid in full when due, subject to any applicable grace period, whether at maturity, by acceleration or otherwise, and interest on the overdue principal and interest on any overdue interest on the Securities of each Series and all other obligations of the Company to the Holders or the Trustee hereunder or under the Indenture or the Securities of such Series will be promptly paid in full or performed, all in accordance with the terms hereof and thereof. The Guarantor hereby agrees that its obligations hereunder shall be unconditional, irrespective of the validity, regularity or enforceability of the Securities of each Series or of the Indenture, the absence of any action to enforce the same, any waiver or consent by any Holder of the Securities of any Series or the Trustee with respect to any provisions hereof, of the Indenture or of the Securities, the recovery of any judgment against the Company, any action to enforce the same or any other circumstance which might otherwise constitute a legal or equitable dis-

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charge or defense of the Guarantor. The Guarantor hereby waives diligence, presentment, demand of payment, filing of claims with a court in the event of insolvency or bankruptcy of the Company, any right to require proceeding first against the Company, protest, notice and all demands whatsoever and covenants that the Guarantee will not be discharged except by complete performance of the obligations contained in the Indenture and the Securities of each Series. If any Holder or the Trustee is required by any court or otherwise to return to the Company or the Guarantor, or any custodian, trustee, liquidator or other similar official acting in relation to the Company or the Guarantor, any amount paid by the Company or the Guarantor to the Trustee or such Holder, the Guarantee, to the extent theretofore discharged, shall be reinstated in full force and effect. The Guarantee constitutes a guarantee of payment and not of collection.

. . . . .

ARTICLE THREE

CONSOLIDATION, MERGER, CONVEYANCE, TRANSFER OR LEASE

. . . . .

SECTION 3.03. Assignment to the Guarantor of the Company's Obligations.

It is acknowledged that, pursuant to Section 4.3 of the Indenture, the Company may assign is obligations under any Series of Securities and the Indenture to the Guarantor or any Subsidiary of the Guarantor in accordance with such Section 4.3 and, if the Company assigns its obligations to the Guarantor in accordance with such Section 4.3 with respect to any Series of Securities, all Guarantees of outstanding Securities of such Series shall automatically terminate and be discharged.

. . . . .

ARTICLE SIX

MISCELLANEOUS

. . . . .

SECTION 6.06. Governing Law.

This Agreement and the Guarantee shall be governed by and construed in accordance with the laws of the State of New York, without regard to the conflicts of laws rules thereof.

. . . . .

FN1 According to the evidence of Mr. Kagan another company in the Harbert group of companies was also purchasing Finance II bonds each time that Harbert made a purchase. Mr. Kagan testified that that company is a different entity than the Applicant in this proceeding and accordingly, I have not referred to that company's purchases.

END OF DOCUMENT

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Index No. 2

1989 CarswellNS 29, 71 C.B.R. (N.S.) 277, 90 N.S.R. (2d) 67, 230 A.P.R. 67

Bank of Nova Scotia v. Janzen (Trustee of)

Re JANZEN and JANZEN; BANK OF NOVA SCOTIA v. COLLINS BARROW MAHEU NOISEUX INC. (Trustee)

Nova Scotia Supreme Court, In Bankruptcy

Hallett J.

Heard: December 19, 1988
Judgment: January 12, 1989
Docket: Halifax Nos. B-11100, B-11101

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Counsel: *P.D. Darling* and *S.D. Piggott*, for appellant.

W.A. Harvey, for respondent.

M.S. Rosen, for trustee.

Subject: Corporate and Commercial; Insolvency

Bankruptcy --- Proving claim — Practice and procedure — Filing proof of claim.

Dividends and distributions — Creditor not filing proper proof of claim, but making trustee aware of claim by correspondence — Proof of claim filed late but prior to distribution of dividends — Creditor entitled to participate in dividend, but penalized in amount of extra costs incurred by trustee — Court discussing relevant principles.

Immediately upon being appointed as trustee in a proposal, the trustee sent out the notices under s. 120(1) of the Bankruptcy Act. The creditor inadvertently failed to return a properly completed proof of claim, and the trustee went ahead and prepared his dividend sheet. The creditor only became aware that a dividend was to be distributed because it had another claim, and it therefore discovered that it was not included for its substantial additional claim. The creditor then filed a properly completed proof of claim prior to the actual distribution of the dividend.

The registrar ruled that as the creditor had been inadvertent and careless with respect to filing its proof of claim, it should not be allowed to participate in the distribution of the dividend. The creditor appealed.

Held:

Appeal allowed.

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An overriding principle in bankruptcy law is that creditors are to be accorded equal and fair treatment and allowed to share pro rata in the assets of the estate. That is why the policy of the courts has been to allow creditors in prior to a distribution. To disallow a creditor's proof of claim filed before the distribution of a dividend is too harsh a penalty, even if the creditor was negligent in filing its proof in the first instance. The creditor should be allowed to participate pursuant to the power given to the court in s. 121 of the Act, but the creditor should bear the additional expenses of the trustee respecting preparation of a new dividend sheet and the trustee's legal costs on a solicitor-and-client basis.

Annotation

In this case the proper proof of claim was filed with the trustee about one week before the date the final dividends were to be issued to creditors. By taking the position that the creditor was now barred from participating in the dividends, the trustee acted not only in disregard of the provisions of s. 150 (formerly s. 121) of the Bankruptcy Act, R.S.C. 1985, c. B-3, but also in complete disregard of his duty as a trustee under the well-known rule in *Re Condon; Ex parte James* (1874), 9 Ch. App. 609 (C.A.). This rule demands that a trustee, as an officer of the court, should do the fullest equity, and even if the trustee has a legal right to assert, the bankruptcy court will not permit the trustee to exercise that right if it would be inconsistent with natural justice to do so. It is a prerogative of mercy reposed in the bankruptcy court to alleviate cases of unusual hardship in which a regard to strict legal or equitable rights would work a manifest injustice.

The better practice for the trustee in this case would have been to apply to the Registrar in Bankruptcy (with notice to the creditor), requesting an order that the creditor be permitted to share in the dividends but pay the trustee's additional expenses and costs. Undoubtedly the registrar would have made such an order.

C.H. Morawetz, Q.C.

Cases considered:

Boddam, Ex parte; Re Taylor (1860), 2 De G. F. & J. 625, 45 E.R. 763 (L.JJ.) — *applied*

McMurdo, Re; Penfield v. McMurdo, [1902] 2 Ch. 684 (C.A.) — *applied*

Pilot Butte Sand & Gravel Co., Re; Glen Wright Trucking Ltd. v. Guar. Trust Co. of Can. (1968), 11 C.B.R. (N.S.) 254 (Sask. Q.B.) — *distinguished*

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3 [now R.S.C. 1985, c. B-3]

s. 106 [now s. 135]

s. 121 [now s. 150]

Forms considered:

Bankruptcy Rules, C.R.C. 1978, c. 388, Sched. III

Form 64

Appeal from disallowance of creditor's claim by registrar.

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***Hallett J.*:**

1 This is an appeal from the decision of the Registrar in Bankruptcy refusing to extend the time for the Bank of Nova Scotia to file a proof of claim to enable the bank to participate in the distribution of a dividend. The decision appealed from conveniently sets out the facts that were before the registrar as follows:

> The Janzens filed proposals with the Official Receiver and Collins Barrow on 30th November 1987. On the same date, Collins Barrow sent notices by registered mail to the creditors, including the proposals, proof of claim forms, and voting letter statement of affairs of the Janzens, for the creditors' consideration. Included therein was a notice pursuant to s. 120(1) of the Bankruptcy Act, indicating that any claims should be filed *within 30 days*, or Collins Barrow could pay dividends, without further notice to creditors. The meeting of creditors was held on 11th December 1987, at which time the proposals were accepted. The trustee's report to the court was filed on 18th December 1987, and on 8th January 1988 an order approving the proposals was granted by Sally Champion, the Deputy Registrar in Bankruptcy. The terms of the proposals were satisfied by the Janzens in the spring of 1988. The funds were paid to Collins Barrow, and Collins Barrow's final statement of receipts and disbursements was approved by the inspector on 17th May 1988. The Official Receiver's office commented on the statement on 3rd June 1988, and it was taxed by the court on 14th June 1988. Notice to the creditors was sent by registered mail to all proven creditors on 21st June 1988, indicating that dividends would be directed to the creditors on 5th July 1988.
>
> Prior to sending the dividends, Collins Barrow was contacted by James E. White ("Mr. White"), Assistant Manager, Consumer Credit, at the Bank of Nova Scotia in Bridgewater, questioning why the Janzens' Scotialine account in the amount of $19,723.12 as of 30th November 1987, with interest at 12.25 per cent per annum from that date, had not been included in the proposed distribution. Collins Barrow advised Mr. White that no proof of claim had been received by them.
>
> At the time of the hearing of the application, a statement of facts, and detailed sequence of events, agreed upon by the parties was submitted to the court. These facts and events are enumerated as follows:
>
> 1. Date of filing of Proposals — November 30, 1987.
>
> 2. Date of appointment of Collins Barrow Maheu Noiseux Inc., Trustee — November 30, 1987.
>
> 3. Documentation sent by registered mail to creditors, inclusive of notice of creditors and Section 120 notice re filing proof of claim — November 30, 1987.
>
> 4. Meeting of creditors — December 11, 1987.
>
> 5. Trustee's Report to Court re approval of Proposal — December 18, 1987.
>
> 6. Ratification of Proposal by Court — January 8, 1988.
>
> 7. Trustee's final statement of receipts and disbursements — approved by Inspector — May 17, 1988, Official Receiver comments — June 3, 1988, taxed by Court — June 14, 1988.
>
> 8. Notice of final dividend to proven creditors by registered mail — June 21, 1988.
>
> 9. Date final dividends to be directed to creditors — July 5, 1988.

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In addition there was an exchange of correspondence between Collins Barrow and the bank, which is reproduced in this decision, inasmuch as the timing and sequence of events is crucial to a determination of the issue at hand:

Scotiabank

Bridgewater Shopping Plaza,

P.O. Box 130, Bridgewater, N.S.

B4V 2W8

December 15, 1987

Collins Barrow

P.O. Box 250

Halifax, Nova Scotia

B3J 2W7.

```
Re: John R. Janzen and Lea Janzen
    Bankruptcy Proposal
---------------------------------
```

Att. Mark Rosen

Dear Sir:

We enclose copies of the last 3 monthly statements to support our Scotialine Claim in regard to the above customers settlement proposal.

Yours very truly,

J.E. White,

Assistant Manager,

Consumer Credit.

.....

December 21, 1987

Scotiabank

Bridgewater Shopping Plaza

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P.O. Box 130

Bridgewater, Nova Scotia

B4V 2W8

Attention: J.E. White — Asst. Manager

Dear Sirs:

Re: John R. Janzen and Lea M. Janzen — Proposals

Receipt is acknowledged of your letter dated December 15, 1987.

We are still awaiting receipt of your Proof of Claims in the above noted matters. We would also like to advise that there were no enclosures with your letter of December 15, 1987 as stated.

Yours very truly,

Mark S. Rosen

Administrator

MSR/bl.

. . . . .

Scotiabank

Bridgewater Shopping Plaza,

P.O. Box 130, Bridgewater, N.S.

B4V 2W8

December 30, 1987

Collins Barrow

P.O. Box 250

Halifax, Nova Scotia

B3J 2W7

Re: John R. Janzen and Lea Janzen

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Bankruptcy Proposal

Dear Sir:

We are enclosing the last 3 monthly statements to support our Scotialine claim which should have been included in our Dec. 15/87 writing.

Yours truly,

G.A. Bristol

Consumer Credit Officer.

. . . . .

January 13, 1988

Bank of Nova Scotia

P.O. Box 130,

Bridgewater, Nova Scotia

Attention: G.A. Bristol — Officer Consumer Credit

Dear Mr. Bristol:

Re: John R. Janzen & Lea M. Janzen — Proposals

Receipt is acknowledged of your proof of claim with respect to the Scotialine account.

We would request that you attach a statement of account to the proof of claim and return same to our office at your earliest convenience.

Should you have any questions, please feel free to contact the undersigned.

Yours very truly,

Mark S. Rosen

Administrator

MSR/bl

Encl.

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. . . . .

Scotiabank

Bridgewater Shopping Plaza

P.O. Box 130, Bridgewater, N.S.

B4V 2W8

June 28, 1988

Collins Barrow

1801 Hollis Street

Halifax, Nova Scotia

B3J 2N7

Re: John & Lea Janzen

Dear Mr. Rosen:

With reference to our telephone conversation enclosed please find original proof of claim and monthly statements on the Janzen's Scotialine.

Yours truly,

J.E. White,

Asst. Manager,

Consumer Credit

Encl.

An affidavit of Mr. White was also filed at the time of the hearing, detailing the sequence of events, and submitting that the claim "by the Bank has been proved and that the Trustee had notice of the claim and, as such, the Bank, as creditor, should be permitted to participate in the distribution of the funds".

Collins Barrow submits that the procedure followed by the bank did not conform with the standards for filing proofs of claim under the Bankruptcy Act, and in fact, when the bank did conform with the said standards, it was too late to be included as a creditor in the payment of dividends.

Ruling On The Appeal To The Court From The Registrar's Decision

2 Section 121 of the [1970] Bankruptcy Act is relevant to this appeal. It provides as follows:

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> 121. [Right of creditor who has not proved claim before declaration of dividend] A creditor who has not proved his claim before the declaration of any dividend is entitled upon proof of his claim to be paid out of any money for the time being in the hands of the trustee any dividend or dividends he may have failed to receive, before that money is applied to the payment of any future dividend, but he is not entitled to disturb the distribution of any dividend declared before his claim was proved by reason that he has not participated therein, except on such terms and conditions as may be ordered by the court.

3 The learned registrar purported to follow the decision of MacDonald J. in *Re Pilot Butte Sand & Gravel Co.; Glen Wright Trucking Ltd. v. Guar. Trust Co. of Can.* (1968), 11 C.B.R. (N.S.) 254 (Sask. Q.B.). He concluded that, as the bank had been inadvertent and careless with respect to the filing of its proof of claim, he refused to allow the bank to participate in the distribution of the dividend.

4 The notice of appeal alleges four grounds:

> (a) the learned Registrar erred in law in failing to find that the The Bank of Nova Scotia had indeed filed a claim within the meaning of Section 120 of the *Bankruptcy Act*, and that an Order pursuant to that Section was therefore unnecessary;
>
> (b) the learned Registrar erred in law in failing to take into account the duty of the Trustee, under the particular circumstances in play here, to advise the Applicant/Appellant that its proof of claim was deficient, before proceeding to declare a distribution;
>
> (c) the learned Registrar erred in law in finding that the Applicant/Appellant had a higher standard of care than ordinary unsecured creditors;
>
> (d) the learned Registrar erred in law in failing to properly exercise his discretion under Section 120(1) of the *Bankruptcy Act*, so that, if it was appropriate to penalize the Applicant/Appellant, the penalty was commensurate with the inconvenience suffered by the Estate Administrator.

5 In reviewing the report of the *Pilot Butte* case, it would appear that the learned registrar followed what is referred to as a "second principle" that was enunciated in the *Pilot Butte* case, that the policy that a court permits a creditor in if a dividend has not been distributed does not apply if a creditor has been inadvertent or careless. However, in the *Pilot Butte* case it states that in such a situation a late-filing creditor is entitled to share only in future distributions. In that case, the learned trial judge found that the claimant had not been inadvertent or careless and, in view of the size of the claim, the trustee should have considered sending a notice to the creditor to prove its claim, and this would have called its attention to the fact that its proof of claim was not in the hands of the trustee. I might say that the trustee should possibly have done the same in this case, but it is not necessary to deal with that issue. I feel the learned registrar erred in the exercise of his discretion. There is an overriding principle in bankruptcy law that creditors are to be accorded equal and fair treatment and share pro rata in the assets of the estate. That is why the policy of the courts has been to allow creditors in prior to a distribution. The second so-called "principle" referred to in the *Pilot Butte* case is premised on the situation where it is contemplated that there will be a future distribution to creditors. In the *Janzen* case before the registrar, this was a one and only distribution. The bank had in fact filed a proof of claim, although it was not in proper form and was returned. Due to negligence, the bank inadvertently failed to return the properly completed proof of claim, and the trustee went ahead and prepared his dividend sheet, and the bank only by reason of having another claim became aware that a dividend was to be distributed and the bank was not included for its substantial claim of $19,723.12 — substantial in relation to claims of other creditors. The bank then filed a properly completed proof of claim *prior* to the actual distribution of the dividend.

6 To disallow a creditor's proof of claim filed before the distribution of a dividend is too harsh a penalty, even if the creditor was negligent in filing its proof in the first instance. The objective of bankruptcy legislation to give all creditors an opportunity to share in the assets can be achieved by penalizing the late-filing creditor by charging against the creditor's share

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of the estate the cost of additional work required by the trustee to alter the dividend sheet, etc. This is the principle referred to in the cases cited in *Pilot Butte*, supra. In my opinion, the learned registrar erred in failing to consider the basic principle that allows creditors with proven claims to share in the estate if the distribution has not been made before the claim is filed. In this case, there was not going to be any further distribution and, considering all the circumstances, to disallow the bank to participate in a share of the amounts available for distribution is an improper exercise of discretion. In my opinion, the bank should be allowed to participate pursuant to the power given to the court in s. 121 of the Bankruptcy Act.

7 I have come to this conclusion based on the reasoning of the court in *Ex parte Boddam; Re Taylor* (1860), 2 De G. F. & J. 625, 45 E.R. 763 (L.JJ.), where the court stated at p. 765:

> I take the general rule to be, that so long as there remain undistributed assets in bankruptcy a creditor is entitled to come in and prove, as is the case in an administration suit so long as there are assets unadministered.

8 Similar sentiments were expressed in the case of *Re McMurdo; Penfield v. McMurdo*, [1902] 2 Ch. 684 (C.A.), where Vaughan Williams L.J. stated at pp. 699-700:

> Now, according to my experience of bankruptcy practice, there never has been any doubt as to the right of a creditor, whether he is a secured creditor or whether he is an unsecured creditor, to come in and prove at any time during the administration, provided only that he does not by his proof interfere with the prior distribution of the estate amongst the creditors, and subject always, in cases in which he has to come in and ask for leave to prove, to any terms which the Court may think it just to impose; and, of course, in every case in which there has been a time limited for coming in to prove, although the lapse of that time without proof does not prevent the creditor from proving afterwards, subject to the conditions which I have mentioned, in every such case he can only come in and prove with the leave of the Court. If that is so, leave must be granted upon such terms as the Court may think just.

9 In the same case, Romer L.J. stated at p. 706:

> As a rule, no injustice is done when a creditor comes in, for the Bankruptcy Court can always impose terms which will prevent any unnecessary delay in the administration of the estate in bankruptcy being caused by the lateness of the creditor coming in, and, as a rule, subject, as I have said, to care being taken that no injustice is done, by special order the Court of Bankruptcy will undoubtedly, notwithstanding rule 1, allow a creditor, notwithstanding his delay, to come in and prove and share in undistributed assets. I will not say that there may not be special circumstances that might justify the Bankruptcy Court in refusing to admit a creditor who came in late; but I have stated what I conceive to be the general rule and practice of the Bankruptcy Court.

10 The foregoing reasoning is the dominant principle to be considered in circumstances such as this, and I feel that the learned registrar erred in not giving dominance to this principle that a creditor, where the assets have not been distributed, should be entitled, with leave of the court, to come in and submit his claim.

11 It is not necessary to decide whether or not the trustee erred in not sending to the bank a s. 106 notice in Form 64 rather than simply returning the proof of claim and asking that it be resubmitted.

12 To conclude this matter, I am granting the appeal and the bank shall be entitled to participate in the dividend subject to the following with respect to costs.

13 On the basis of the agreed statement of facts, it cannot be said that the trustee acted improperly in not forwarding a form of notice of disallowance; by returning the proof of claim, the trustee had not exercised a decision at that point to disallow the claim. The trustee was simply asking the bank to resubmit it and, through inadvertence, the bank failed to do so until after it became aware that the dividend had been declared. I think it might have been better had the trustee sent a formal notice of disallowance.

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14 Under all the circumstances, I think it is the bank that should bear the additional costs of the trustee as taxed on a solicitor-and-client basis with respect to the hearing before the registrar and this hearing, as the bank was negligent in failing to file a proper proof of claim in a timely fashion. Those costs shall be for the account of the bank, and any other costs, fees or expenses (such as preparing a new dividend sheet) incurred by the trustee as a result of the bank being allowed in shall be deducted from the bank's share of the distribution.

15 This is an appropriate way to dispose of the matter of costs, notwithstanding that the bank has been successful on this application. Had the bank acted more prudently and filed its proper proof of claim in a timely fashion, neither the application before the registrar nor that before myself would have been necessary.

Appeal allowed.

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Index No. 3

Nova Scotia Statutes
Companies Act
Part IV — Management and Administration
Liability of Members
s 135. Limits of liability

Nova Scotia Current to Gazette Vol. 36:12 (June 15, 2012)

135. Limits of liability

In the event of a company being wound up, every present and past member shall, subject to this Section, be liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges, and expenses of the winding up and for the adjustments of the rights of the contributories among themselves, with the qualifications following:

(a) a past member shall not be liable to contribute if he has ceased to be a member for one year or upwards before the commencement of the winding up;
(b) a past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member;
(c) a past member shall not be liable to contribute unless it appears to the court that the existing members are unable to satisfy the contributions required to be made by them in pursuance of this Act;
(d) in the case of a company limited by shares, no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member;
(e) in the case of a company limited by guarantee, no contribution shall be required from any member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up;
(ea) in the case of an unlimited company, no contribution exceeding the amount, if any, unpaid on the shares in respect of which the member is liable as a past member, shall be required from a past member who was not a member of the company at any time on or after the time the company became unlimited;
(f) nothing in this Act shall invalidate any provision contained in any contract whereby the liability of the individual members of the contract is restricted, or whereby the funds of the company are alone made liable in respect of the policy or contract;
(g) a sum due to any member of a company, in his character of a member, by way of dividends, profits or otherwise, shall not be deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.

2007, c. 34, s. 40

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Index No. 4

- Since the practical combined effect of the U.S. and Canadian tax regimes is to treat the Canadian unlimited company as a branch for U.S. tax purposes, but as a separate company for Canadian tax purposes, the principals behind the corporation enjoy the best of both worlds.

- Canadians emigrating to the U.S. can avoid double taxation on their Canadian holdings and secure a higher cost basis for U.S. tax purposes.

To obtain this treatment, section 301.7701-2(b)(8)(ii)(A) of the *Internal Revenue Code 1986* requires:

> With regard to Canada, any corporation or company formed under any federal or provincial law which provides that the liability of all of the members of such corporation or company will be unlimited.

§2.84 In addition to the tax benefit of unlimited liability incorporation, there are a number of other features of such a corporation that may make it attractive to certain investors.[212] The directors of an unlimited liability company do not have to be resident in Canada, but any such company must have a registered office in Nova Scotia. An unlimited liability company may be incorporated with or without share capital. Where it possesses share capital, changes in the share capital may be made by way of a member resolution that becomes effective immediately. The *Companies Act* also allows the issuance of par value shares (non-par value shares are also allowed). In addition, the Act does not bar an unlimited liability company from owning shares of its parent or prohibit a subsidiary from acquiring shares of its parent.

§2.85 An unlimited liability company is formed by filing with the Registrar of Joint Stock Companies under *Companies Act* a signed memorandum and articles of association. As under the U.K. Act, these documents provide a contractual framework for the eventual company that arises. The memorandum and articles must be accompanied by a lawyer's declaration concerning the propriety of the incorporation. Unlimited liability companies must have a corporate name (as opposed to a number name), and the name must include one of the words or abbreviations "Company", "Co.", "Corporation", "Corp.", "ULC" or "Unlimited Liability Company" at the end of the corporate name. The use of the words "Limited" or "Incorporated" are prohibited.

---

[212] For instance: one of the most surprising uses for an unlimited liability company can be to enhance shareholder protection. A ULC may actually prove to be a more effective device to limit a shareholder's potential personal liability than an limited liability corporation. For instance, unlimited liability may be employed as a substitute for a shareholder guarantee. Such an arrangement may be attractive where the company will have only a single creditor, and the shareholder intends to sell off the company relatively quickly should it be a successful venture. In many cases, it will prove easier to extricate a departing shareholder from liability under an unlimited liability regime, than to extricate the shareholder of a limited liability corporation from liability under a personal guarantee. In England, unlimited liability companies are less regulated, and are exempt from the public disclosure of corporate accounts. If any Ontario regime is drafted to relieve from such provisions applicable to limited liability corporations (*e.g.*, with respect to dividend payment), unlimited companies may prove to have a degree of popularity even where tax benefits are not a consideration.

§2.86 A limited company under the Nova Scotia law may not directly convert to an unlimited company, but such a transition can be accomplished indirectly through amalgamation. (In contrast, U.K. companies can migrate directly from unlimited to limited status.) Under the amalgamation method, the limited company amalgamates with an unlimited company to form an unlimited company. As a prelude to such a transaction, both companies must have been incorporated, continued, or must otherwise exist, under the Nova Scotia *Companies Act*.

§2.87 Somewhat surprisingly, there are a number of measures that can be taken to limit the liability of the members of a supposedly unlimited liability company. Some of these arise under the *Companies Act* itself. In particular, a member is only liable for debts of the company existing at the time he or she ceases to be a member and a past member is not liable to contribute at all if he or she has not been a member for a one-year period prior to the wind-up. In addition, a past shareholder, if potentially liable, is not required to contribute unless existing shareholders are unable to satisfy their obligations to pay. These restrictions on liability generally follow the rules of liability applicable under partnership law.

§2.88 The liability of a member of an unlimited liability company can also be limited contractually, which is a useful device where there are only one or two large lenders and sufficient security is in place to address the debt of the unlimited company. If doing business with the company is sufficiently attractive, such creditors may be prepared to contractually agree to not pursue the shareholder in the event of default. Another technique employed to limit liability is to make use of an "S" corporation under U.S. tax law, as an intermediary between the unlimited liability companies and the ultimate investor.

(ii) The Alberta Regime

§2.89 Effective, May 17, 2005, Alberta amended its *Business Corporations Act* ("Alberta BCA")[213] to permit the incorporation of unlimited liability corporations. The Alberta legislation weds the unlimited concept to a pre-existing business corporation that closely resembles that in effect under the OBCA and CBCA.

§2.90 There are a number of important differences, however, between the Alberta and Nova Scotia approach. Under the Alberta legislation, the articles of the corporation must include an express statement that the liability of each of its shareholders "for any liability, act or default of the unlimited liability corporation is unlimited in extent and joint and several in nature". Accordingly, a creditor of an AULC will have a direct claim against all shareholders of the corporation for all liabilities owed to the creditor without having to first seek recourse against the AULC or have it wound up. Under the Nova Scotia regime, although the liability of the members of such a company is not limited, the members have no direct liability to creditors. Instead, their responsibility is acti-

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[213] R.S.A. 2000 c. B-9.

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GOWER'S PRINCIPLES OF MODERN COMPANY LAW

FIFTH EDITION

By

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CHAPTER 5

ADVANTAGES AND DISADVANTAGES OF INCORPORATION

Legal entity distinct from its members

As already emphasised, the fundamental attribute of corporate personality—from which indeed all the other consequences flow—is that the corporation is a legal entity distinct from its members. Hence it is capable of enjoying rights and of being subject to duties which are not the same as those enjoyed or borne by its members. In other words, it has "legal personality" and is often described as an *artificial person* in contrast with a human being, a *natural person*.[1]

As we have seen, corporate personality became an attribute of the normal joint stock company only at a comparatively late stage in its development, and it was not until *Salomon* v. *Salomon & Co.*[2] at the end of the nineteenth century that its implications were fully grasped even by the courts. The facts of this justly celebrated case were as follows:

Salomon had for many years carried on a prosperous business as a leather merchant. In 1892 he decided to convert it into a limited company and for this purpose Salomon & Co. Ltd. was formed with Salomon, his wife and five of his children as members and Salomon as managing director. The company purchased the business as a going concern for £39,000—"a sum which represented the sanguine expectations of a fond owner rather than anything that can be called a businesslike or reasonable estimate of value."[3] The price was satisfied by £10,000 in debentures, conferring a charge over all the company's assets, £20,000 in fully paid £1 shares and the balance in cash. The result was that Salomon held 20,001 of the 20,007 shares issued, and each of the remaining six shares was held by a member of his family, apparently as a nominee for him. The company almost immediately ran into difficulties and only a year later the then holder of the debentures appointed a receiver and the company went into liquidation. Its assets were sufficient to discharge the debentures but nothing was left for the unsecured creditors. In these circumstances Vaughan Williams J. and a strong Court of Appeal held that the whole transaction was contrary to the true intent of the Companies Act and that the company was a mere sham, and an alias, agent, trustee or nominee for Salomon who remained the real proprietor of

[1] A company, even if it has only one member, is a "corporation aggregate" as opposed to the somewhat anomalous "corporation sole" in which an office, *e.g.* that of a bishop, is personified.
[2] [1897] A.C. 22, H.L.
[3] *Per* Lord Macnaghten at p 49.

the business. As such he was liable to indemnify the company against its trading debts. But the House of Lords unanimously reversed this decision. They held that the company has been validly formed since the Act merely required seven members holding at least one share each. It said nothing about their being independent, or that they should take a substantial interest in the undertaking, or that they should have a mind and will of their own, or that there should be anything like a balance of power in the constitution of the company. Hence the business belonged to the company and not to Salomon, and Salomon was *its* agent. In the blunt words of Lord Halsbury L.C.[4]

> "Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not."

Or, as Lord Macnaghten put it[5]:

> "The company is at law a different person altogether from the subscribers . . . ; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers, as members, liable in any shape or form, except to the extent and in the manner provided by the Act."[6]

Of course this decision does not mean that a promoter can with impunity defraud the company which he forms or swindle his existing creditors. In the *Salomon* case it was argued that the company was entitled to rescind in view of the wilful overvaluation of the business sold to it. But the House held that in fact there was no fraud at all since the shareholders were fully conversant with what was being done. Had Salomon made a profit which he concealed from his fellow shareholders the position would have been different.[7] Nor was there any fraud on Salomon's pre-incorporation creditors, all of whom were paid off in full out of the purchase price. Otherwise they or

[4] At p. 31.
[5] At p. 51.
[6] For an early statutory recognition of the same principle, see 22 Geo. 3 c. 45, which disqualified those holding Government contracts from election to Parliament but expressly provided (s.3) that the prohibition did not extend to members of incorporated companies holding such contracts.
[7] See below Chap. 12.

Salomon's trustee in bankruptcy might have been entitled to upset the sale.[8] And today the charge securing the debenture might be invalidated if there was a successful petition for a winding-up or an administration order within two years.[9] But, in this particular case, Salomon seems to have been one of the victims rather than the villain of the piece for he had mortgaged his debentures and used the money to try to support the tottering company. However, the result would have been the same if he had not, and even if he had been the only creditor to receive anything from the business which was "his" in fact though not in law.

This decision opened up new vistas to company lawyers and the world of commerce. Not only did it finally establish the legality of the "one-man" company and showed that incorporation was as readily available to the small private partnership and sole trader as to the large public company, but it also revealed that it was possible for a trader not merely to limit his liability to the money which he put into the enterprise but even to avoid any serious risk to the major part of that by subscribing for debentures rather than shares. This result seems shocking, and the decision has been much criticised.[10] The only justification for it is that the public deal with a limited company at their peril and know, or should know, what to expect. In particular a search of the company's file at Companies House should reveal its latest annual accounts and whether there are any charges on the company's assets.[11] But the accounts will probably be months out of date and, in the case of a small or medium sized company, may be expurgated editions of those circulated to the members.[12] Nor does everyone having dealings with a company have the time or knowledge needed to search the file. The experienced business man with his trade protection associations can take care of himself, but the little man, whom the law should particularly protect, rarely has any idea of the risks he runs when he grants credit to a company with a high-sounding name,[13] impressive nominal capital (not paid up in cash), and with assets mortgaged up to the hilt.[14] Nor is it practical for the

[8] Under what are now ss.423 to 425 of the Insolvency Act 1986.
[9] Insolvency Act 1986, s.245.
[10] See, *e.g.* O. Kahn-Freund, *Some Reflections on Company Law Reform* (1944) 7 M.L.R. 54 (a thought-provoking article still well worth study) in which it is described as a "calamitous decision."
[11] But not necessarily the amount secured; most companies grant floating charges to their bankers to secure "all sums due or to become due" on their current overdrafts and the register of charges will not give any indication of the size of the overdraft at any particular time.
[12] Companies Act 1985 ss.247–251: see below Chap. 17.
[13] There are undoubtedly many who think that "Ltd." is an indication of size and stability (which "plc" may be but "Ltd" certainly is not) rather than a warning of irresponsibility.
[14] But no sympathy was wasted on him by the H.L. "A creditor who will not take the trouble to use the means which the statute provides for enabling him to protect himself must bear the consequences of his own negligence": per Lord Watson at p. 40.

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unemployed workman, who is offered a job with a limited company, to decline it until he has first searched the company's file.[15]

Since the Salomon case, the complete separation of the company and its members has never been doubted. As we shall see later,[16] there are cases in which the legislature, and to a very small extent the courts, have allowed the veil of incorporation to be lifted, but in general it is opaque and impassable. The consequences, however, are not necessarily wholly beneficial to the members.[17] For example, if a trader incorporates his business he will cease to have an insurable interest in its assets even though he is the beneficial owner of all the shares. If therefore he forgets to assign the insurance policies, and to obtain any necessary consents of the insurers, nothing will be payable if the assets perish.[18] Similarly, a parent company will not have an insurable interest in the assets of its subsidiary companies even though wholly owned, for the rule that a company is distinct from its members applies equally to the separate companies of a group.[19] In Kahn-Freund's striking phrase[20] "sometimes corporate entity works like a boomerang and hits the man who was trying to use it."

(1) *Limited liability*

It follows from the fact that a corporation is a separate person that its members are not as such liable for its debts.[21] Hence in the absence of express provision to the contrary the members will be completely free from any personal liability. This is, in fact, the position as regards municipal and ecclesiastical corporations and the modern public corporations, and may be so as regards statutory and chartered companies, the members of which will be under personal liability only if, and to the extent that, the statute or charter so provides.

But as regards a company registered under the Companies Acts a complete absence of any liability is not permitted. Such a company can either be registered as unlimited, in which case the members are in effect guarantors of its obligations without any restriction on amount,[22] or it can be limited by shares or guarantee.[23] In the case of

[15] The likely result would be to lose him his unemployment benefit.

[16] Below Chap. 6.

[17] See especially Kiralfy, *Some Unforseen Consequences of Private Incorporation* in (1949) 65 L.Q.R. 231, and Kahn-Freund, *loc. cit.* and below, Chap. 6.

[18] *Macaura* v. *Northern Assurance Co.* [1925] A.C. 619, H.L.; *Levinger* v. *Licences, etc. Insurance Co.* (1936) 54 Ll.L.R. 68.

[19] As will be pointed out later, inroads have been made into this principle, but it still remains the general rule though for tax purposes "group relief" had drawn its sting.

[20] *Loc. cit.* p. 56.

[21] This sentence was quoted and relied on by Kerr L.J. in *Rayner (Mincing Lane) Ltd.* v. *Dept. of Trade* [1989] Ch. 72 at p. 176 as an accurate statement of English law although, as he pointed out, it is not accurate in relation to most Civil Law countries—including Scotland so far as partnerships are concerned—or to international law: at pp. 176–183.

[22] "In effect" because, of course, the *modus operandi* is different; the creditor has no direct right against the member, as he would have against a surety on default by the principal debtor.

[23] The Companies Acts (now 1985 Act, ss.306–307) have always provided that a limited company may have directors with unlimited liability. It is not surprising that these

a company limited by shares each member is liable to contribute when called upon to do so the full nominal value of the shares held by him in so far as this has not already been paid by him or any prior holder of those shares. In the case of a guarantee company each member is liable to contribute a specified amount to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member. In effect, therefore, the member, without being directly liable to the company's creditors, is in both cases a limited guarantor of the company.

When, therefore, obligations are incurred on behalf of a company, the company is liable and not the members, though the company may ultimately be able to recover a contribution from them to enable it to discharge its obligations. If the company is an unlimited one their liability to contribute will be unlimited; if it is limited by shares their liability will be limited to the unpaid nominal value of their shares and in practice their shares are today likely to be fully paid up so that they will be under no further liability. If the company is limited by guarantee they will be under no liability until it is wound up, and then, in practice, only for a derisory sum.[24] In contrast an unincorporated association, not being a legal person, cannot be liable, and obligations entered into on its behalf can bind only the actual officials who purport to act on its behalf, or the individual members if the officials have actual or apparent authority to bind them. In either event the persons bound will be liable to the full extent of their property unless they expressly or impliedly restrict their responsibility to the extent of the funds of the association, as the officials may well do. Hence the extent to which the member will be liable depends on the terms of the contract of association. In the case of a club, and presumably the same applies to learned and scientific societies, there will generally be implied a term that the members are not personally liable for obligations incurred on behalf of the club. But very different is the position of members of a partnership, an association carrying on business for gain. Each partner is an agent of all the others and his acts done in "carrying on in the normal way business of the kind carried on by the firm" bind the partners.[25] Only if the creditor knows of the limitation placed on the partners' authority will the other members escape liability.[26] Moreover, an attempt to restrict the partners' liability to partnership funds by a provision to that effect in the partnership agreement will

provisions have long been a dead letter except occasionally in relation to professions which permit their members to practise as incorporated companies but only if the directors accept personal liability.

[24] See Chap. 1, p. 11 n. 36 above.

[25] Partnership Act 1890, s.5. This applies equally to Scotland thus largely negativing the consequence of recognising the Scottish firm as a separate person.

[26] *Ibid.* ss.5 and 8.

be ineffective even if known to the creditors[27]; they will only be able to restrict their financial liability, in respect of acts otherwise authorised, by an express agreement to that effect with the creditor concerned.[28]

There is, it is true, now a method whereby liability can be limited without forming an incorporated company; namely, by a limited partnership under the Limited Partnerships Act 1907. But this has many disadvantages in comparison with a company. In particular, it is not possible to limit the personal liability of all the partners but only some of them.[29] Moreover, even the limited partners lose their privilege of limited liability if they take any part in the management of the business.[30] This latter rule is especially inconvenient, for although a person who puts money into a business may be happy to leave the running of it to his colleagues while all goes well, he will probably want to be able to intervene if things go wrong. If a limited partner does so, his attempt to salvage the wreck may well result in the whole of his fortune sinking with it.

Hence a limited company is generally found preferable. It enables the liability of all the members to be limited without restriction on the part which they play in the management, and, although it involves somewhat greater formality, publicity and expense, these are not very onerous. In practice, therefore, limited partnerships are used only where for some reasons an incorporated company is inappropriate (*e.g.* in the case of certain professions which companies are not allowed to practise) but one member of the firm is not prepared to accept full liability for its debts or the other partners do not want him to play any part in the management. This may occur on the retirement from active participation of a senior partner whom it is wished to retain as a consultant or for the prestige value of his name and reputation. Save in these rare cases where limited partnerships are appropriate, the only practical alternatives are either complete personal liability or limited liability through the medium of a company.

In the case of small private limited companies the members' freedom from personal liability may, in practice, prove to be largely illusory. Banks and others who grant the company formal credit facilities are likely to require the members, or such of them as are directors, personally to guarantee the company's indebtedness. If, then, the company becomes insolvent, members or directors face personal liabilities which may bankrupt them. Limited liability protects them only in respect of claims by trade creditors who have

[27] *Re Sea, Fire and Life Insurance Co.* (1854) 3 De G.M. & G. 459.
[28] *Hallett* v. *Dowdall* (1852) 21 L.J.Q.B. 98. It is a criminal offence to carry on business under a name ending with "Limited" unless duly incorporated with limited liability: Companies Act 1985 s.34.
[29] Limited Partnership Act 1907, s.4(2).
[30] *Ibid.* s.6(1). They may only "advise with the partners."

Index No. 6

Indexed as:

Olympia & York Developments Ltd. (Re) (Ont. Ct. (Gen. Div.))

IN THE MATTER OF The Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36
AND IN THE MATTER OF a plan of arrangement of Olympia & York Developments Limited and all other corporations set out in Schedule "A" attached hereto, with head offices in the City of Toronto, Province of Ontario
Olympia & York Developments, et al., Applicants

[1994] O.J. No. 1335

Action No. B125/92

Ontario Court of Justice - General Division
Commercial List - Toronto, Ontario

Farley J.

Heard: March 4, 1994.
Judgment: March 14, 1994.

(11 pp.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors' arrangement legislation -- Arrangement, classes of creditors -- Valuation of shares for voting purposes.

The Bank of Nova Scotia (BNS) appealed a decision of the Claims Officer. The Administrators of Olympia & York Canary Wharf Holdings (Canary Administrators) cross-appealed. Olympia & York Developments Ltd. (O&Y) had made a plan of arrangement under the Companies Creditors Arrangement Act. In January, 1993, the Claims Officer made a decision determining valuation of shares for voting purposes. The applicant BNS argued that the value of the Canary Administrators' claim should be eliminated, which would have the effect of giving the BNS a veto, enabling it to defeat the proposal.

HELD: The appeal and cross-appeal were dismissed. The court rejected BNS's argument that the Canary Administrators had no standing to file a proof of claim, commenting that the Canary

Administrators were the only persons who could act for O&Y at this point. Secondly, the court considered whether the claim would have only nominal value. The BNS had not advanced any evidence to dispute the material submitted by the Canary Administrators. There was nothing to show that the Canary Administrators' current plan of attack would not be implemented. For the purpose of valuation for voting, it was not reasonable to assume that the claim would be only nominal. Nor did the court see the possibility that some contributors may fail to pay or may be insolvent as an aspect of valuing security. Finally, the court rejected BNS's argument that a subsidiary should not be permitted to vote on a plan proposed by its parent.

STATUTES, REGULATIONS AND RULES CITED:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 12, 54(3), 66, 121.
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 12.
Insolvency Act, 1986 (UK), ss. 14(5), 22, 74, 79, 122, 141, 148, 149(1), 149(2), 150, 160, 165.

Patricia D. Jackson, for the Bank of Nova Scotia.
Robert J. Walker and Robert J. Wadden, for Olympia & York Canary Wharf Holdings in administration.
I. Berl Nadler, for the Applicant.
Nathan Cheifetz, for the Canadian Imperial Bank of Commerce.
William Horton, for the Royal Bank of Canada.
J.A. Carfagnini, for the National Bank of Canada.

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1 **FARLEY J.**:-- The Bank of Nova Scotia ("BNS") appealed the January 22, 1993 decision of the Claims Officer, David Henry asking that it be varied in part and that the claim of the Administrators of Olympia & York Canary Wharf Holdings ("Canary Administrators") be deleted in its entirety for the purpose of voting on Class 35 (Olympia & York European Holdings Limited ("European") Unsecured Creditors). It was submitted that the Claims Officer had erred in deciding that (i) the claim of the Canary Administrators ("Claim") which had been listed on the Class 35 list should be so listed and entitled to vote; (ii) the Claim should have other than a nominal value; and (iii) the amount of the Claim should be increased from $431,646,401 to $862,246,089.97. The Canary Administrators cross appealed asking in the event of my determining that the Claims Officer had improperly exercised his discretion that I allow the Canary Administrators to vote the entire amount requested in the Canary Administrators' Proof of Claim in the amount of 1,088,365,708.69 pounds sterling ($2,520,463,817.90).

Background

2 The vote proceeded after the Claims Officer's determination. Based on the allowed valuation more than 75% in value of Class 35 voted in favour. If the value of the Canary Administrators' Claim had been eliminated, then the BNS would have been able to defeat the proposal as it would then have had a veto.

3 Olympia & York Canary Wharf Holdings ("CW") is "unusual" in the sense that it is an unlimited liability company. On liquidation, if the realized assets of such a company are not sufficient to meet its obligations, then its shareholders face the aspect of a call not only for the unpaid portion of their partly paid shares (if any) but also for the shortfall then determined. Such an "animal" does not appear to be present under Canadian corporate legislation as it is in the U.K. No reason was given for this type of vehicle being chosen for CW although one might suspect that there were certain tax or other advantages anticipated. European is the parent company of CW holding 95% of its shares; it is therefore open to such a call exposure.

4 How were the numbers above derived? The exchange rate utilized appears to be $2.31 equals 1 pound sterling (approximately). All further numbers given are approximate figures. The CW intercompany debt was indicated to be 393 million pounds sterling, mainly made up of 259 million pounds sterling owed to Olympia & York Contractors Limited, 113 million pounds sterling owed to Olympia & York (UK) Limited, 1/3 million pounds sterling to Canary Wharf Management Limited, 21 million pounds sterling to various O&Y companies (which claim was subsequently dropped) and some miscellaneous 2 pounds sterling items. These miscellaneous 2 pounds sterling amounts are all immaterial as well as the 1/3 million pounds sterling (given the magnitude of the other amounts involved) - except for the identification of one 2 pounds sterling amount being owed to European. It would seem that to the extent that European funded CW, only 2 pounds sterling was by way of debt (leaving the implication that the balance was funded by equity).

5 Dropping the 21 million pounds sterling claim, the intercompany indebtedness of CW was 373 million pounds sterling (or $862 million). For voting valuation purposes, it was proposed that half of this be allowed - or $431 million. It appears (although not directly) that the $2.5 billion figure is a larger shortfall expectation which includes the foregoing amounts.

Nature of Appeal and Practical Aspects

6 I would emphasize that the subject matter of this appeal is a valuation for voting purposes only. I also note that the BNS has to knock out most of the $431 million originally fought over in order to prevail with a veto. If it does not, then for all practical purposes it matters not whether the Claim is $862 million or $2.5 billion. On that basis alone, it would not seem necessary to deal with the Canary Administrators' cross appeal nor the appeal by the BNS against the Claims Officer's increase of the Claim from $431 million to $862 million. As the Claims Officer mentioned, this gets into an exercise of piling Ossa on Pelion - a half scoop of ice cream provides more than enough calories; there is no necessity to ask for a single or double scoop.

7 Let me now turn to whether the Canary Administrators should have been allowed to make a

Claim for voting purposes and, if so, should the Claim be allowed for more than a nominal amount?

Standard of Review

8 The Canary Administrators submit that the standard of review to be applied is that of Marleen Investments Ltd. v. McBride (1979), 23 O.R. (2d) 125 (H.C.J.). However it seems to me that in a situation such as this in which the determination is so knife edge vital to the end result that this case would more properly fall into the considerations as discussed in Stoicevski v. Casement (1983), 43 O.R. (2d) 436, 43 C.P.C. 178 (C.A.) and Westminer Canada Holdings Ltd. v. Coughlan (1990), 75 O.R. (2d) 405, 73 D.L.R. (4th) 584, 41 O.A.C. 377 (Div. Ct). I am in this regard mindful of the extreme time constraints and pressures that the Claims Officer and counsel were working under so that the vote could be held the next day I do not mean to say in mentioning this that this is a basis independent of itself, but rather one which might be considered as being a little atmosphere superadded to the vitality question. I pause to note that there seems to be an increasing number of "instantaneous" decisions that judicial officers have to make. To attempt to deal with this heavy burden those judicial officers must act alone but they must of necessity rely heavily upon the winnowing and distillation abilities of counsel together with their logic, practicability, wisdom, reasonableness and candour I believe that I am echoing the sentiments of the Claims Officer when I say that I appreciate how far counsel were able to go in this process before leaving me with the thorny questions above.

Standing to Make Claim

9 The BNS submits that the Canary Administrators have no standing to make the Claim. It relies upon the fact that under English insolvency law, a call for contribution from the shareholders of an unlimited company can be made after a winding up order has been made. See Insolvency Act, 1986 (UK) especially at sections 74, 14, 22, 122, 79, 149, 150 and 160. No such order has been made as to CW, but the Canary Administrators fully expect to request same in due course given CW's submarine status. In support of the assertion that the Canary Administrators have no standing to file a proof of claim, even if it is convenient for them to do so, the BNS relies on two of my decisions: Re Rizzo and Rizzo Shoes Ltd (1991), 6 O.R. (3d) 441 (Gen. Div.) at pp. 449-50 and Ontario (Registrar of Mortgage Brokers) v. Matrix Financial Court (unreported [1992] O.J. No. 1570, released July 24, 1992) at pp. 3 and 6.

10 However it seems to me that one has to look at the foundation stones of the intent of the Companies' Creditors Arrangement Act ("CCAA") and the nature of the "claim" relating to CW Clearly CCAA is to be treated as remedial legislation which is to be liberally interpreted in the overall scheme of allowing those companies capable of reorganizing themselves to again become vital elements of our society and economy; see Nova Metals Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (N.S.) 101 (Ont.C.A.). S. 12(1) CCAA provides:

> For the purposes of this Act, "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 Act [now Bankruptcy and Insolvency Act].

11 Under the English insolvency legislation, the administrator is deemed to act as the company's agent (s. 14(5)). After a wind up order has been made, the court may make an order for contribution; this is an order to pay "to the company" (s. 149(1)). While it is true that no liquidator has been appointed who would be able to request the court to make such a contribution order, it seems to me that any such claim is the company's claim, not the claim for the benefit of either an administrator or a liquidator. Who could advance such a claim at the present (keeping in mind the tripartite nature of s. 12 CCAA - (1) type of claim (2) determination of amount and (3) admitting for voting purposes while reserving the right to contest liability)? The simple answer appears to be the company - or in this case CW How can CW act? Of necessity, it appears that CW must act at this stage of events and time by way of the Canary Administrators acting on its behalf. Their powers to do so appear contemplated in the Schedule 1 powers under the English insolvency legislation (especially at items 20 and 23). As distinct from Rizzo and Matrix supra, the Canary Administrators are of necessity the only persons who can act for CW (at least in this regard); they are not volunteers who came in to "assist" the employee creditors (Rizzo) or mortgage holders (Matrix) who could still act on their own behalf.

12 The claim of a creditor under s. 12 CCAA incorporate the concepts of the Bankruptcy and Insolvency Act, RSC 1985, c. B-3 as amended ("BIA") and includes the contingent claim of a creditor for unliquidated damages (s. 121 BIA). A contingent or unliquidated liability is a debt provable in bankruptcy and may be valued for the "full amount", its value should be reduced only to the extent the creditor holds good security, so as to avoid the problem of "doubly proved claims"; see Re Film House Limited (1974), 19 C.B.R. (N.S.) 23 (Ont. S.C.) and Re J. Le Bar Seafoods Inc. (1981), 38 C.B.R. (N.S.) 64 (Ont. S.C.).

13 I accept the Claims Officer's characterization of the "future liability to a call under the UK statute is analogous to a guarantee under Canadian bankruptcy law which guarantee is unsecured."

Does the Claim Have Only a Nominal Value

(a) Will A Call Be Made?

14 It is understood that before European could be called upon to make a contribution as the shareholder of the unlimited company CW the following steps would have to take place:

(i) CW to be put into liquidation (at the request of the Canary Administrators to the court or alternatively by resolution of its shareholder European and its creditors);
(ii) a liquidator would have to be appointed;
(iii) the liquidator after appointment would have to determine if it were appropriate to make such a call for contribution and the amount; and

(iv) assuming liquidation by court order, the court would have to grant leave to make the call.

(See Insolvency Act, 1986 (UK) ss. 122, 141, 148-150 and 165).

15 The undisputed evidence is that the Canary Administrators will make a liquidation application to the court. I note the affidavit of Peter Garstang Totty sworn Nov. 13, 1992 at paragraph 15 where he swears:

> The decision is solely that of the joint administrators but there is a clear advantage, and no disadvantage, in moving from administration to liquidation in due course, and the administrators inform me, and I believe them, that their intention is to put the creditor into liquidation as soon as the usefulness of the administration has ended.

There would not seem to be any practical impediment why such application would not be granted.

16 In this regard I note the affidavit of Alan Robert Bloom, one of the Canary Administrators, sworn January 19, 1993 at paragraph 5 where he swears concerning CW in administration:

> [CW in administration] is merely a holding company its only assets are shares in its subsidiary companies. It owns no land or buildings and therefore, subject to preliminary reconstruction of those assets for tax planning purposes, there is no obstacle to placing [CW in administration] into liquidation. To the best of my knowledge and belief, this will not affect any proposed reconstruction or reorganization of other companies within the UK group of Olympia & York companies and I confirm that it is the Joint Administrators' present intention to place [CW in administration] into liquidation to enable the claim against European Holdings to be pursued.

"The claim against European Holdings" is of course the call against European to make good on the deficiency which CW will with virtual certainty experience. Mr. Bloom goes on to say at paragraph 6:

> On the best information currently available to the Joint Administrators, it is estimated that in the event of a liquidation the shortfall to the unsecured creditors would be, at the very least 372 million pounds sterling and any such shortfall would need to be made good by [CW's] shareholders.

17 The BNS did not advance any evidence to dispute the material submitted by the Canary Administrators. It seems to me that at a minimum the BNS would have to have rebutted the "standard" procedures available in pursuing ACW's call against European. There was nothing set out to show that it was improbable that the Canary Administrators' current plan of attack would not

be implemented - or permitted to be implemented. There was nothing to suggest that the plan would be abandoned because the costs, procedural complexities or time delays involved would not merit acting on it vis-à-vis expected recoveries from European (see s. 150(2)). That CW may recover less than the amount called upon does not appear to be the appropriate basis for valuing the claim (based on the call); the valid amount of the claim and what might be recovered are different measurement results.

18 I therefore conclude that for the purpose of valuation for voting, it is reasonable to assume that there will be a call by CW (through a future appointed liquidator) upon European. At this stage there would not appear to be any compelling reason why that liquidator would not make a call for the full deficiency although there may well be a shortfall in recovery from European.

(b) Set off

19 The following subsections of the Insolvency Act, 1986 (UK) are of note:

> 149 Debts due from contributor company
>
> (1) The court may, at any time after making a winding-up order, make an order on any contributory for the time being on the list of contributories to pay in manner directed by the order; any money due from him (or from the estate of the person who he represents) to the company, exclusive of any money payable by him or the estate by virtue of any call in pursuance of the Companies Act or this Act.
>
> (2) The court in making such an order -
>
> (a) in the case of an unlimited company, allow to the contributory by way of set-off any money due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit.

20 There is of course a first hurdle that there was not any evidence as to what the English law of set-off would be. However there was cited the English case of Federal Commerce and Navigation Co. Ltd. v. Molena Alpha Inc., [1978] 1 Q.B. 927, [1978] 3 W.L.R. 309, [1978] 3 All E.R. 1066 (C.A.). This was referred to in Holt v. Telford, [1987] 2 S.C.R. 193. Lord Denning at pp. 974-5 of the Federal case discussed the concepts of set-off and cross-claims at common law and in equity. He stated:

> But the courts of equity, as was their wont, came in to mitigate the technicalities of the common law. They allowed deductions by way of equitable set-off -

> whenever there were good equitable grounds for directly impeaching the demand which the creditor was seeking to enforce: ... We have to ask ourselves: what should we do now so as to ensure fair dealing between the parties?... This question must be asked in each case as it arises for decision: and then, from case to case, we shall build up a series of precedents to guide those who come after us. But one thing is quite clear: it is not every cross-claim which can be deducted. It is only cross-claims that arise out of the same transaction or are closely connected with it. And it is only cross-claims which go directly to impeach the plaintiff's demands, that is, so closely connected with his demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim.

21 Wilson J. in delivering judgment for the court in Holt supra apparently adopted the general principles concerning equitable set-off drawn by Macfarlane J.A. from his review of the English authorities:

1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands: Rawson v. Samuel, [1841] Cr. & Ph. 161; 41 E.R. 451 (L.C.).
2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed: ... [Br. Anzani (Felixstowe Ltd. v. Int. Marine Mgmt (U.K.) Ltd., [1980] Q.B. 137, [1979] 3 W.L.R. 451, [1979] 2 All E.R. 1063].
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 cross-claim: ... [Fed. Commerce and Navigation Co. v. Molena Alpha Inc, [1978] Q.B. 927, [1978] 3 W.L.R. 309, [1978] 3 All E.R. 1066].
4. The plaintiff's claim and the cross-claim need not arise out of the same contract: Bankes v. Jarvis, [1903] 1 K.B. 549 (Div. Ct.); Br. Anzani.
5. Unliquidated claims are on the same footing as liquidated claims: [Nfld. v. Nfld. Ry Co., [1888] 13 App. C. 199 (P.C.)].

22 Even if we were to look at the question of set-off in this case on that basis, I am not persuaded by the BNS's position that there is some ear tagging involved of the amount to be claimed from European on the call being monies (or assets) provided in the first instance to CW by European. With respect I do not follow this argument (and that in some way this allows the defeat of creditors who have not been funded directly or indirectly by European). It may be true that European has advanced great amounts of money to CW; apparently as noted above mostly by equity since only 2 pounds sterling was shown as a debt. Others have loaned money to CW The sad result is that in liquidation there will be a substantial shortfall. Contrary to the concepts involved in a limited liability company in an unlimited liability company the shareholders are exposed to a call for the

shortfall notwithstanding whatever amount may have been subscribed and paid for as an equity investment. S. 149(2) of the Insolvency Act, 1986 (Uk) only allows for set-off in the case of an unlimited company of "any money due to" the shareholder. While this provision does raise the question of whether the frog can ever get out of the well by making a half leap every time, it is clear that money subscribed by way of equity is not money that could be considered as due to European. I do not see any basis upon which European would be able to claim equitable set-off based on the material before me. The closest one could get any linkage would be contrary to the position of the BNS - i.e. unfortunately the value of CW's assets deteriorated (or CW did not get value for its money on its original investment) so that it could be said that European did not fund it sufficiently to withstand the storm.

(c) European Insolvency

23 I have previously alluded to s. 150 of the Insolvency Act, 1986 (UK) as to the court taking into consideration in making a call "the probability that some of the contributories may partly or wholly fail to pay it" (s. 150(2)). The BNS asserts that since European is insolvent, it may fail, at least in part, to pay up on a call and therefore the claim should be assigned a nominal value. Again I think this confuses claim and recovery I do not see this as an aspect of valuing security.

Question of Related Party Having a Claim Voting

24 The BNS asserts that under CCAA, a subsidiary is not permitted to vote on a plan proposed by its parent. It cited as authority for that proposition: Re Northland Properties Ltd. (1988), 73 C.B.R. (N.S.) 166 (B.C.S.C.) at p. 170; Re Dairy Corporation of Canada Limited, [1934] O.R. 436 (C.A.) at p. 441; Re The Wellington Building Corporation Ltd., [1934] O.R. 653 (H.C.J.) as well as s. 54(3) BIA. Aside from the interplay between the BIA and CCAA as provided in s. 66 BIA, it would not seem that there is provision for a direct importation of s. 54(3) BIA into a CCAA situation. There is of course the principle of the cited cases which involves the aspect of a corporation not being able to in effect stuff the ballot boxes in its own favour. However it seems to me that when one looks at the present situation the potential for that abuse is eliminated. The Canary Administrators are in control of CW; they are appointees of the English court and not beholden to or at the beck and call of European (or other Olympia & York companies). I would presume that they were acting in the best interests of CW as determined by their own independent assessment. If inappropriately they favour one party or group, they could be called to task before the UK court.

25 In my view the claim of CW (based on its probable future call upon European as its shareholder for the shortfall) should not be put in at a nominal amount. For the practical reasons discussed before I do not think it necessary to discuss the question of $431 million as opposed to $862 million nor to get into the question of increasing the claim to $2.5 billion.

Conclusion

26 In the end result, I do not find it necessary to disturb the decision of the Claims Officer.

FARLEY J.

Index No. 7

Case Name:

Antigonish (Town) v. Antigonish (County)

Between
Town of Antigonish, appellant, and
Municipality of the County of Antigonish, respondent

[2006] N.S.J. No. 85

2006 NSCA 29

241 N.S.R. (2d) 332

19 M.P.L.R. (4th) 155

146 A.C.W.S. (3d) 555

2006 CarswellNS 89

Docket: CA 242677

Nova Scotia Court of Appeal
Halifax, Nova Scotia

T.A. Cromwell, G.B. Freeman and L.L. Oland JJ.A.

Heard: September 23, 2005.
Judgment: March 7, 2006.

(67 paras.)

Municipal law -- Municipalities -- Amalgamation or restructuring -- Dissolution -- Appeal by Town of Antigonish from the decision of the Nova Scotia Utility and Review Board amalgamating the Town and the Municipality of the County of Antigonish dismissed -- The Board had the jurisdiction to order an amalgamation regardless of whether this resulted in the creation of a regional municipality or resulted in the dissolution of the Town.

Appeal by the Town of Antigonish from the decision of the Nova Scotia Utility and Review Board determining that the amalgamation of the Town and the Municipality of the County of Antigonish

would be in the best interests of the Town and Municipality. The County of Antigonish contained three municipal entities, the Town, the Municipality and Havre Boucher Village Commission. Havre Boucher was not a municipality, but a municipal government. The Town applied to the Board for the annexation of several thousand acres of the Municipality. The Municipality subsequently applied for the amalgamation of it and the Town. The Board considered both the annexation and amalgamation applications. It determined that amalgamation would be in the best interests of the Town and Municipality. The Town argued that the Board erred in finding that it had the jurisdiction to hear an application for amalgamation. It argued that the proposed amalgamation would result in the forced creation of a regional municipality, which was beyond the Board's jurisdiction. The Town also argued that the Board considered irrelevant factors, including the existence of Havre Boucher and eligibility for equalization funding from the Province, and that a Town cannot be amalgamated with another municipality since it resulted in the dissolution of the Town.

HELD: Appeal dismissed. The Utility and Review Board Act contained a strong privative clause regarding the Board's findings of fact. However, there was no requirement of deference to decisions regarding the Board's jurisdiction and the standard of review was one of correctness. The legislative history would suggest that the Board had jurisdiction to order amalgamation. The Town's position ignored the presumption against tautology. There was no genuine conflict or inconsistency between a union of municipalities resulting from the adjudicative process under section 358 of the Municipal Government Act and one resulting from the political process under section 372. Whatever similarities the outcome of a successful amalgamation may have to a regional municipality, it was not a regional municipality. The Act allowed municipalities to be amalgamated, and the definition of municipalities included towns. The Town's argument respecting dissolution ignored the definitions in the Act. There was no conflict between the provisions of section 358 and 394 of the Act, which had different purposes. The possibility of the Havre Boucher continuing was not determinative of the Board's decision.

Statutes, Regulations and Rules Cited:

Cape Breton Regional Municipality Act, S.N.S. 1994, c. 3

Halifax Regional Municipality Act, S.N.S. 1995, c. 3, s. 217

Interpretation Act, R.S.N.S. 1989, c. 235, ss. 9(5), 9(5)(e), 9(5)(f)

Municipal Affairs Act, R.S.N.S. 1989, c. 296

Municipal Boundaries Act, S.N.S. 1964, c. 8, s. 20

Municipal Boundaries and Representation Act, S.N.S. 1982, c. 10, s. 20

Municipal Boundaries and Representation Act, R.S.N.S. 1989, c. 298, s. 20

Municipal Government Act, S.N.S. 1998, c. 18, ss. 3(ar) "municipal government", 3(aw) "municipality", 3(be) "regional municipality", 356, 357, 358, 359, 360, 361, 362, 362(2), 362(3), 363(1), 363(2), 363(3), 367, 372, 379(1), 379(2), 383, 394

Municipal Grants Act, R.S.N.S. 1989, c. 302

Queens Municipality Act, S.N.S. 1995, c. 9

Utility and Review Board Act, S.N.S. 1992, c. 11, ss. 26, 30(1)

Court Summary:

Statutory interpretation -- Municipal Government Act, S.N.S. 1998, c. 18, s. 358, 372 and 394.

Each of the Town of Antigonish and the Municipality of the County of Antigonish applied to the Nova Scotia Utility and Review Board, the Town for annexation of part of the Municipality and the Municipality for amalgamation with the Town. Both applications were made pursuant to s. 358 of the Municipal Government Act. The Board determined that it had the jurisdiction to hear the amalgamation application. After considering both the annexation and amalgamation applications, it was of the preliminary opinion that the best interests of the Town and Municipality would be served by their amalgamation.

Issue: Whether the Board erred in finding that it had the jurisdiction to hear an application for the amalgamation of the Town and the Municipality.

Result: Appeal dismissed. The existence of both s. 358 concerning amalgamations and annexations and s. 372 which deals with the creation of a regional municipality within the same Act does not amount to an internal conflict, repugnancy or inconsistency such that the presumption of coherence would apply. Each provides a distinct process for joining municipalities and only that under s. 372 results in a "regional municipality" as that term is defined in the statute. There was no evidence that the Legislature intended s. 372 to be exhaustive and to exclude s. 358, which specifically refers to amalgamations, from having any application with respect to amalgamation.

Section 394 of the Act which pertains to the dissolution of a town does not prevent the amalgamation of a town with another municipality. The Board did not exceed its jurisdiction by relying too heavily upon the possibility of the Havre Boucher Village Commission continuing to exist, nor did it speculate improperly regarding entitlement to equalization funding from the Province.

[Note: This summary does not form part of the Court's judgment. Quotations must be from the judgment, not this summary.]

Counsel:

John MacPherson, Q.C. and Jack Innes, Q.C., for the appellant

Robert Grant, Q.C. and Nancy Rubin, for the respondent

Bruce Outhouse, Q.C., for the Nova Scotia Utility and Review Board, not present

Edward Gores, Q.C., for the Attorney General of Nova Scotia, not present

Gary Cusack in person, for the Antigonish Chamber of Commerce, not present

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Held: Appeal dismissed without costs per reasons for judgment of L.L. Oland J.A.; G.B. Freeman and T.A. Cromwell JJ.A. concurring.

L.L. OLAND J.A.:--

Introduction

1 In May of 2001, the Town of Antigonish (the "Town") applied to the Nova Scotia Utility and Review Board (the "Board") for the annexation of several thousand acres of the Municipality of the County of Antigonish (the "Municipality"). Later that very same month, the Municipality applied to the Board for the amalgamation of it and the Town.

2 The public hearing before the Board took 11 days. After determining that it had the jurisdiction to hear the Municipality's amalgamation application, the Board proceeded to consider both the annexation and the amalgamation applications. Its preliminary opinion (2005 NSUARB 12), which issued in February 2005, was that the amalgamation that would be in the best interests of the Town and the Municipality. The Board indicated that after receiving the results of a plebiscite which would be held to measure the public support for an amalgamated municipal unit, it would consider all the evidence and then render its ultimate decision. The holding of the plebiscite was stayed after the Town appealed the Board's preliminary opinion.

3 The Town's appeal to this court raises a single issue, namely whether the Board erred in finding that it had the jurisdiction to hear an application for the amalgamation of the Town and the Municipality. For the reasons which follow, I am of the view that it did not so err.

Background

4 Three municipal entities lie within the boundaries of the County of Antigonish: the Town, the Municipality, and Havre Boucher Village Commission. As will be seen, the fact that all three exist was considered by the Board in determining whether it could hear the Municipality's amalgamation

application.

5 Each of the Town and the Municipality brought its application for annexation or amalgamation respectively pursuant to s. 358 of the Municipal Government Act, S.N.S. 1998, c. 18 (the Act"):

> Amalgamation or annexation
>
> Municipalities may be amalgamated or the whole or part of a municipality may be annexed to another upon application to the Board by
>
> (a) the Minister;
> (b) a municipality; or
> (c) the greater of ten percent or one hundred of the electors in the area proposed to be amalgamated or annexed. (Emphasis added)

6 Section 358 falls under Part XVI (Boundaries) of the Act. Each of the Town and the Municipality qualifies as a "municipality" as defined in its s. 3(aw):

> "Municipality" means a regional municipality, town or county or district municipality, except where the context otherwise requires or as otherwise defined in this Act;

7 Havre Boucher Village Commission is not a "municipality" as defined in the Act. It comes within the definition of a municipal government in s. 3(ar):

> 3(ar) "municipal government" means a municipal unit, village or service commission in the area to be incorporated as a regional municipality, and includes every authority, board, commission, corporation or other entity of that municipal unit, village or service commission and every joint authority, board, commission, committee or other entity involving that municipal unit, village or service commission;

8 The essence of the Town's argument on appeal is that the proposed amalgamation of the Town and the Municipality would result in the forced creation of a regional municipality, which is beyond the Board's jurisdiction. According to s. 3(be) of the Act, a "regional municipality" is a regional municipality established by or continued under the Act. The definition of that term specifically includes the Cape Breton Regional Municipality, the Halifax Regional Municipality, the Region of Queens Municipality, and the area over which each of those bodies corporate has jurisdiction.

9 The creation of a regional municipality is set out in s. 372 which falls under Part XVII (Municipal Incorporation) of the Act. That section begins:

Establishment of regional municipality

(1) The Board may, if requested by all of the councils of the municipalities in a county, undertake a study of the form of municipal government in the county to determine whether a regional municipality would be in the interests of the people of the county.

(2) Where

(a) a study of the form of municipal government in a county to determine whether a regional municipality would be in the interests of the people of the county has been undertaken, whether the study was undertaken by the Minister or otherwise prepared; and

(b) a plebiscite has taken place and its results show that a majority of the electors who voted in the plebiscite are in favour of the establishment of a regional municipality for the county,

the Governor in Council may, on the recommendation of the Minister, order that a regional municipality be established for the county.

Thus a regional municipality can only be created following the requisite approach by all the municipal councils within a county, the submission of a study, the holding of a plebiscite showing a majority of the electors in favour, the Minister of Housing and Municipal Affairs' recommendation and, even then, only if the Governor in Council should so order.

10 The Town also argues that in reaching its preliminary conclusion regarding amalgamation, the Board considered irrelevant factors, such as the existence of the Village of Havre Boucher and eligibility for equalization funding from the Province under the Municipal Grants Act, R.S.N.S. 1989, c. 302. Furthermore it submits that a town cannot be amalgamated with another municipality, since this results in the dissolution of the town contrary to s. 394 of the Act. That provision requires an application to the Board by the Minister, the town council, or ten per cent of the electors of the town.

11 The issues argued before the Board which concerned its jurisdiction to hear an amalgamation application under s. 358 of the Act were as follows:

(a) Does s. 372 which deals with the establishment of a regional municipality implicitly prohibit the amalgamation of all municipalities in a county under s. 358?

(b) Does s. 394 which deals with the dissolution of a town implicitly prohibit the amalgamation of two or more municipalities if one of them is a town?

(c) Since the Village of Havre Boucher does not necessarily cease to exist under an amalgamation order, is the form of government which results from an amalgamation under s. 358 a "regional municipality" as contemplated by section 372?

12 The Board responded to each of these issues in the negative. At para. 86 of its decision, it stated its conclusion on the issue of jurisdiction thus:

> The Board has found that the result of an amalgamation under s. 358 is that, unlike under s. 372, Havre Boucher may continue to exist. Even if this were not so, however, the Board also considers that while a similar result (i.e., combining the municipal units) may be achieved by two different avenues under the Act, that does not mean that the result should only be achieved by using one of the methods, to the exclusion of the other. The Board considers that nothing, explicit or implicit, in the legislation compels such a conclusion, nor does any principle of statutory interpretation of which it is aware. Based on the Board's conclusions on questions (a) to (c) described above, it finds that it has the jurisdiction to consider the Municipality's application to amalgamate the Municipality and the Town. (Emphasis added)

Issues

13 The core issue on this appeal, namely whether the Board erred in finding that it had the jurisdiction to hear an application for the amalgamation of the Town and the Municipality pursuant to s. 358 of the Act, requires consideration of the following:

1. To what extent should debates in the Legislature and legislative history be considered in determining the intent of the Legislature in enacting certain provisions of the Act?
2. Is the result of a s. 358 amalgamation application the creation of a regional municipality?
3. Does the Board have jurisdiction where an amalgamation would result in the dissolution of the Town contrary s. 394 of the Act?
4. Did the Board exceed its jurisdiction by considering irrelevant factors when rendering its decision?

Before addressing these matters, I must first determine the correct standard of review.

Standard of Review

14 In dealing with the question of its jurisdiction to hear the Town's amalgamation application, the Board stated:

> para. 52 ... the Board views the task before it as strictly one of statutory interpretation. As a result, the statutory framework and the applicable provisions are of primary significance. In this case, all provisions under review are contained in one statute, i.e., the Municipal Government Act.

15 According to the Town, the standard of review of the Board's decision in respect of a matter of statutory interpretation is one of correctness. In its view, Myers v. Windsor (Town), [2003] N.S.J. No. 197, 2003 NSCA 64 which concerned the Board's interpretation of a provision pertaining to amendment of land-use by-laws is a complete answer. There Hamilton, J.A. wrote:

> 16 The standard of review on appeal of a Board decision to this Court on questions of law and jurisdiction is one of correctness. Heritage Trust of Nova Scotia et al. v. Nova Scotia (Utility and Review Board), [1994] N.S.J. No. 50 (C.A.). The Board's interpretation of the legislation that confers jurisdiction on the Board is afforded no deference.

16 While the Town suggests that Myers, supra, is determinative, Canadian jurisprudence requires an analysis under the pragmatic and functional approach whenever the court conducts a judicial review of an administrative tribunal's decision: see, for example, Dr. Q. v. College of Physicians and Surgeons of British Columbia [2003] 1 S.C.R. 226 at paras. 24-35. In Creager v. Provincial Dental Board of Nova Scotia, [2005] N.S.J. No. 32, 2005 NSCA 9, Fichaud, J.A. recounted the applicable factors in assessing the appropriate level of curial deference as follows:

> para. 15 ... Under the pragmatic and functional approach, the court analyses the cumulative effect of four contextual factors: the presence, absence or wording of a privative clause or statutory appeal; the comparative expertise of the tribunal and court on the appealed issue; the purpose of the governing legislation; and the nature of the question, fact, law or mixed. From this, the court selects a standard of review of correctness, reasonableness, or patent unreasonableness. The functional and practical approach applies even when there is a statutory right of appeal: Dr. Q. v. College of Physicians and Surgeons of British Columbia, [2003] 1 S.C.R. 226, at paras. 17, 21-25, 33; Law Society of New Brunswick v. Ryan, [2003] 1 S.C.R. 247, at para. 21. The approach applies even to pure issues of law, for which the standard of review need not be correctness. The existence of the statutory right of appeal and whether the issue is one of law, are merely factors weighed with the others in the process to select the standard of review: Ryan at paras. 21, 41, 42; Dr. Q. at paras. 17, 21-26, 28-30, 33-34.

17 Thus in addition to considering the nature of the question, which I agree is one of statutory interpretation, for which the Board would be accorded scant if any deference, the other contextual factors still must be examined. The first factor concerns the presence or absence of a privative clause or statutory right of appeal. The Utility and Review Board Act, S.N.S. 1992, c. 11 (the

UARB Act) contains a strong privative clause regarding the Board's findings of fact. The finding or determination of the Board upon a question of fact within its jurisdiction is binding and conclusive (s. 26). There is no absolute privative clause, one which would shield the Board's decisions from review. Rather, an appeal lies to this court from an order of the Board upon any question as to its jurisdiction or any question of law (s. 30(1)). This suggests a more searching standard of review with respect to those questions. The subject matter of the appeal here concerns a decision of the Board as to its own jurisdiction.

18 Next to be taken into account is the expertise of the Board. The UARB Act does not set out any statutorily prescribed expert qualifications for membership on the Board. The Board is an independent quasi-judicial body which has both regulatory and adjudicative functions. The Act gives it the authority to attend to various matters concerning municipalities including, upon application, municipal boundary lines (s. 356 and s. 357) and the incorporation or dissolution (s. 383 and s. 394 respectively) of a town. Before this court it was undisputed that the Board has adjudicated several matters involving the Town and the Municipality, including ones dealing with water utilities, the Town electric utility, land use planning, and municipal electoral boundaries. Although it has not heard any amalgamation application under s. 358 or its predecessors, the Board has heard applications regarding alternation of municipal boundaries by annexation. On this appeal however the question pertains to the Board's own jurisdiction, a question outside its core area of expertise as it concerns municipalities. Relative to this court, it lacks any expertise which is superior in regard to that question.

19 The final factor to be considered is the purpose of the legislation. Greater deference is to be given where a statute's purpose requires an administrative body "to select from a range of remedial choices or administrative responses, is concerned with the protection of the public, engages policy issues, or involves the balancing of multiple sets of interests or considerations": Dr. Q., supra, at para. 31. Section 363(1) of the Act provides that the Board may order amalgamation or annexation if satisfied that the order would be in:

> ... the best interests of the inhabitants of the area, taking into account the financial and social implications of the order applied for ...

Here, however, the matter under appeal is not the final determination or even the initial determination of the applications for amalgamation and annexation. Rather, the issue is one pertaining to the Board's authority to even hear the Municipality's application. As a result, this factor does not demand deference to the Board's decision as to its jurisdiction.

20 After considering the four contextual factors of the functional and pragmatic approach, it is my view that the standard of review to be applied to the question of the Board's jurisdiction to hear an amalgamation application pursuant to s. 358 of the Act is that of correctness.

Analysis

The Board's Jurisdiction

21 In its decision at para. 254, the Board stated that it had no jurisdiction in respect to the creation of a regional municipality. The Town and the Municipality agree that, as the Board itself recognized, the Board lacks the jurisdiction to establish a regional municipality. On this appeal from the Board's decision the Town submits that, both in fact and in law, the application brought by the Municipality for amalgamation, if successful, will create just such a municipality. It says that if the Board's decision is upheld, there will be two methods by which a single government unit within a county can be established.

22 The Town's arguments are based on the fact that the Act contains two provisions which refer to amalgamation, namely s. 358 which concerns amalgamations and annexations and s. 372 which deals with the creation of a regional municipality. According to the Town, the Legislature intended the two sections to serve two distinct and separate processes. Its factum urged that:

> ... Section 372 was intended to address the difficulties which had arisen through the "forced" amalgamations in Cape Breton and Halifax and to ensure that any future regional municipalities were created on a voluntary basis with the support of all of the political units contained therein, i.e. the municipal councils (section 372(1)) as well as the electors in the county as confirmed by a plebiscite (372(2)(b)). Section 358 was intended to apply to the "usual" situation in which a municipality applies to annex a portion of a neighbouring municipality. Such annexations were not intended to lead to the creation of regional municipalities.

23 The Municipality agrees with the Town's submission that s. 372 and s. 358 were intended to serve different purposes. Where the parties differ is in their interpretation of the authority granted the Board under s. 358. The Town submits that the application of that provision is limited to the "usual" situation of annexation. The Municipality takes the position that a "plain and ordinary" reading of it confirms that the Legislature vested the Board with the authority to hear and to decide amalgamation applications.

Statutory Interpretation

24 E.A. Driedger set out the modern principle of statutory interpretation in the Construction of Statutes (2nd ed. 1983), at p. 87 as follows:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

This principle has been cited and relied upon in numerous decisions, and has been acknowledged as the preferred approach. See, for example, Rizzo & Rizzo Shoes Ltd. (Re), [1998] 1 S.C.R. 27, at 41;

Bell ExpressVu Limited Partnership v. Rex, [2002] 2 S.C.R. 559 and the cases cited at para. 26; and Bristol-Myers Squibb Co. v. Canada (Attorney General), [2005] S.C.J. No. 26 at para. 95.

25 Also to be considered is s. 9(5) of the Interpretation Act, R.S.N.S. 1989, c. 235, as amended which directs that:

> 9(5) Every enactment shall be deemed remedial and interpreted to insure the attainment of its objects by considering among other matters
>
> (a) the occasion and necessity for the enactment;
> (b) the circumstances existing at the time it was passed;
> (c) the mischief to be remedied;
> (d) the object to be attained;
> (e) the former law, including other enactments upon the same or similar subjects;
> (f) the consequences of a particular interpretation; and
> (g) the history of legislation on the subject.

I will begin by considering the extent to which the legislative history of s. 358 and s. 372 and the debates in the Legislature may be considered.

Legislative History and Debates in the Legislature

26 Professor Ruth Sullivan, Sullivan and Driedger on the Construction of Statutes, 4th ed. (Markham: Butterworths, 2002) states at p. 497 that the general tendency in the modern evolution of statutory interpretation is to move from a rule-based to a principle-based approach and further at p. 499 that:

> ... it is now well accepted that legislative history, Parliamentary debates, and similar material may be quite properly considered as long as it is relevant and reliable and is not assigned undue weight ...

See also Municipal Enterprises Ltd. v. Nova Scotia (Attorney General), [2003] N.S.J. No. 26, 2003 NSCA 10 at para. 65.

(a) Legislative History

27 The Act is the culmination of the consolidation of earlier legislation governing municipalities and the enactment of new legislation. Previous to its passage in 1998, municipalities could apply to annex portions of adjoining municipalities or to amalgamate with those municipalities under provisions first contained in the Municipal Boundaries Act, S.N.S. 1964, c. 8, s. 20 and thereafter in the Municipal Boundaries and Representation Act, R.S.N.S. 1967, c. 195, s. 18, the Municipal

Boundaries and Representation Act, S.N.S. 1982, c. 10, s. 20 and the Municipal Boundaries and Representation Act, R.S.N.S. 1989, c. 298, s. 20. These provisions were all essentially similar to s. 358 of the Act.

28 The Board noted at para. 361 that prior to the Municipality's application, neither those provisions nor s. 358 had been used for amalgamation purposes:

> While the Board occasionally receives applications for annexation, the application for amalgamation is unique in the Board's experience.

29 No legislation provided for the establishment of regional municipalities until the enactment of the Halifax Regional Municipality Act, S.N.S. 1995, c. 3, s. 217; the Cape Breton Regional Municipality Act, S.N.S. 1994, c. 3; and the Queens Municipality Act, S.N.S. 1995, c. 9. Those statutes created regional municipalities in each of those counties. They also dissolved the towns contained within those regional municipalities.

30 The passage of the Act in 1998 effected a major consolidation of the legislation with respect to municipal governments. The Act repealed 19 statutes and amended many others (see s. 545-583 of the Act). The legislation that was repealed included the Municipal Affairs Act, R.S.N.S. 1989, c. 296, the Municipal Boundaries and Representation Act, supra, the Halifax Regional Municipality Act, supra, the Cape Breton Regional Municipality Act, supra, and the Queens Municipality Act, supra. Section 372 on the creation of regional municipalities first appeared in the Act.

31 It is noteworthy that the predecessor of s. 358 as contained in the Municipal Boundaries and Representation Act, supra, did not disappear when the Act was passed by the Legislature. Rather, that provision was transposed to Part XV1 (Boundaries) of the Act as s. 358. It continued to refer to amalgamations as well as to annexations. Moreover, although somewhat modified, the provisions which set out the procedures to be followed regarding preliminary orders for amalgamations or annexations (now s. 359-362), were incorporated in the Act. Indeed, in some instances such as ss. 362(2)(3) [required studies] and s. 367 [effect of annexation or amalgamation "unless the Board otherwise orders"], the Board's powers were increased.

32 In my view, the legislative history would suggest a reaffirmation of the Board's jurisdiction to order amalgamation pursuant to s. 358.

(b) Legislative Debates

33 In support of its submission that the legislative intent behind s. 372 on the creation of regional municipalities was to remedy the "mischief" of forced amalgamations, the Town urged that certain excerpts from Hansard, regarding comments made during the debates in the legislature when the Act was introduced, were relevant and should be considered. To that end, it filed an appeal book volume containing those extracts.

34 Much of the material sought to be introduced did not consist of statements or accompanying text supplied by the minister introducing or defending the Act in the Legislature, which can be helpful in establishing legislative intent. Rather, they were statements or comments made by members of the opposition who criticized the lack of consultation prior to the formation of the Cape Breton and Halifax Regional Municipalities. The minister did not say anything which would even suggest that the Act was intended as a response to those criticisms. Furthermore, it is significant that none of the remarks directly address the question of whether or not s. 372 which deals with the creation of regional municipalities, was intended to displace or to be paramount over s. 358 which concerns amalgamations and annexations.

35 In my view, the material the Town sought to be introduced does not satisfy the threshold tests of relevance and reliability. Accordingly the volume of Hansard extracts will not be considered in the search for legislative intent.

Whether s. 358 Amalgamation Order Creates a Regional Municipality

36 According to the Town, the Board erred in determining that the combining of municipal units "may be achieved by two different avenues under the Act ..." It says that s. 358 is limited to annexations and argues that both in fact and in law, the application for amalgamation under that provision, if successful, will create a regional municipality. The Town added that the evidence before the Board supports the conclusion that the Municipality seeks the establishment of a single regional municipal in the County of Antigonish. At para. 252 of its decision the Board noted that the Warden of the Municipality suggested that "amalgamation could be the first step on the path to regional government." In addition, the Chair of the Havre Boucher Village Commission advised that if the Board should decide to order the amalgamation of the Municipality and the Town:

> ... the Village of Havre Boucher intend to request that it be included in the amalgamation so that the resulting municipality would qualify as a Regional Municipality.

37 For convenience, I set out again s. 358 and s. 372 of the Act:

> Amalgamation or annexation
>
> 358 Municipalities may be amalgamated or the whole or part of a municipality may be annexed to another upon application to the Board by
>
> (a) the Minister;
> (b) a municipality; or
> (c) the greater of ten percent or one hundred of the electors in the area proposed to be amalgamated or annexed.

> Establishment of regional municipality
>
> 372(1) The Board may, if requested by all of the councils of the municipalities in a county, undertake a study of the form of municipal government in the county to determine whether a regional municipality would be in the interests of the people of the county.
>
> (2) Where
>
> (a) a study of the form of municipal government in a county to determine whether a regional municipality would be in the interests of the people of the county has been undertaken, whether the study was undertaken by the Minister or otherwise prepared; and
> (b) a plebiscite has taken place and its results show that a majority of the electors who voted in the plebiscite are in favour of the establishment of a regional municipality for the county,
>
> the Governor in Council may, on the recommendation of the Minister, order that a regional municipality be established for the county.

38 Section 358 respecting amalgamations and annexations is followed by various provisions dealing with the application and hearing process. For example, s. 359 sets out the contents of an application for a preliminary order, s. 360 details the notification to be given of the hearing before the Board, s. 361 lists the persons who are to be heard, s. 362 deals with any preliminary order the Board may make, and s. 363(2) the contents of an order. All these provisions, either directly or indirectly, refer to applications or orders for amalgamations and annexations. Section 372, respecting the creation of a regional municipality, is also accompanied by provisions dealing with the application and the process. Those provisions include ones dealing with the transition to a regional municipality.

39 Statutory interpretation uses certain rules to guide what may be examined to determine legislative intent and meaning. For example, the analysis may include the application of the "presumption against tautology" which Professor Sullivan in Sullivan and Driedger on the Construction of Statutes, supra, described thus at p. 159:

> ... every word and provision found in a statute is supposed to have a meaning and a function. For this reason courts should avoid, as much as possible, adopting

> interpretations that would render any portion of a statute meaningless or pointless or redundant.

She also notes that this presumption applies not only to individual words and phrases but also to paragraphs and sections.

40 The Town's position that s. 358 is limited to annexations ignores the express references to amalgamations in that provision and in the procedural provisions which follow. It consequently ignores the presumption against tautology.

41 The foundation for the Town's arguments is another principle of statutory interpretation, that known as the "presumption of coherence." It provides that the various sections of a statute should and must be read together in a coherent fashion, each portion serving a particular purpose. The Town submits that the Board erred in failing to consider this presumption.

42 Professor Sullivan explained the governing principle underlying the presumption of coherence thus at pp. 262-263:

> It is presumed that the provisions of legislation are meant to work together, both logically and teleologically, as parts of a functioning whole. The parts are presumed to fit together logically to form a rational, internally consistent framework; and because the framework has a purpose the parts are also presumed to work together dynamically, each contributing something toward accomplishing the intended goal.
>
> The presumption of coherence is also expressed as a presumption against internal conflict. It is presumed that the body of legislation enacted by a legislature does not contain contradictions or inconsistencies, that each provision is capable of operating without coming into conflict with any other. As LaForest J. wrote in Friends of Oldman River Society v. Canada (Minister of Transport) [[1992] 1 S.C.R. 3, at p. 38]:
>
>> ... there is a presumption that the legislature did not intend to make or empower the making of contradictory enactments ...

43 The question becomes whether the existence of both sections 358 and 372 within the Act amounts to an internal conflict, repugnancy or inconsistency. In Toronto Railway Co. v. Paget (1909), 42 S.C.R. 488, at 499, Anglin, J. stated that:

> It is not enough to exclude the application of the general Act that it deals somewhat differently with the same subject-matter. It is not "inconsistent" unless

> the two provisions cannot stand together.

If they can "stand together and both operate without either interfering with the other," there is no irreconcilable inconsistency or conflict: Tabernacle Permanent Building Society v. Knight, [1892] A.C. 298, at 302 (H.L.).

44 The Act provides for two distinct processes in respect to the joining of municipalities. One, that under s. 358, is essentially adjudicative in nature. Under it, municipalities may apply to the Board for a hearing to determine whether amalgamation would be "in the best interests of the inhabitants of the affected area" (s. 363(1)). The second, under s. 372, is heavily political in nature. Under that process, the Minister must recommend to the Governor in Council the creation of a regional municipality and it is the Governor in Council which determines whether one will be formed. The consent of the municipalities involved and the support of the electors in the area, as expressed through a plebiscite, are also required.

45 In my opinion, there is no genuine conflict or inconsistency between a union of municipalities resulting from the "adjudicative" process under s. 358 and one resulting from the "political" process under s. 372.

46 According to the Town, a successful s. 358 amalgamation application would result in a regional municipality; consequently, the Board would have exceeded its jurisdiction. It says that if any form of amalgamation is authorized under s. 358, it would be that of one municipality with any other municipality or municipalities, but not all the municipalities in a county. The last would result in a single municipal unit with authority over the entire county. That, the Town submits, is a regional municipality and the only way to create that entity is through s. 372 which calls for a political process entirely removed from the Board.

47 The difficulty with this argument is that the two provisions have different objectives and concern different aspects of municipal amalgamation. By definition, s. 358 cannot be used to create a regional municipality. An order pursuant to that provision does not result in a "regional municipality" as that term is defined in the Act. It is s. 372 that must be used to create such a municipality. Quite simply, whatever similarities the outcome of a successful s. 358 application for amalgamation may have to a regional municipality, it is not a regional municipality. Moreover, it is not recognized as a regional municipality. As will be seen in the passage later in this decision dealing with equalization grants, there are practical implications which depend on whether the amalgamated entity was formed under s. 358 or s. 372.

48 In my respectful opinion, the situation here is not one to which the internal coherence principle applies. The provisions do not conflict and they are not inconsistent with one another. What they do, is overlap. Each sets out a method whereby municipalities may seek to be combined. Professor Sullivan states at p. 264:

> When two provisions are applicable without conflict to the same facts, it is

> presumed that each is meant to operate fully according to its terms. So long as overlapping provisions can apply, it is presumed that they are meant to apply. The only issue for the court is whether the presumption is rebutted by evidence that one of the provisions was intended to provide an exhaustive declaration of the applicable law.

49 There was no evidence before the Board or the court that s. 372, which deals with the creation of regional municipalities, was intended to be exhaustive. Both it and s. 358 contemplate the merger of two or more municipalities. Nothing in the wording of s. 358 suggests that amalgamations, pursuant to its terms, were to be limited as the Town urges. Furthermore, a plain reading of s. 372 does not disclose any prohibition against an amalgamation of all the municipalities in a county pursuant to s. 358. I am not persuaded that s. 372, which pertains to regional municipalities, was intended to exclude s. 358, which specifically refers to amalgamations, from having any application or a restricted application with respect to amalgamations.

50 In my view, the Board did not err in failing to rely upon the presumption of coherence or in determining that the Act allows for the combining of municipal units by two different methods.

Dissolution of the Town

51 Section 394 of the Act provides:

> A town may be dissolved upon application to the Board by
>
> (a) the Minister;
> (b) the council of the town; or
> (c) ten percent of the electors of the town.

The Town argues that a town cannot be amalgamated with another municipality, since this would result in its dissolution contrary to s. 394, which it maintains is the sole method for the dissolution of a town.

52 An amalgamation does result in the loss of the identities of the amalgamating entities and their continuation as a new one. In MacPump Developments Ltd. v. Sarnia (City) (1994), 20 O.R. (3d) 755, the Ontario Court of Appeal stated:

> [38] The word "amalgamation" does not admit of a single meaning. Used in the corporate law context, an amalgamation may extinguish old entities and create new entities in their place, or it may blend those pre-existing entities and continue them under the auspices of the new amalgamated entity. The effect of a particular amalgamation depends on the purpose the amalgamation is intended to promote as discerned by an examination of the agreement or statute bringing about the amalgamation: R. v. Black & Decker Manufacturing Co., [1975] 1

> S.C.R. 411; 1 N.R. 299, at pp. 416-418; Witco Chemical Co. v. Oakville (Town), [1975] 1 S.C.R. 273; 1 N.R. 453, at pp. 281-283. In my view, the same assessment must be made where amalgamation occurs in the municipal law context: Municipal Act, R.S.O. 1990, c. M-45; s. 7, Interpretation Act, R.S.O. 1990, c. I-11, s. 27(a).
>
> [39] In pursuing the purpose underlying the statutory amalgamation of two former municipalities, it is important to focus on the overall thrust of the relevant legislation rather than on isolated words in specific provisions. When I read the Sarnia-Lambton Act as a whole and, in particular, those provisions specifically relating to the amalgamation of Old Sarnia and Clearwater, I am satisfied that it was intended that the two former municipalities should be rolled into one and continued as a single undertaking. In the language of Dickson, J., in Black and Decker, supra, at p. 421, "the end result is to coalesce to create a homogeneous whole." Or to use the words of Kelly, J.A., in Stanward Corp. v. Denison Mines Ltd., [1966] 2 O.R. 585 (C.A.), at p. 592, the legislative intent was "to provide that what were hitherto two shall continue as one."

See also Rogers, The Law of Canadian Municipal Corporations, Vol. 1 (Toronto: Carswell, 2003) which states at p. 71:

> ... An "amalgamation" has been defined as a fusion of two or more legal entities into a continued new union with the obligations, by-laws and assets of the former municipalities ...

53 I am, however, not convinced that because the proposed amalgamation will result in the dissolution of the Town, the Board exceeded its jurisdiction by considering the Municipality's amalgamation application.

54 After all, s. 358 begins "Municipalities may be amalgamated ..." and, as set out earlier, the term "municipality" is defined at s. 3(aw) to "mean ... a town." The Town's argument that s. 394 prevents amalgamations involving towns completely fails to acknowledge or to apply the statutory definition to the term "municipality" as established by the Legislature in the Act.

55 As to the Town's submission that there is no precedent for the dissolution of a town being brought about by the amalgamation application made pursuant to s. 358 this, of course, is nothing more than the natural consequence of the fact that the Municipality's application for amalgamation is apparently the first under that provision.

56 The Town then argues that the matter falls under the principle of construction that, within a statute, special provisions prevail over general ones. It says that consequently, s. 358 which deals with amalgamations should give way to s. 394 which deals with the dissolution of a town. Professor

Sullivan set out the principle thus at p. 273:

> Implied exception (generalia specialibus non derogant). When two provisions are in conflict and one of them deals specifically with the matter in question while the other is of more general application, the conflict may be avoided by applying the specific provision to the exclusion of the more general one. The specific prevails over the general; it does not matter which was enacted first.

57 In my view, there is no conflict such as that put forward by the Town. Sections 358 and 394 have different purposes. The purpose of the former is to permit the Board to hear applications for the amalgamation or annexation of municipalities. The purpose of the latter is to permit it to hear applications for the dissolution of a town. As discussed earlier, an amalgamation results in the loss of the identities of the amalgamating entities and their continuation as a new one. Again, a conflict arises only if one refuses to ascribe to the term "amalgamation" in s. 358 its plain and ordinary meaning and refuses or fails to apply the statutory definition given to the term "municipality."

58 In the result, I am not satisfied that the Board exceeded its jurisdiction because a s. 358 amalgamation would result in the dissolution of the Town.

Irrelevant Factors

59 According to the Town, the Board considered irrelevant factors in reaching its preliminary conclusion that amalgamation, rather than annexation, was in the best interests of the inhabitants of the area and thus exceeded its jurisdiction. In particular, the Town says that the Board took into account the existence of the Village of Havre Boucher, and eligibility for equalization funding under the Municipal Grants Act, supra. I will address each in turn.

(a) The Village of Havre Boucher

60 In order to appreciate the Town's argument regarding the Village, it would be helpful to set out the effect of the incorporation of a regional municipality and an order for the amalgamation of all municipalities in a county as it pertains to the Village. In the former situation, the "municipal governments" in the area to be incorporated as a regional municipality are dissolved and their assets and liabilities are vested in the regional municipality (s. 379(1) and (2) of the Act). Since Havre Boucher Village Commission comprises a "municipal government" under s. 3(ar) of the Act, it would be automatically dissolved following the establishment of a regional municipality.

61 However, an amalgamation does not have the same effect. In that situation, the Board would have the discretion to determine whether the Village Commission should be dissolved or affected in any another way. Section 363(3) which relates to orders for amalgamation and annexation provides that:

> 363(3) An order of the Board may

> (a) adjust assets and liabilities among those affected by the order as the Board considers fair;
> (b) annex, amalgamate, continue or dissolve boards, commissions, villages and service commissions and allocate their assets as the Board considers fair; and
> (c) require compensating grants for a period of not more than five years from a benefiting municipality to a municipality that loses assessment as a result of an order. (Emphasis added)

62 The Town takes the position that the Board relied heavily upon the continued existence of the Village of Havre Boucher in deciding that it had jurisdiction to consider amalgamation, when that was an irrelevant factor. It points to the following passage in its decision:

> para. 68 Thus, an amalgamated municipal structure clearly falls outside the scope of a regional municipality as contemplated in s. 379(1), since the Village Commission, a "municipal government" as defined in s. 3(ar), does not automatically collapse into a new amalgamated municipal unit. Upon the creation of a regional municipality, a village commission is automatically dissolved, without exception, and its assets and liabilities are assumed by the new municipal entity (s. 379). There is no discretion to do otherwise in the case of a regional municipality. Thus, in the opinion of the Board, the existence of the Havre Boucher Village Commission, and the conflicting operation of ss. 363(3)(b) and 379, prove fatal to the Town's argument. (Emphasis added)

63 However, it is clear from its decision that, in the Board's assessment, the possibility of the Village Commission's continuing existence was nowhere near determinative. It stated that even if that were not the case, its decision would have been the same. At para. 86, the last and summary paragraph of its consideration of the jurisdiction issue, the Board wrote:

> The Board has found that the result of an amalgamation under s. 358 is that, unlike under s. 372, Havre Boucher may continue to exist. Even if this were not so, however, the Board also considers that while a similar result (i.e., combining the municipal units) may be achieved by two different avenues under the Act, that does not mean that the result should only be achieved by using one of the methods, to the exclusion of the other. The Board considers that nothing, explicit or implicit, in the legislation compels such a conclusion, nor does any principle of statutory interpretation of which it is aware ... (Emphasis added)

64 The Board did not rely upon the existence of the Village Commission, as urged by the Town, in making its determination.

(b) Equalization Funding

65 The second irrelevant factor the Town claims the Board considered in rendering its decision, relates to entitlement to equalization grants under the Municipal Grants Act, supra. At para. 70 of its decision, the Board stated:

> In addition to the impact upon village commissions, the Board notes a second clear distinction between the proposed amalgamated unit and a regional municipality, which relates to the resulting unit's eligibility for equalization funding under the Municipal Grants Act, R.S.N.S. 1989, c. 302. While a regional municipality clearly qualifies for funding as a Class 1 entity under s. 9(1)(a) of the Act, it appears that an amalgamated body comprising all municipalities within a county would not automatically attract similar treatment. Using the example cited above, the Municipality of the County of Victoria (which comprises the only municipality within Victoria County) is designated as a Class II municipality under the Municipal Grants Act, s. 9(1)(b). A different funding formula applies to a county municipality. While the issue of equalization could be a topic of discussion between provincial and municipal officials in the event of amalgamation ... it appears doubtful that an amalgamated unit would be treated in like fashion to a regional municipality under the present legislative structure for equalization funding. (Emphasis added)

66 This was not, as the Town submits, improper speculation on the part of the Board as to the level of funding which a new amalgamated entity might receive nor inappropriate reliance on the provisions of the Municipal Grants Act, supra to determine its jurisdiction to consider an application for amalgamation under s. 358 of the Act. The Town was arguing before the Board that the Municipality's amalgamation application would result in a regional municipality. Parts XVI and XVII of the Act and the provisions of the Municipal Grants Act could be argued as indications that the Legislature intended to treat "regional municipalities" as special entities in certain respects. Moreover, s. 9(5)(e) and (f) of the Interpretation Act, supra requires consideration of "the consequences of a particular interpretation." Taking these factors in combination into account, I am not persuaded by the Town's argument that the Board erred in considering the Municipal Grants Act and funding availability.

Disposition

67 The standard of review of the Board's decision in respect to its jurisdiction to hear an application pursuant to s. 358 of the Act is that of correctness. Not having been persuaded that it erred in finding that it had such jurisdiction, I would dismiss the appeal. This being an appeal of a tribunal decision, there will be no award of costs.

L.L. OLAND J.A.
Concurred in:

G.B. FREEMAN J.A.
T.A. CROMWELL J.A.

cp/e/qw/qlmxf/qljxl/qlsxs

Index No. 8

Nova Scotia Statutes
Interpretation Act
Rules of Construction
s 9.

Nova Scotia Current to Gazette Vol. 36:12 (June 15, 2012)

9.
9(1) Law always speaking
The law shall be considered as always speaking and, whenever any matter or thing is expressed in the present tense, it shall be applied to the circumstances as they arise, so that effect may be given to each enactment, and every part thereof, according to its spirit, true intent, and meaning.

9(2) Expression of time
"Now", **"next"**, **"heretofore"** or **"hereafter"** in an enactment refer to the time when the enactment comes into force.

9(3) "shall" or "may"
In an enactment,
"shall" is imperative and **"may"** is permissive.

9(4) "herein"
"Herein" used in a Section or provision of an enactment relates to the whole enactment and not to that Section or provision only.

9(5) Interpretation of enactment
Every enactment shall be deemed remedial and interpreted to insure the attainment of its objects by considering among other matters

(a) the occasion and necessity for the enactment;
(b) the circumstances existing at the time it was passed;
(c) the mischief to be remedied;
(d) the object to be attained;
(e) the former law, including other enactments upon the same or similar subjects;
(f) the consequences of a particular interpretation; and
(g) the history of legislation on the subject.

9(6) Reference to Sovereign
Where in an enactment the Sovereign is referred to or a person, body, office, officer, place, property, article or thing is described or qualified by words descriptive of the Sovereign, the reference or words shall be read as if written in the masculine gender when the Sovereign is male and as if written in the female gender when the Sovereign is female.

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Index No. 9

Friday 15th October, 1999

In the Matter of Glen Express Limited v

No. 7270 of 1998

High Court of Justice Chancery Division

Mr. Justice Neuberger

Representation

- Miss R. Ismail (instructed by Messrs. Kingsford Stacey) appeared on behalf of the Applicant.
- Mr. S. Prentis (instructed by Messrs. Eyton Morris Winfield, Northampton) appeared on behalf of the First Respondent.
- Mr. R. Reed (instructed by Messrs. Butcher Burns) appeared on behalf of the Second and Third Respondents.

JUDGMENT

MR. JUSTICE NEUBERGER:

This is an application by the liquidator on Glen Express Ltd. ("the company"), against Mr. Ronald Peiris, a former director of the company, for payment of just under £100,000 on the basis that that sum was due on the directors' loan account of the company at the time it went into liquidation pursuant to a resolution made on 29th May last year.

There were three issues, one of which has been conceded. The first issue was whether Mr. Peiris was liable for this money, subject to this case on the other two issues. That point has been conceded by Mr. Peiris and I say no more about it. The second issue is whether the liquidator has established the precise sum said to be owing. In relation to that issue it seems to me that the liquidator has to establish his case on the balance of probabilities, and, applying that test, I am easily satisfied that this sum was owing. It is undisputed that as at 30th September, 1997, the balance on the directors' loan account was £62,729. The basis for contending that a larger sum is now due is that, since that time, the company's own records of movements in its nominal ledger up to 6th April, 1998, showed that there was slightly more (some £3,000) owing to the company on Mr. Peiris's loan account nine days before 29th May 1998. Mr. Peiris has not called any oral evidence or produced any documents, and although he has given evidence, he has not challenged the amount claimed. I am quite satisfied that subject to his argument on the third issue, to which I now turn, Mr. Peiris is liable for this sum.

Mr. Peiris's third argument is that he had a right of set-off such that the whole of his liability for the sum of just under £100,000 is extinguished. The right of set-off arises out of Rule 4.90 of the Insolvency Rules 1986, which provides: "(1)This Rule applies where, before the company goes into liquidation there have been mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company providing or claiming to prove for a debt in the liquidation. "(2)An account shall be taken of what is due from each party to the other in respect of the mutual dealings, and the sums due from one party shall be set off against the sums due from the other."(3)Sums due from the company to another party shall not be included in the account take under paragraph (2) if that other party had notice at the time they became due that a meeting of creditors had been summoned under section 98 or (as the case may be) a petition for the winding up of the company was pending."(4)Only the balance (if any) of the account is provable in the

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liquidation. Alternatively (as the case may be) the amount shall be paid to the liquidator as part of the assets". The effect of that rule was considered authoritatively by the House of Lords in Stein v. Blake [1996] 1 AC 243. In his speech, with which the other members of the House of Lords agreed, Lord Hoffmann also considered the duty of the liquidator to estimate the value of certain debts pursuant to Rule 4.86, which provides: "(1)The liquidator shall estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value; and he may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him.He shall inform the creditor as to his estimate and any revision of it."(2)Where the value of a debt is estimated under this Rule, or by the court under section 168(3) or (5), the amount provable in the winding up in the case of that debt is that of the estimate for the time being".The effect of the decision in Stein v. Blakeis that, in insolvency, set-off (a) is mandatory, (b) is pound for pound, (c) is self-executing, (d) operates from the date of insolvency, (e) is to be operated with the benefit of hindsight, so that contingencies which have matured after that date can be properly taken into account and (f) is not dependent on proofs of debt being lodged.

The basis for Mr. Peiris's claim that he has a valid set-off in respect of the whole of the sum claimed arises from the fact that the company borrowed money from the Bank of Ceylon ("the bank"), and Mr. Peiris guaranteed the company's liability to the bank in respect of this account and, indeed, provided security for his guarantee. At the time the company went into liquidation the bank was owed, it would appear, some £170,000 for which it lodged a proof of debt in the normal form, recording that it had the benefit of a guarantee from Mr. Peiris and that it had the benefit of security of three properties which he owned to support the guarantee.

Mr. Peiris has not paid the bank pursuant to his guarantee, nor has he yielded any of the properties secured to the bank in respect of any of the money due from the company to the bank. I have a copy of a letter dated 18th October, 1999, to Mr. Peiris from the bank stating that if he does not pay the amount due to the bank by the end of October 1999, i.e. in some ten days time, the bank "will be compelled to initiate legal action to recover the dues". Apart from the money it claims from Mr. Peiris, the company appears to have no significant assets whatever, according to the evidence of the liquidator.

In those circumstances Mr. Peiris's case is as follows. First, it is clear that the bank will look to him for the payment of the whole of the £170,000. Secondly, he will have to pay the bank the whole of that sum or a substantial proportion. Thirdly, by paying to the bank the sum of £170,000 or thereabouts, he will be subrogated as guarantor of the company's liability to the bank and become a creditor of the company. Fourthly, as a result, he will have a claim against the company which significantly exceeds the claim which the company has against him. Fifthly, in those circumstances the rule of set-off would apply (see Rule 4.90 and Stein v. Blake). Sixthly, in these circumstances, both as a matter of law and as a matter of common sense, he is clearly a contingent creditor of the company. Seventhly, his contingent claim is virtually the whole of the £170,000. Eighthly, he should accordingly be exonerated from liability by the rules of set-off. Ninthly, it would be ridiculous, and unfair if the fact that he has not paid the bank the sums which he is undoubtedly going to have to pay means that he has no right of set-off whatever, whereas if he had paid the bank, at any rate by 28th May 1998, he would undoubtedly have a right of set-off.

On the face of it and viewed from Mr. Peiris's angle, that argument looks, as a matter of principle and commercial reality, formidable. However, the point that is made by Miss Roxanne Ismail, who appears on behalf of the liquidator, is that it is well established that, subject to what the 1986 Insolv-

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ency legislation expressly provides, there is a fundamental and overriding principle, namely the rule against double proof. In particular, she says that that rule serves to prevent a guarantor, who has not paid off the creditor of the company, being treated as somebody who is entitled to proof. In other words, only once the guarantor has paid is he entitled to proof. She contends that that submission is supported by the unanimous decision of the Court of Appealin In re Fenton [1931] 1 Ch 85. Consideration of the judgments in that case show different members of the Court of Appeal putting forward somewhat different reasons for their conclusion, but they all appear to me to be agreed on one particular reason, namely the reason against double proof. In his judgment, Lord Hanworth, Master of the Rolls, said at p.109:

"There is another rule which is well founded in bankruptcy, the rule against a double proof. The substance of it is expressed by Mellish L.J. in In re Oriental Commercial Bank (1): 'the true principle is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts'. Now the debt in respect of which the set-off is claimed is the debt in respect of which the banks have a right of proof against the Association. They have a right under s.65 and the rules to come in an tender a proof at any time before a dividend is declared an to be admitted to prove, subject to certain limits imposed by the rules. If two of the banks have not yet exercised their full rights of proof, that is because there appears to be nothing for the unsecured creditors to receive, but their right of proof exists. If the trustee of Fenton's estate were allowed to set off the debt due to the banks which Fenton guaranteed, he would exercise that right in respect of the same debt for which the largest creditor bank has already proved, and the other two can prove. It would in effect be a double proof. But it would be more: it would be an allowance to Fenton's estate in full of a debt due to another which Fenton has not paid himself; with the result that Fenton's general creditors would benefit to the extent of the debt which is primarily due from the Association to the banks. The rule, therefore, against double proof also prevents Fenton's trustee from setting off this liability of Fenton's to the banks which has not crystallized into a debt due to Fenton". Lawrence L.J. said at p.114:

"The reason why, in my opinion, such a claim … cannot be set off is because so long as the estate of the principal debtor remains liable to the principal creditor the surety will not be permitted to prove against the estate of the principal debtor, as such a proof would be a double proof for the same debt, and would therefore be inadmissible as being contrary to the established rule in bankruptcy". In a pithy observation Romer L.J. said to much the same effect at p.120:

"The only reason why Fenton is prevented from proving his claim is that his claim is in respect of the same debt as is that of the banks, and as between him and the banks the latter have the prior right of proof".

Mr. Peiris's argument falls foul of that principle, unless he can in some way get round it. Two arguments have been put forward on his behalf by Mr. Sebastian Prentis. The first is that the rule against double proof cannot, at least in circumstances such as the present, survive the clear code in the 1986 Insolvency legislation and especially Rule 4.90 which has been so fully considered by Lord Hoffmann. In my judgment there is nothing in the reasoning and nothing that necessarily flows from the reasoning of Lord Hoffmann in Stein v. Blaketo lead to the conclusion that In re Fentonis no longer good law. Stein v. Blakewas not concerned in, and did not in any way involve, the rule against double proof.

I am fortified in that conclusion by two text books. The first is **Set Off** by Rory Dereham, second edition, 1996, where he considers the principles relating to double proof at p.226–230 and cites Re Fenton as still being good law (see for instance at p.229 note 38 and p.227 note 22). Even more

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tellingly, **Rowlatt on Principle and Surety**, fifth edition, 1999, considers in some detail, and summarises, the effect of Stein v. Blake in paragraph 11–20 and then turns to say this at paragraph 11–21:

“Where the surety has made no actual payment to the creditor, he cannot set-off his contingent liability as at the relevant date against debts due to the principal. This is despite the fact that the surety' debt arises out of mutual dealings and is otherwise a provable debt. This was decided by Re Fenton on the basis that such set-off would infringe the rule against double proof since it was always open to the creditor to prove”. Despite the identity of the editors of **Rowlatt on Principle and Surety**, it is possible that that passage could be per incuriam, but I have reached the conclusion that the rule against double proof remains good law. It is an overarching principle which still applies to insolvency, and nothing in Stein v. Blake calls it into question.

The second argument raised by Mr. Prentis is that the provisions of rule 4.86 of the Insolvency Rules should apply not merely to valuing Mr. Peiris's claim as a contingent creditor liable under the guarantee, but to the bank's claim. He says that the bank's debt should not be treated as valued at £170,000, as one would have thought it should at first sight, but, because the bank has the benefit of a guarantee supported by security**** that debt, and I quote from rule 486(1):

“By reason of its being subject to any contingency or for any other reason does not bear a certain value”. Mr. Prentis says that the value of £170,000, which one would prima facie ascribe to the debt, should be scaled down to take into account the fact that it is in practice secured, albeit that he does not pretend that vis-a-vis the company the bank can be treated as a secured creditor — quite rightly, in the light of the way in which s.248 of the Insolvency Act 1986 is worded.

Ingenious though that argument is, and although it may have obvious attraction to a person in Mr. Peiris's unfortunate position, I cannot accept that argument either. First of all, it does not seem to me to give the natural meaning to the words:

“The value of any debt which by reason of its being subject to any contingency or for any other reason does not bear a certain value”. Secondly, it appears to me to be impractical in its effect. As Miss Ismail points out, it would involve a liquidator in a case such as this having to investigate the value of Mr. Peiris's covenant and the value of the property he has provided by way of security. Investigations as to Mr. Peiris's solvency and otherwise may be relatively easy in his particular case, but one can easily imagine many circumstances in which they would be burdensome and difficult or even impossible. Thirdly, it appears to me that valuing a debt in this way could often involve the value of the debt as against the company depending on the solvency of the company. The more solvent the company, the greater the value of the debt. That itself seems to have a commercially unattractive and illogical circularity about it. If the creditor would normally expect to receive 3p in the pound, the debt on Mr. Prentis's argument would be scaled down very substantially so he would only receive a tiny proportion, whereas if the company was solvent the debt may well be valued at a great deal more than if it was insolvent. That seems to me a curious result.

Accordingly, I must reject the contentions put forward on behalf of Mr. Peiris. While I do have some sympathy with his argument of unfairness, it does seem to me that that sympathy should be limited. He was the person controlling the company. He could have ensured that the Bank was paid off on or before 28th May 1988 before the company was put into liquidation. Wisdom of hindsight is a fine thing, but it does seem to me that he could have protected himself. Unfortunately for him, he did not do so. In these circumstances I conclude that the claim brought by the liquidator against Mr. Peiris succeeds in full.

MISS ISMAIL: My Lord, I have got a straightforward application for costs then.

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MR. PRENTIS: Which, in a straightforward manner, I cannot resist.

MR. JUSTICE NEUBERGER: I do not think you can, no. Thank you very much. If I am going to assess costs in one I should assess costs in the other.

MISS ISMAIL: My Lord, that is what I was going to ask. I do not have a schedule either.

MR. JUSTICE NEUBERGER: Perhaps you would all liaise.

MISS ISMAIL: We can all liaise.

MR. JUSTICE NEUBERGER: Fine. Thank you very much.
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Index No. 10

ICLR: Probate/Family/1963/STEAMSHIP ENTERPRISES OF PANAMA INC., LIVERPOOL (OWNERS) v. OUSEL (OWNERS) AND OTHERS. THE LIVERPOOL (No. 2). - [1963] P. 64

[1963] P. 64

[COURT OF APPEAL]

STEAMSHIP ENTERPRISES OF PANAMA INC., LIVERPOOL (OWNERS) v. OUSEL (OWNERS) AND OTHERS. THE LIVERPOOL (No. 2).

1959 Nov. 17, 18, 19; Dec, 7, 8, 9, 10, 11, 21.

Lord Merriman P.

1960 July 28.

Hodson, Ormerod and Harman L.JJ.

Shipping - Limitation of liability - Double proof - Claim of harbour authority for expenses of wreck-raising - Claim of owner of sunk vessel in respect of contingent claim by harbour authority for wreckraising expenses under powers contained in private Act - Mersey Docks and Harbour Board Act, 1954 (2 & 3 Eliz. 2, c. xlv), s. 3.

Ships' Names - The Liverpool.

Double proof, rule against - Applicability - Debts arising out of tort or under statute - Limitation action - Claims by harbour board under statute against wreck and by wreck in tort against colliding vessel.

On January 8, 1957, the Ousel was sunk in the Port of Liverpool as a result of a collision with the *Liverpool*, whose owners admitted liability for the collision. On the same day the Mersey Docks and Harbour Board gave notice to the owners of the *Ousel* that the board had taken possession of the *Ousel* under powers contained in the Mersey Docks and Harbour Board Act, 1954, and that after raising, removing or destroying her they would sell any property recovered for the purposes of defraying their expenses. They also gave notice that if their expenses exceeded the proceeds of sale

they would claim the difference from the owners of the *Ousel* up to the limit of her liability under the Merchant Shipping Acts, 1894-1954.

The *Liverpool* obtained a decree under the Merchant Shipping Acts, 1894-1954, limiting her liability in respect of the collision. Among the claims made against the fund were a claim by the owners of certain cargo in the *Ousel*, a claim by the Mersey Docks and Harbour Board for expenses incurred and damage sustained in clearing the River Mersey of the wreck of the *Ousel*, and a claim by the owners of the *Ousel*, which included an (item 22)) in respect of "Mersey Docks and Harbour Board. Contingent claim of board in respect of wreck raising expenses, viz., statutory limit of *Ousel*." It was not disputed that the board's claim against the fund covered to some extent the same ground as the subject-matter of the board's statutory claim against the *Ousel* (which was limited to approximately £10,000), which in turn was the subject of item 22 of the *Ousel's* claim against the fund.

Lord Merriman P. held that only the *Ousel's* claim for £10,000 should be allowed, and that the board had to reduce its claim by a like amount.

The board appealed:-

Held, (1) that the board did not need to reduce its claim against the fund by giving credit for £10,000 which it was entitled to recover from the *Ousel* under its statutory power; the board had

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[Reported by D. R. ELLISON, Esq., Barrister-at-Law.]

that statutory right to recoup its expenses quite apart from the *Liverpool's* wrongdoing and there as no reason why it should give credit for the value of that right when proving against the fund (post, p. **84**).

Morris Ltd. v. Perrott and Boulton [1945] W.N. 148; [1945] 1 All E.R. 567, C.A. applied.

Dicta of Jessel M.R. in The Ettrick (1881) 6 P.D. 127, C.A.; and of Lord Inglis in *Burrell v. Simpson* (1876) 4 Rettie 177, 182; The Countess [1923] A.C. 345; 39 T.L.R. 302, H.L.; and *In the matter of John Plummer and William Wilson* (1841) 1 Ph. 56, 59 considered.

(2) That the rule against double proof of claims by rival claimants against an insufficient fund applied to a limitation action in Admiralty in the same manner as in bankruptcy, winding up or creditors' administration actions (post, p. **84**).

In re Oriental Commercial Bank (1871) L.R. 7 Ch. 99; *In re Hoey* (1918) 88 L.J.K.B. 273; *The Cheldale* [1947] A.C. 265; 63 T.L.R. 11; [1946] 2 All E.R. 696, H.L. applied.

(3) That both debts were the same, for the board's right against the *Liverpool* was the cost to which the board was put as a result of the collision which flowed from the *Liverpool's* wrongdoing, and the statutory liability of the *Ousel* was part of that same debt, and as the rule against double proof applied the fund could not be subjected to both claims (post, pp. **85-86**).

Dictum of Scrutton L.J. in *In re Melton* [1918] 1 Ch. 37, 60; 34 T.L.R. 20, C.A. applied.

(4) That of the two competing claims, the board had priority because it was out of pocket by the whole of its claim while the Ousel had not yet been obliged to pay, and accordingly, the board's claim against the fund would be allowed and that of the Ousel disallowed.

In re Fenton [1931] 1 Ch. 85; 46 T.L.R. 478, C.A. applied.

Decision of Lord Merriman P., post, p. **70**; [1960] 2 W.L.R. 541; [1960] 1 All E.R. 465 reversed.

Preliminary points of law.

On January 8, 1957, the Panamanian tanker *Liverpool* and the British coaster *Ousel* were in collision in the Port of Liverpool. As a result of the collision the *Ousel* was beached, and on the same day the Mersey Docks and Harbour Board gave notice to the owners of the *Ousel* that the *Ousel*, her cargo, furniture, tackle or apparel were, or were likely to become, an obstruction or impediment or danger to the safe and convenient navigation or use of the Port of Liverpool or the sea channels leading thereto, and that pursuant to section 3 of the Mersey Docks and Harbour Board Act, 1954,1 and all other powers in that behalf, the Board

1 Mersey Docks and Harbour Board Act, 1954, s. 3: "(1) ... the Board may take

> possession of and raise remove blow up or destroy any vessel

had taken possession thereof and would proceed to raise, remove, blow up or destroy the same as might be deemed necessary. The notice also stated that any property recovered would be sold by the board and the proceeds applied as a common fund for the payment of the expenses incurred in connection with raising, removing, blowing up or destroying the obstruction, impediment or danger and with the detainer andsale of any such property, the surplus, if any, being returned to the persons entitled thereto. The notice provided further that if the expenses so incurred exceeded any proceeds of sale or other sum payable to the board, the difference, up to but not exceeding the amount prescribed by the Merchant Shipping Acts, 1894-1954, as the limit of liability to damages of an owner of a ship in respect of loss or damage to vessels, goods, merchandise or other things, was recoverable by the board from the owners of the *Ousel*.

> which may have been or shall here after be sunk stranded or abandoned in any of the docks or elsewhere within the port of Liverpool or any of the sen channels leading thereto or the wreck of any such vessel and the whole or any part of the cargo furniture tackle or apparel of any such vessel or wreck ... if in the judgment of the marine surveyor for the time being of the Board ... the same shall be or be likely to become an obstruction or impediment or danger to the safe and convenient navigation or use of the dock port or sea channel. (2) The Board may sell in such manner as they may think fit any vessel wreck cargo matter article or thing which may be raised or removed or any cargo matter article or thing which may be saved from any vessel or wreck which may be blown up or destroyed and out of the proceeds of such sale (which when arising from any vessel or wreck ... shall be regarded as a common fund for the purpose) shall pay any duties and purchase tax payable to Her Majesty and may retain the expenses incurred by them in the exercise of their powers under this section and also any expenses incurred by them in marking buoying watching lighting or otherwise controlling the vessel wreck cargo matter article or thing or giving warning to shippingof the presence thereof and shall render the overplus (if any) to the person or persons entitled to the same. (3) If the proceeds of sale of the vessel or of the wreck of the vessel and the cargo furniture tackle and apparel thereof so raised removed blown up or destroyed are insufficient after paying the said duties and purchase tax to reimburse the Board for the said expenses the Board may recover the deficiency from the person who was the owner of the vessel

> at the time of the sinking stranding or abandonment thereof ... as a debt in any court of competent jurisdiction: Provided that if the owner of the vessel so raised removed blown up or destroyed is not under the provisions of the Merchant Shipping Acts 1894 to 1952 as amended by any enactment for thetime being in force entitled to limit his liability in respect of the said deficiency that owner shall not be liable to pay to the Board in respect thereof a sum exceeding the amount prescribed in section 503 (1) (iii) ... of the Merchant Shipping Act 1894 as amended by any enactment for the time being in force as the limit of liability to damages of the owner of a ship in respect of loss or damage to vessels goods merchandise or other things. ..."

Liability for the collision was admitted by the owners of the *Liverpool*, who, on May 17, 1957, commenced proceedings in the Liverpool District Registry by which they claimed to limit their liability in accordance with the provisions of the Merchant Shipping Acts, 1894-1954, and on May 28, 1958, a decree of limitation was made limiting the liability of the owners of the *Liverpool* in respect of the collision to a sum of £106,226 12*s.* 10*d.* with interest thereon at 4 per cent. from the date of the collision.

A number of claims were made against the limitation fund, including a claim by the owners of certain cargo in the *Ousel* for £142,903 11*s.* 3*d.*, a claim by the owners of the *Ousel* for £70,765 5*s.* 1*d.* and a claim by the Mersey Docks and Harbour Board for £128,382 11*s.* 7*d.* for expenses incurred and damage sustained in connection with clearing the Mersey of the wreck of the *Ousel*. The board's claim against the limitation fund, which was a common law claim in tort founded on the admitted negligence of the *Liverpool* in causing the wreck of the *Ousel*, consisted of a sum of £188,742 5*s.* 10*d.*, representing the whole of the expenses incurred in removing the *Ousel* and her cargo, from which was deducted the sum of £60,359 14*s.* 3*d.* which had been realised by the board by the sale of part of the *Ousel's* cargo and equipment. The board made no deduction in their claim in respect of the sum of £10,835 12*s.* 0*d.*, which was agreed to be the statutory limit of the liability of the *Ousel* prescribed by section 503 (1) (ii) of the Merchant Shipping Act, 1894, and which the board were entitled to claim under the Mersey Docks and Harbour Board Act, 1954, as stated in the board's notice of January 8, 1957. It was not disputed that the board's claim to some extent covered the same ground as the subject-matter of the board's claim against the *Ousel* under the Mersey Docks and Harbour Board Act, 1954. This sum of £10,835 12*s.* 0*d.* was included in the claim of the owners of the *Ousel* against the *Liverpool* limitation fund as item 22 thereof, and was described therein as "Mersey Docks and Harbour Board. Contingent claim of board in respect of wreck raising expenses, viz., statutory limit of *Ousel*."

On December 4, 1958, the part cargo-owners filed objections to the claim of the Mersey Docks and Harbour Board, and on December 29, 1958, the part cargo-owners filed objections - to the claim of-the owners of the *Ousel*, including an objection to item 22 on the ground that there was no evidence in support thereof. On February 10, 1959, the part cargo-owners, in a letter addressed to the solicitors both for the owners of the *Ousel* and

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for the Mersey Docks and Harbour Board, stated that their contentions relating to item 22 would be: "(a) That the owners of the *Ousel* are not entitled to include this item in their claim against the fund unless - (i) it has actually been paid by them to the board, or alternatively (ii) there is a reasonable certainty that it will be so paid. (b) That, if the owners of the *Ousel* are entitled to include this item in their claim ... then the board's claim against the fund must be reduced by the corresponding amount."

Accordingly on May 28, 1959, the part cargo-owners applied to the Liverpool District Registrar for directions that they should be at liberty to raise as against the owners of the *Ousel* and the Mersey Docks and Harbour Board by way of further objections the points of law set out in the letter of February 10, 1959, but the registrar dismissed the application as against the Mersey Docks and Harbour Board. On appeal to Karminski J. on June 22, 1959, the registrar's order was varied to permit the part cargo-owners to raise the points of law set out in the letter of February 10, 1959, against the Mersey Docks and Harbour Board as well as against the owners of the *Ousel*, and it was ordered that the following two questions (which had been agreed by counsel for the three parties) should be tried as separate issues by a judge alone:

> "1. Whether item 22 of the claim of the owners of the *Ousel* should be allowed notwithstanding that the liability to the Mersey Docks and Harbour Board to which such item relates is contingent only.
>
> "2. Whether, if the said item 22 of the claim of the owners of the *Ousel* is allowed, the Mersey Docks and Harbour Board must give credit in their claim for an amount equivalent to the amount of the said item on the ground that otherwise there will not be a rateable distribution of the limitation fund among the several claimants."

During the course of the hearing Lord Merriman P. allowed question 1 to be amended in the manner stated in his judgment.

Eustace Roskill Q.C. and ***H. V. Brandon*** for the part cargo-owners.

Roland Adams Q.C. and ***R. F. Stone*** for the owners of the Ousel.

J. V. Naisby Q.C. and ***G. N. W. Boyes*** for the Mersey Docks and Harbour Board.

The following authorities and cases were cited in argument in addition to those referred to in the judgment: Williams on Bankruptcy, 17th ed., pp. 151 and 183; Temperley's Merchant Shipping Acts, 5th ed., pp. 331, 333, 335, 339, 557 and 558; Scrutton on Charterparties and Bills of Lading, 14th ed., pp. 456, 461; Rowlatt's Law of Principal and Surety, 3rd ed., p. 309; Halsbury's Laws of England, 3rd ed., vol. 2, pp. 472-474; *In re Fenton*2; *The Disperser*3; *The Kronprinz Olav*4; *The American Jurist and Claycarrier*5; *Pilkington v. Wood*6; *The Byzantion*7; *The Victoria*8; *Prehn v. Bailey*, *The Ettrick*9; *The Emilie Millon*10; *Stonedale No. 1 (Owners) v. Manchester Ship Canal Co.*11; *Ex parte Rushforth*12; *Ex parte Cotton*13; *Dee Conservancy Board v. McConnell*14; *Midland Banking Co. v. Chambers*15; *In re Reis*, *Ex parte Clough*16; *In re Rissik*17; *In re Rowe*, *Ex parte Derenburg & Co.*18; *Morris v. Robinson*19; *Ex parte Kendall*20; *In the matter of John Plummer and William Wilson*21; *Ex parte West Riding Union Banking Co.*, *In re Turner*22; *In re Melton, Milk v. Towers*23; *Commecial Bank of Australia Ltd. v. Official Assignee of the Estate of John Wilson & Co.*24; *Castellain v. Preston*25; *Cargo Ships El-Yam Ltd. v. Invoer-en-Transportonderneming Invotra N.V.*26; *C. A. Van Eijck and Zoon v. Somerville*27; *London Rangoon Trading Co. Ltd. v. Ellerman Lines Ltd.*28; *Ex parte Tayler*, *In the matter of Henry Houghton*29; *Standard Oil Co. of New York v. Clan Line Steamers Ltd.*30; *Hobson v. Bass*31; *In re Blackburne*, *Ex parte Strouts*32; *The Corchester*.33

Cur. adv. vult.

2 [1931] 1 Ch. 85.

3 [1920] P. 228; 36 T.L.R. 578.

4 [1921] P. 52.

5 [1958] 1 Lloyd's Rep. 423; [1958] 2 All E.R. 659.

6 [1953] Ch. 770; [1953] 3 W.L.R. 522; [1953] 2 All E.R. 810.

7 (1922) 38 T.L.R. 744; 16 Asp. M.L.C. 19.

8 (1888) 13 P.D. 125.

9 (1881) 6 P.D. 127.

10 [1905] 2 K.B. 817.

11 [1956] A.C. 1; [1955] 3 W.L.R. 203; [1955] 2 All E.R. 689.

12 (1805) 10 Ves. 409.

13 (1883) 11 Q.B.D. 301.

14 [1928] 2 K.B. 159.

15 (1869) L.R. 4 Ch. 398.

16 [1904] 2 K.B. 769; 20 T.L.R. 547; affirmed sub nom. *Clough v. Samuel* [1905] A.C.

442; 21 T.L.R. 702.

17 [1936] Ch. 68.

18 [1904] 2 K.B. 483.

19 (1824) 3 B. & C. 196.

20 (1811) 17 Ves. 514.

21 (1841) 1 Ph. 56.

22 (1881) 19 Ch.D. 105.

23 [1918] 1 Ch. 37; 34 T.L.R. 20.

24 [1893] A.C. 181; 9 T.L.R. 307.

25 (1883) 11 Q.B.D. 380.

26 Unreported, 1955 C. No. 3722, December 2, 1958.

27 [1906] A.C. 489; 22 T.L.R. 715.

28 (1923) 39 T.L.R. 284; 14 Ll.L. Rep. 497.

29 (1857) 1 De G. & J. 302.

30 [1924] A.C. 100; 40 T.L.R. 148.

31 (1871) L.R. 6 Ch. 792.

32 (1892) 9 Morr. 249.

33 [1957] P. 84; [1956] 3 W.L.R. 1090; [1956] 3 All E.R. 878.

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Dec. 21. LORD MERRIMAN P. read the following judgment, in which he stated the facts and continued: The owners of the Ousel claim £10,835 12*s.* 0*d.* under the heading "Mersey Docks and Harbour Board contingent claim of Board in respect of wreckraising expenses; namely, statutory limit of 'Ousel.'" It is this claim, hereinafter called item 22, which is the subject of the present reference.

The part cargo-owners attack the inclusion of this item, both in the *Ousel's* claim and, in substance, also in the board's claim. On behalf of the *Ousel* it is contended that though the money has not actually been paid, in circumstances which I will discuss later, they have no escape from their liability to pay this sum to the board as being the deficiency referred to in section 3 (3) of the

Mersey Docks and Harbour Board Act, 1954, reduced to the amount of the limitation under the Merchant Shipping Acts.

The board, on the other hand, claim that they are entitled to recover in full the amount due under their private Act, if and when it suits them to do so, and also to claim a dividend, if I may so call it, from the fund on the full amount of their claim, with the proviso that the sum recovered from these two sources does not exceed the total amount of the board's claim against the *Liverpool*.

At the outset of his argument Mr. Naisby stated emphatically that he stood by this contention, and the board have never receded from this position.

It was ordered that this dispute should be tried as an issue in the reference, and two questions were agreed before Karminski J., in chambers for submission to the court, as follows: "It is ordered that the following two agreed questions be tried as separate issues by a judge alone: 1. Whether item 22 of the claim of the owners of the *Ousel* should be allowed notwithstanding that the liability to the Mersey Docks and Harbour Board to which such item relates is contingent only. 2. Whether, if the said item 22 of the claim of the owners of the *Ousel* is allowed, the Mersey Docks and Harbour Board must give credit in their claim for an amount equivalent to the amount of the said item on the ground that otherwise there will not be a rateable distribution of the limitation fund among the several claimants."

During the hearing, as there appeared to be some doubt whether question 1 was wide enough to ensure that the question of double proof was raised, I allowed that question to be amended in the following terms: "1. Whether item 22 of the claim of

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the claimants the owners of the *Ousel* should be disallowed on the grounds: (a) that in substance it forms part of or is the same as part of the claim of the Mersey Docks and Harbour Board; (b) that the sum to which the said item relates has not yet been paid to the board by the claimants the owners of the *Ousel*; and (c) that accordingly, unless such item is disallowed, there will not be a rateable distribution of the limitation fund among the several claimants."

I allowed this amendment by virtue of R.S.C., Ord. 28, r. 12, so as to ensure the determination of the real issue raised by this proceeding.

Mr. Adams stated that he was specifically instructed not to raise question 2 as against the board. Mr. Naisby also disclaimed any intention of arguing question 1 against the *Ousel* unless he was driven to do so, if question 2 was answered against the board. This mutual abstention from attack on each

other by the rival claimants to the fund seemed to me to justify Mr. Roskill's observation that this looked like an agreement that the *Ousel* should be treated as having paid the board the amount of item 22, but that the board should be treated as not having received that amount. It is only fair to say, however, that the rigidity of this attitude was somewhat modified in the answers to Mr. Roskill's cogent reply, and after question 1 was amended.

On behalf of the part cargo-owners it was argued by Mr. Roskill that the inclusion of item 22, both in the *Ousel's* claim and in substance in the board's claim, gave rise to the issue of double proof, so that either the contingent claim of the *Ousel* should be disallowed, or, if allowed, that the board should be compelled to give credit against their claim for the same amount.

Alternatively, it was contended that the board should deduct item 22 from their claim against the *Liverpool*, on the principle that they ought, as reasonable persons, to mitigate their loss; or, alternatively, on the ground that their failure to take the reasonable step of recovering the amount of item 22 prevented that part of their loss from flowing from the wrongdoing of the *Liverpool*.

The rule against double proof is very clearly stated in *In re Oriental Commercial Bank*1 by Mellish L.J.: after saying that the rule applies in the Court of Chancery as well as in the Court of Bankruptcy, and therefore would apply equally where companies are being wound up, he said2: "It seems to me that the principle is a perfectly sound one." Then, after an immaterial

1 (1871) L.R. 7 Ch. 99.

2 Ibid. 103.

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reference to the application of the rule to joint and separate estates, he continues: "But the principle itself - that an insolvent estate, whether wound up in Chancery or in Bankruptcy, ought not to pay two dividends in respect of the same debt - appearsto me to be a perfectly sound principle. If it were not so, a creditor could always manage, by getting his debtor to enter into several distinct contracts with different people for the same debt, to obtain higher dividends than the other creditors, and perhaps get his debt paid in full. I apprehend that is what the law does not allow; the true principle

is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts."

This statement of the principle was followed by Horridge and Roche JJ. in *In re Hoey*,3 a case in which the bankrupt had charged his property direct to mortgagees and had conveyed to his wife and another the equity of redemption of the property, with a covenant that he would discharge the mortgage liability within a certain period. This was held to raise the principle of double proof on the ground that he had entered into covenants both with the mortgagee and with his wife, but that they were both covenants to pay the same debt, and if they were both allowed to prove in respect of that debt higher dividends would be paid in respect of that debt than in respect of the debts of other creditors.

There has been a very full and exhaustive examination by Mr. Naisby of the bankruptcy law relating to contracts of guarantee, the suggestion being that as several of the cases relating to double proof were cases dealing with suretyship, the law relating to such cases could conveniently be applied to any case in which the question of double proof arises.

One such rule is that where the surety guarantees the whole debt with a limit of the amount for which he is to be liable under his guarantee, the principal creditor, even though the surety has already paid the limited amount due from him, can prove in the bankruptcy of the debtor for the whole of his debt without taking into account that which he has received from the surety: see, for example, *In re Sass*4 and *In re Houlder*.5 On the other hand, if the surety guarantees part of the debt only, the creditor must give credit, in proving against the bankrupt's estate, for that which he has received from the surety; or, if he is able to prove for the whole amount because he has not yet recovered from the

3 (1918) 88 L.J.K.B. 273.

4 [1896] 2 Q.B. 12; 12 T.L.R. 333.

5 [1929] 1 Ch. 205.

surety, he must account for the proportionate part of the dividend to the surety on payment being made subsequently by the latter.

From this it was argued by analogy that the effect of the Mersey Docks and Harbour Board Act, 1954, in the present case is that the deficiency mentioned in section 3 (3) is the whole debt, while a limit is imposed on the recovery by the proviso; thus leading to the conclusion that the board, as creditor, can prove in full against the limitation fund, without giving credit for the amount of item 22.

It is true that some of the cases of double proof arise out of contracts of guarantee; but it does not seem to me to follow from this that all cases of double proof are governed by the law relating to cases of guarantee.

In *Ellis v. Emmanuel*6 Blackburn J., delivering the judgment of Cairns L.C., Brett J. and himself, after a full review of all the cases on the subject, said7: "I think in such a case it is a question of construction on which the court is to say whether the intention was to guarantee the whole debt with a limitation on the liability of the surety, or to guarantee a part of the debt only."

The present case is not one of suretyship at all, but if it is to be treated as such by analogy, and if the construction of the Mersey Docks and Harbour Board Act, 1954, is to decide whether the intention was to guarantee the whole debt with a limitation on the liability of the surety, or to guarantee a part of the debt only, my opinion is that the latter is the correct view.

The debt which the *Ousel* in the supposed capacity of surety is to pay under the Mersey Docks and Harbour Board Act, 1954, is, in my opinion, the debt constituted by section 3 (3) and the proviso combined; that is to say, the portion of the deficiency calculated with reference to section 503 (1) (ii) of the Merchant Shipping Act, 1894.

In my opinion the suggestion that the *Ousel* as the supposed surety guarantees the whole deficiency under section 3 (3) subject to a limit by the proviso arises from the failure to distribute the two senses in which the word "limitation" is used in connection with the principle of limitation of liability in Admiralty and in the analysis of the suretyship cases by Blackburn J. to which I have referred.

On behalf of the board it was argued that nearly all the reported cases of double proof were cases in which what was held

6 (1876) 1 Ex.D. 157.

7 Ibid. 169.

to be in substance the same debt arose out of contract, though not necessarily out of the same contract.

Nevertheless, the object of the principle being to avoid the payment of two dividends in respect of what is in substance the same debt, I do not see why the principle should not apply to a debt arising out of a tort - see Professor Glanville Williams on Joint Torts and Contributory Negligence, p. 173, s. 49.

Nor, on the other hand, does it seem to me to matter that the subject of the rival proof arises out of the Mersey Docks and Harbour Board Act. The point, as it seems to me, is that item 22 is in effect co-extensive with part of the board's claim against the fund, and that both arise directly out of the same subject-matter; namely, the wreck of the *Ousel* in the Mersey, and the expense incurred by the board in clearing the Mersey of obstruction by the wreck.

The fact that the board's claim against the *Liverpool* is a common law claim in tort, while the board's claim against the *Ousel* results from their private Act, seems to me to be immaterial. It is true that in *In re Oriental Commercial Bank*,8 Mellish L.J. used the words "although there may be two separate contracts" in respect of what he held to be in substance the same debt. But that was a case of two separate contracts. On the other hand, in *In re Moss*,9 Bigham J., quoting with approval the judgment of the county court judge whose decision was under appeal, said10: "there clearly would be a double proof in respect of the same sum in substance although the nature of the liability in each case assumes a different form." These words are wide enough to cover the present case.

In my opinion, there is no obligation to reject one claimant rather than the other in applying the rule of double proof.

I think that as Lord Uthwatt said in *Morrison Steamship Co. Ltd. v. Greystoke Castle (Cargo Owners)*,11 when considering the rival claims of cargo and the carrying ship against the colliding ship in respect of general average expenses, "the reality of the situation dictates the choice to be made."12

Here the owners of the *Ousel*, once the board had served the notice and taken possession under their private Act, had no escape from the obligation to pay the board the amount of item 22. To debar them, therefore, from proving against the limitation fund the item of loss which plainly results from the *Liverpool's*

8 L.R. 7 Ch. 99, 103, 104.

9 [1905] 2 K.B. 307.

10 Ibid. 312.

11 [1947] A.C. 265; 63 T.L.B. 11; [1946] 2 All E.R. 696.

12 [1947] A.C. 265, 309.

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wrongdoing would be harsh indeed. On the other hand, the board, quite rightly and properly, have decided to put in train the enforcement of their rights under the private Act, and can at any moment

receive the fruits of doing so.

In *Morris Ltd. v. Perrott and Boulton*13 Lord Goddard, delivering the judgment of the Court of Appeal, said14: "If the causes of action are different, judgment without satisfaction against one is no bar to an action against the other, and this is so even if the plaintiff deliberately refrains from proceeding to execution on the first judgment."

But, in my opinion, this is not a case of deliberately refraining from proceeding to execution. On the contrary, it is a case of avowed intention to collect item 22, the fruits of the steps that the board have taken under their private Act, but to postpone collection, if possible, until the limitation fund has been distributed.

I can see no reason why the principle of double proof should not apply to a limitation action, as well as to bankruptcy and winding up.

The desirability of avoiding the payment of two dividends in respect of what is, in substance, the same debt, applies equally to a limitation fund. In this context it is, perhaps, worth noting that in *The Stoomvaart Maatschappij Nederland v. P. & O. Steam Navigation Co*.,15 Lord Selborne L.C. treated bankruptcy and the statutory limitation of liability in Admiralty as being on the same footing in equity.16

If the rule against double proof applies at all, it seems to me that the reality of the situation indicates that the board should be debarred from proving for a dividend for that part of their loss in respect of which they can recover in full from the *Ousel*; that is to say, the answer to question 1, both in its original and its amended form, is that item 22 of the claim of the *Ousel* should be allowed; and the answer to question 2 is that the board must give credit in their claim for an amount equivalent to the amount of item 22.

At one stage of the argument it was suggested that to make this order would be to confiscate the sum legitimately due to the board as the result of their private Act. This suggestion of confiscation is taken from the opinion of Lord Finlay in *Mersey*

13 [1945] 1 All E.R. 567; [1945] W.N. 148.

14 [1945] 1 All E.R. 567, 569.

15 (1882) 7 App.Cas. 795.

16 Ibid. 801.

Docks and Harbour Board v. Hay, The Countess.17 But that was a case where the particular claimant had a possessory lien, notwithstanding which it was argued that he must prove as an unsecured claimant. Seeing that it was decided that rateable distribution does not affect priorities and that the respective rights must be considered qualitatively as well as quantitatively (*per* Lord Birkenhead L.C.18, to deprive the claimant of his priority and reduce him to the level of an unsecured claimant against the fund would truly have been to confiscate his priority.

Reduced from rhetoric to hard fact, it now appears that the so-called confiscation means that the board will get about £1,200 less than the full amount, after taking into account that the amount of item 22 is deducted from the board's claim on the basis that the board has received, or must be taken to have received, that amount, and that the *Ousel* is entitled to prove for the amount of item 22.

This, no doubt, is very unfortunate, but so is the fact that there are other innocent victims of the *Liverpool's* ability to limit her liability for her admitted wrongdoing. I do not think that I can decide this case solely on an assessment of the comparative merits of innocent victims.

However the matter may stand in connection with the rule against double proof, there is, in my opinion, a simpler solution to the problem; namely, the obligation which rests upon the board to mitigate the loss which they have sustained by the wrongful act of the *Liverpool*; I was myself responsible for introducing this aspect of the matter into the discussion, but Mr. Roskill adopted it, and the topic has been fully argued.

Let me say at once that this is not a question of one tortfeasor making the hopeless attempt to insist that another tortfeasor shall be sued first, or at all, as a condition of determining his own liability;

or, indeed, of the tortfeasor dictating to the board whom else they shall sue, or in what order.

In this case notice under the Mersey Docks and Harbour Board Act was served by the board on the owners of the *Ousel* on the very day on which, as the result of the collision for which the *Liverpool* has accepted the sole blame, the *Ousel* was driven ashore in such a way as to block the Mersey Channel, for the upkeep of which the board are responsible.

This notice was given in pursuance of the rights of the board under their private Act. It has been suggested, indeed it has

17 [1923] A.C. 345, 363; 39 T.L.R. 302.

18 Ibid. 356.

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almost been assumed in the course of the argument, that the Act not merely gives the board the right but imposes the duty to act as they have done. I am not so sure about that; nor, in my opinion, does it matter. Plainly they have the right, and whether there is also the duty or not the board must at least have an option about the time when the steps laid down in the Act are taken.

In this case they acted at once, and in doing so they plainly acted of their own volition. From the giving of the notice everything proceeded through the prescribed stages; from the board taking possession of the *Ousel*, the sale of the cargo, the blowing up of the ship, down to the calculation of the "deficiency," and, finally, to the reduction of the amount of the "deficiency," to the amount for which alone the *Ousel* was liable under the limitation provided by section 3 (3) and the proviso combined.

On January 26, 1959, the board stated explicitly that it was their intention to enforce liability under their private Act against the *Ousel*.] About the amount there has been complete certainty since the exchange of letters between the parties respectively in June, 1959.

So far, I repeat, the actions of the board were at their own volition and were in no way dictated by any third party. All that is lacking, therefore, is the actual payment of the money.

I find as a fact that from the moment when the amount was ascertained the owners of the *Ousel* have been ready and willing to pay the money due, but the board have persistently maintained what I regard as the farce of refraining from taking the money. This action also is entirely of their own volition, and the refusal was emphatically repeated in the course of the argument, when Mr. Adams, on behalf of his clients, was instructed to offer immediate payment, or to pay the money into court.

Accordingly, as I was advised that there was no machinery for payment into court by a defendant in the course of a reference arising out of a limitation action, it was arranged that Messrs. Walton would act as stake-holders of the amount of item 22 for whom it might concern.

In these circumstances, the question how the matter stands is one of law.

It has been common ground in this case that the classic statement about mitigation of loss by Viscount Haldane L.C. in his speech in the *British Westinghouse Electric and Manufacturing Co. Ltd. v. Underground Electric Railways Company of*

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London Ltd.,19 although made in an action arising out of a breach of contract, applies equally, mutatis mutandis, to tort. I will preface the citation from the *Westinghouse* case by a short passage from the judgment of Scrutton L.J. in *Payzu Ltd. v. Saunders*,20 when he said21: "Whether it be more correct to say that a plaintiff must minimise his damages, or to say that he can recover no more than he would have suffered if he had acted reasonably, because any further damages do not reasonably follow from the defendant's breach, the result is the same. The plaintiff must take [quoting Lord Haldane L.C. in the *Westinghouse case*22] 'all reasonable steps to mitigate the loss consequent on the breach,' and this principle 'debars him from claiming any part of the damage which is due to his neglect to take such steps.'"

After this passage, Lord Haldane L.C.22 quoted James L.J. in *Dunkirk Colliery Co. v. Lever*23 as follows: "'The person who has broken the contract is not to be exposed to additional cost by reason of the plaintiffs not doing what they ought to have done as reasonable men, and the plaintiffs not being under any obligation to do anything otherwise than in the ordinary course of business.'"

Lord Haldane continued24: "As James L.J. indicates, this second principle does not impose on the plaintiff an obligation to take any step which a reasonable and prudent man would not ordinarily take in the course of his business. But when in the course of his business he has taken action arising

out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act."

Then, after citing *Staniforth v. Lyall*25 as an illustration of this rule, Lord Haldane continued26: "I think that this decision illustrates a principle which has been recognised in other cases, that, provided the course taken to protect himself by the plaintiff in such an action was one which a reasonable and prudent person might in the ordinary conduct of business properly have taken, and, in fact did take whether bound to or not, a jury or an arbitrator may properly look at the whole of the facts and ascertain the result in estimating the quantum of damage."

19 [1912] A.C. 673, 688-690.

20 [1919] 2 K.B. 581; 35 T.L.R. 657.

21 [1919] 2 K.B. 581, 589.

22 [1912] A.C. 673, 689.

23 (1878) 9 Ch.D. 20, 25.

24 [1912] A.C. 673, 689.

25 (1830) 7 Bing. 169.

26 [1912] A.C. 673, 690.

Both Bankes and Scrutton L.JJ. in *Payzu Ltd. v. Saunders*27 emphasised that the duty imposed on the plaintiff involved a conclusion of fact, to be arrived at on a consideration of all the circumstances of the case.28

Applying these observations, the "transaction" is the grounding of the *Ousel* in the Mersey Channel. The action taken by the board, whether they were bound to take it or not, under their private Act was reasonable and prudent, and one which they would ordinarily take in the course of their business. This action has diminished their loss, inasmuch as item 22 is receivable by the board in full, and is not the subject of proof on which a mere dividend out of the fund is recoverable. If the fact that the board have chosen not to receive the amount of item 22 makes any difference, and they are not to be treated as having received it, or are not estopped from saying that they have not received it, I regard their refusal to receive payment as unreasonable. They are deliberately refraining from accepting the money so as not to be prevented from alleging, for what it is worth, that they have not received it.

Accordingly, to the extent that the amount of item 22 is included in the board's claim against the fund, I do not consider that the fact that they have not actually received it follows reasonably from the wrongdoing of the *Liverpool*. On the contrary, it flows in my opinion, from the unreasonable refusal of the board to receive the amount of item 22 from the *Ousel*. Putting it the other way, they have been able to minimise the damage in that respect at any moment since the precise amount was ascertained and agreed.

For these reasons, also, as well as on the issue of double proof, I think that question 2 must be answered against the board.

Judgment for the part cargo-owners. Costs of part cargo-owners and owners of the "Ousel" to be paid by the Mersey Docks and Harbour Board. Leave to appeal granted to Mersey Docks and Harbour Board.

Solicitors: *Waltons & Co.; Weightman, Pedder & Co., Liverpool; R. H. Bransbury, Liverpool.*

The board appealed.

27 [1919] 2 K.B. 581; 35 T.L.R. 657.

28 [1919] 2 K.B. 581, 589.

J. V. Naisby Q.C., G. H. Newsom Q.C. and ***G. N. W. Boyes*** for the Mersey Docks and Harbour Board. The consequences of the decision of Lord Merriman P. would be very far reaching. The question in the appeal is whether the effect of a decree of limitation of liability, limiting the liability of the owners of the *Liverpool*, would affect the position of the Board. The effect of the judgment might well be that, quite apart from any question of limitation, a harbour authority would be bound to proceed against the innocent owner of a wreck rather than the wrongdoer who had caused the damage. It is submitted that there was no duty on the Board to proceed against an innocent party in order to diminish the loss payable by a wrongdoer. There was no legal obligation upon a creditor to pursue his remedies in any particular order to benefit one of his debtors. The rule of double proof should not be applied to the present case. There are material differences between bankruptcy or winding-up proceedings and limitation proceedings.

Eustace Roskill Q.C. and ***H. V. Brandon*** for the part cargo-owners. It is submitted that for all practical purposes a limitation fund is the same as a statutory insolvency or statutory bankruptcy. It is akin to the estate of a bankrupt, who had insufficient funds to meet his liabilities, or the estate of a company in liquidation, which could not meet its liabilities.

Roland Adams Q.C. and ***R. F. Stone*** for the owners of the *Ousel*. The simple question before the court is whether the claim of the *Ousel* is allowable, notwithstanding that it is only contingent.

1960. July 28. HODSON L.J. The judgment of the court will be read by Harman L.J.

HARMAN L.J. This is an appeal from a decision of the President delivered on December 21, 1959, on two issues raised in an action in the Admiralty Court under which the plaintiffs, the owners of the steamship *Liverpool* (which was wholly responsible for a collision within the area of that port) have been allowed to limit their liability under sections 503 and 504 of the Merchant Shipping Act, 1894. The sum paid into court under this order amounts to some £112,000. The aggregate of the claims against the fund greatly exceed this sum and the dividend payable is likely to be in the region

of 6*s.* in the oe. All the facts are agreed and are sufficiently stated in the judgment of Lord Merriman P., and we need not repeat them beyond saying that the issue here is a tripartite one between three of the claimants.

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First of these is the Mersey Docks and Harbour Board, in which the area of the port is vested under its Act of 1857 and which, under its latest Act of 1954, is empowered by section 3 to take possession of any vessel sunk, stranded or abandoned within the limits of the port, and to dispose of it as it thinks fit. The board is also empowered by the same section to sell any chattel salved from the vessel and to set the proceeds against the expenses incurred in its operations. This it has done and has thus reduced its gross expense to a sum just under £130,000, which is the amount claimed.

The next claimants are the owners of the sunken vessel, the *Ousel*, whose claim amounts to just over £70,000, of which about £60,000 is agreed, and the last £10,000 is the subject-matter of the present dispute. This last sum represents a claim to be indemnified against the sum payable by the owners of the *Ousel* to the board as hereafter explained.

Thirdly, there are claimants to cargo and so on, whose claims amount to £170,000.

Certain of the cargo claimants have raised the instant question which arises out of the right conferred on the board by the Act of 1954 apart from its common law claim for damages in tort against the *Liverpool*, now represented by the fund in court, to claim over against the owners of the *Ousel* any deficiency in the amount recovered after giving such credits as the Act enjoins. This deficiency, having regard to the proviso to section 3 (3), which entitles the *Ousel* to limit its liability, amounts to the £10,000 already mentioned. The cargo-owners allege that this sum is being in effect claimed twice against the fund, first by the board and second by the *Ousel*.

The President's decision was that the claim by the owners of the *Ousel* for the £10,000 should be allowed, but that the board must reduce its claim against the fund by a like amount. There thus arise, as we apprehend, the following questions: Can both the board and the *Ousel* prove for the £10,000 against the fund, and if not which of them is to give way? The President decided that only one proof should be admitted to rank - and that the *Ousel's*. The board appeals.

It seems to us that logically the first question to decide is whether the board should reduce its claim. The President's answer in the affirmative rested on two considerations, first that the board by letter dated January 8, 1957, gave notice to the owners of the *Ousel* that any deficiency was recoverable by them from the owners, and secondly, that by letter dated January 26,

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1959, the board gave further notice to the owners of the *Ousel* in these terms: "So far as concerns the main question contained in your letter, it is clear that whether the board makes a claim upon your clients, and if so for what sum, must depend upon the amount of the share that they may receive of the limitation fund. As matters stand at present it appears that the board's prospective share will still leave them with a deficiency on their wreck expenses greatly exceeding the amount of your clients' statutory liability under section 3 of the board's Act of 1954, and in such case the board will, of course, look to your clients for payment of the sum for which they are liable under the statute." The President held that by taking these steps the board had in effect mitigated its damages in tort against the *Liverpool* by the amount it was in a position to recover from the *Ousel* under its statutory power. He further held that the board ought in reason to mitigate its loss by enforcing this claim, and that not to do so is unreasonable and, therefore, to the extent of the £10,000 the damages do not flow from the wrongdoing. In so deciding the President followed the principles as to mitigation of damages laid down in *British Westinghouse Electric and Manufacturing Co. Ltd. v. Underground Electric Railways Co. of London Ltd.*[1]

In our judgment, the first part of the President's decision does not fit the facts. Let it be conceded that if the board had recovered the £10,000 from the *Ousel* under its statutory power that would have been satisfaction pro tanto of the damages; still the fact is that the board has not recovered this sum, and, in our judgment, there is no duty upon it to do so. It is true that at the trial of the issue the *Ousel* owners declared themselves ready to pay and in fact tendered the money, which is now on deposit with stakeholders, but we cannot see that this makes any difference, for the tender has never been accepted. The passage from the judgment of Lord Goddard in *Morris Ltd. v. Perrott* and *Boulton*[2] cited by the President shows quite clearly that even if the board had obtained judgment against the *Ousel* there would have been no duty upon it to proceed to execution in alleviation of the *Liverpool*, which is a tortfeasor. Here, in fact, no claim for payment has ever been made. The letter of January 26, 1959 (from which I have read), is merely an intimation that a claim may be made hereafter.

As to the second part of the President's decision, this case,

1 [1912] A.C. 673, 688.

2 [1945] 1 All E.R. 567, 569.

in our judgment, has nothing to do with the duty to mitigate damages. It concerns the board's legal rights, and no duty rests on it at the demand of a tortfeasor to satisfy part of the damages by resorting to another tortfeasor; still less by resorting to an innocent party made liable merely by statute.

If it were otherwise there would be no necessity for the Law Reform (Married Women) and Tortfeasors Act, 1935, and the law about contributions between tortfeasors, for any tortfeasor could oblige the creditor to sue the other debtors in order to alleviate his burden. The President in fact recognises this in his judgment in these words3: "Let me say at once that this is not a question of one tortfeasor making the hopeless attempt to insist that another tortfeasor shall be sued first, or at all, as a condition of determining his own liability; or, indeed, of the tortfeasor dictating to the board whom else they shall sue, or in what order."

If there be no duty on the board to enforce its rights against the *Ousel* it can prove for its whole debt against the *Liverpool* without taking those rights into account. It is true that the claim is not being made against the *Liverpool* herself because she has taken advantage of the right to limit her liability, but she remains nevertheless the tortfeasor and the principle applies, in our opinion, to a claim arising out of the tortfeasor's wrongdoing: see in this connection the observations of Jessel M.R. in *The Ettrick*4, where he was construing section 54 of the Merchant Shipping Act, which gave a right to a shipowner in default to limit his liability. It has been argued that, having paid the money into court, the owner was no longer a wrongdoer, but this the Master of the Rolls denied saying5 "It" (that is to say, the Act) "does not make his acts right if they were previously wrongful."

Limitation in its Admiralty significance results in a position not unlike that in bankruptcy, and has, indeed, been said by Lord President Inglis, in *Burrell v. Simpson & Co*.6 to be analogous to a statutory insolvency. See also *The Countess*7, where all their Lordships insisted that distribution of the fund is to be made rateably, and Lord Sumner approved Lord Inglis' observations. This is the position in bankruptcy (see the Bankruptcy Act, 1914, s. 33 (2) and (7)), and in liquidation of an insolvent limited company (see the Companies Act, 1948, ss. 302 and 317).

3 Ante, p. 76; [1960] 2 W.L.R. 541, 551.

4 (1881) 6 P.D. 127.

5 Ibid. 132.

6 (1876) 4 R. 177, 182.

7 [1923] A.C. 345, 382; 39 T.L.R. 302.

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It is a well-known rule in bankruptcy that a creditor having a security against the estate of the debtor must either surrender his security and prove for the whole debt, or value his security and prove for the balance, but it has never been the law that a creditor having a security against a third party for his debt must give credit for that when proving in the bankruptcy: see, for instance, *In the matter of John Plummer and William Wilson.*8

So here the board has a statutory right to recoup its expenses quite apart from the *Liverpool's* wrongdoing, but we see no reason why it should give credit for the value of that right when proving against the fund.

The first question should therefore be answered by saying the board need not reduce its claim by giving credit for the £10,000.

The second question is whether the *Ousel* can enforce its claim to the £10,000 which is the agreed amount of its liability to the board under the Act of 1954. This is a contingent claim, for the *Ousel* is not yet out of pocket by that or any other sum under this head. There is no reason, however, why a contingent claim should not rank just as it does in any other case where there are rival claimants against an insufficient fund. Such a claim must be valued.

The objection of the other claimants is that to allow the claim to rank would be to allow two claims in respect of the same debt: this rasises the question of double proof. The principle is best explained in Mellish L.J.'s judgment in *In re Oriental Commercial Bank.*9 The relevant passage has already

been cited in the President's10 judgment and we do not repeat it here. A further good illustration is provided by *In re Hoey,*11 also alluded to by the President. Does this principle apply in a limitation action in Admiralty? There seems to us no reason why not. The principle must, as it seems to us, as a matter of justice, apply wherever there are rival claimants against an insufficient fund, as it does in bankruptcy, winding-up, and creditors' administration actions.

A good deal of time was spent in the court below in the search for analogies. First was that of principle and surety, where different rules prevail according to whether the guarantee is of the whole debt subject to a limit or is of a part of the debt (see, for instance, *In re Sass*12): we do not pretend to follow the reasons for this distinction, and are of opinion that the analogy is of no

8 (1841) 1 Ph. 56. 59.

9 (1871) 7 Ch.App. 99. 103.

10 Ante, p. 71; [1960] 2 W.L.R. 547.

11 (1918) 88 L.J.K.B. 273.

12 [1896] 2 Q.B. 12; 12 T.L.R. 333.

help here where there is no principal debtor and no surety. Similarly we forbear to discuss cases on negotiable instruments (such as *In re Blackburne*, *Ex parte Strouts*13 where equally abstruse reasoning has been applied and fine distinctions taken.

It is true that the reported cases appear to arise out of contract, and indeed it is difficult to think of a case other than one like the present to which the rule might apply in cases of tort, though perhaps *The Cheldale*14 supplies a parallel. The principle is that the fund must not be saddled with two proofs where the two creditors are both seeking to enforce the same debt.

Are the two debts the same? This seems to us to be the difficult part of the case. The board's right against the *Liverpool* is the cost to which the board as owner of the port has been put as a result of the collision. The damage that flows from the *Liverpool's* wrongdoing is the reasonable cost of removing the obstruction: see *Dee Conservancy Board v. McConnell*.15 Now this cost was some £60,000 more than the amount claimed, and, in our judgment, the board might have claimed for the full amount and was not bound to exercise its statutory right to sell the salvaged chattels. It might have returned them to their owners, who then would have been obliged to give credit for their value when quantifying their claims against the fund. The board, however, did exercise its right of sale and has, in our judgment, rightly given credit for the sums realised. This is an instance of mitigating damages.

The £10,000 for which the *Ousel* seeks to prove is agreed as to quantity and has been called "the statutory limit of the *"Ousel.*" It arises out of the proviso to section 3 (3) of the Act of 1954, and is the "deficiency" in the amount recovered by the board from sales of salved material against "expenses" incurred by it in exercise of its statutory powers under the section. These are the very same expenses as are claimed as damages in tort against the *Liverpool:* the two claims would be of the same amount but for the proviso to section 3 (3), which enables the owners of the wrecked vessel to limit their liability by reference to her tonnage. This has been done here, so that only £10,000 of the £130,000 expenses can be claimed against the *Ousel* and by her by way of indemnity against the *Liverpool*. That is, in fact, a part of the same debt, and in our judgment if both sums can be proved for, the same debt will have been proved for twice to

13 (1802) 9 Morr. 249, D.C.

14 [1947] A.C. 265; 63 T.L.R. 11; [1946] 2 All E.R. 696.

15 [1928] 2 K.B. 159, C.A.

the extent of £10,000. It was pointed out by Scrutton L.J. in *In re Melton*16 that in considering the rule against double proof technicalities are not to be regarded. These are his words16: "To these two sets of legal principles I have mentioned it remains to add the fact of the debtor's bankruptcy, and in particular the rule in bankruptcy that there must not be a double proof for the same debt, with the further explanation that, in determining whether the two proofs are in respect of the same debt, regard must be had, not to technicalities, but to the substance, as was pointed out in *In re Oriental Commercial Bank.*"17

In our judgment, therefore, the fund is not to be subjected to both liabilities.

If we are right so far, the further question arises: which of the competing claimants may prove? In our judgment, the answer is that the board has priority because it is actually out of pocket by the whole of its claim, whilst the *Ousel* is not because she has not yet been obliged to pay. Authority for this is to be found in *In re Fenton*.18 That was a very different case from the present, but is of assistance. Fenton was guarantor of certain debts to banks of an association in which he was interested. Both he and the association were insolvent. He had paid nothing under his guarantee, but claimed to prove in the liquidation of the association in respect of his liability, which was a contingent debt and, as Lord Romer pointed out,19 would have been provable as such but for the rule against double proof, for the banks as principal creditors had already proved for the same debt, and had priority because they were out of pocket while Fenton was not.

The result may appear harsh to the *Ousel*, which was, after all, an innocent victim of the *Liverpool's* wrongdoing, but it flows from the wrongdoer's statutory right to limit her liability which results in loss to all the claimants.

If, having received its dividend, the board, being, as it will be, still out of pocket, seeks to enforce its statutory right against the *Ousel*, the interesting question will arise whether the latter will be able to resist this claim to the extent of the dividend recovered by the board in respect of the £10,000 on some such principle as is illustrated in *In re Sass*20 and *In re Houlder*.21 This is not a question which is raised here. It has not been

16 [1918] 1 Ch. 37, 60; 34 T.L.R. 20.

17 7 Ch.App. 99.

18 [1931] 1 Ch. 85.

19 Ibid. 120.

20 [1896] 2 Q.B. 12; 12 T.L.R. 333.

21 [1929] 1 Ch. 205.

argued and we do not propose to attempt to answer it. It is, however, to be observed that if the *Ousel* can maintain a defence on these lines, exactly the same result will have been achieved as that which flows from the President's decision: a result, it may well be thought, consonant with justice and good sense.

For the reasons we have indicated, while agreeing with the President on the question of double proof and that of whether the two debts are the same, we have arrived at a different conclusion and this appeal must be allowed and declarations substituted to the following effect: (a) that the claim of the board against the fund ought to be allowed at its full amount, and (b) that the claim of the owners of the *Ousel* ought to be disallowed.

Appeal allowed. Declarations (a) that the board's claim against the fund be allowed to the full amount, and (b) that the claim of the owners of the Ousel be disallowed. The owners of the Ousel to pay half the costs of the board and the full costs of the part cargo-owners on the appeal and in the court below. Leave to appeal to the House of Lords.

Solicitors: *R. H. Bransbury, Liverpool; Waltons & Co.; Weightman, Pedder & Co., Liverpool*.

Index No. 11

Indexed as:

Olympia & York Developments (Re)

IN THE MATTER OF the Bankruptcy of Olympia & York Developments Limited, a corporation incorporated under the laws of the Province of Ontario and having its principal place of business in the City of Toronto, in the Municipality of Metropolitan Toronto

[1998] O.J. No. 4903

80 O.T.C. 369

4 C.B.R. (4th) 189

84 A.C.W.S. (3d) 15

Court File No. 97-CL-000161

Ontario Court of Justice (General Division)
In Bankruptcy

Blair J.

November 26, 1998.

(30 pp.)

[Ed. note: A Corrigendum was released by the Court December 17, 1998 and the correction has been made to the text.]

Bankruptcy -- Claims provable -- What constitutes -- Creditors -- Rights, effect of bankruptcy of debtor -- Claims -- Severability -- Practice -- Evidence and proof -- Appeals -- From registrar's decision, nature of appeal -- Double proof.

Appeal by the Trustee in Bankruptcy of Olympia and York Developments Limited from a decision by the Registrar that a claim by York's creditor, A&G Lenders, and the claim of the Olympia and York Resources Credit Corporation did not constitute a double proof. Both of these claims arose out of a jumbo loan transaction. Resources had been incorporated for the sole intent of giving effect to

the Jumbo Loan. The Registrar found that Resources had a separate corporate existence from York, that a genuine debtor and creditor relationship did exist between York and Resources, and that one payment would not discharge both claimants' claims against York. The Trustee argued that allowing both claims amounted to a double proof. It was admitted that the A&G Lenders comprised substantially all of the creditors of Resources. However, the Trustee for Resources had filed a proof of claim in the York bankruptcy. York's Trustee was prepared to acknowledge one claim, either by Resources or the A&G Lenders, and argued that there was in substance only one debt. The respondents argued that the claim by Resources on the York debt and the claim of the A&G Lenders on the guarantee of the Resources debt were not claims in relation to the same debt.

HELD: Appeal allowed. The order of the Registrar was set aside. An order was granted directing that the claims of the A& G Lenders and of Resources against the estate of York constituted a double proof against the estate. There was a declaration that the A&G Lenders and Resources were entitled to rank for payment of one dividend out of the estate of York. The loan from the A&G Lenders to Resources and the continuing loans of the same funds from Resources to York were in substance the same debt. There was an inseparable nexus between the obligation of Resources to pay the A&G Lenders and the obligation of York to make payments to Resources. The Registrar erred in law by finding that the existence of a separate corporate entity and a debtor and creditor relationship between the parent and the subsidiary meant that the same-debt-in-substance test could not be met.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

Counsel:

Geoffrey B. Morawetz and Benjamin T. Glustein, for Pricewater-house Coopers Inc. (formerly Coopers & Lybrand Limited), in its capacity as the trustee in bankruptcy of Olympia & York Developments Limited.
Benjamin Zarnett, PricewaterhouseCoopers Inc., (fomerly Coopers & Lybrand Limited, in its capacity as the trustee in bankruptcy of Olympia & York Developments Limited.
John A. MacDonald and Arthur Peltomaa, for Credit Lyonnais Canada, in its capacity as security agent for the A&G Lenders, and Deloitte & Touche, in its capacity as trustee in bankruptcy of Olympia & York Resources Credit Corporation.

BLAIR J.:--

I. OVERVIEW AND BACKGROUND

Overview

1 The issues on this appeal turn on what is known as the rule against double proof in bankruptcy matters.

2 Olympia & York Developments Limited ("OYDL") and Olympia & York Resources Credit Corporation ("OYRCC") are bankrupt corporations.[1] OYRCC is a wholly owned subsidiary of OYDL created for the single purpose of receiving the sum of US $2.5 billion by way of what was termed a "Jumbo Loan" from a syndicate of lenders known as the "A&G Lenders". Immediately upon receipt, the monies were advanced by OYRCC to OYDL, which gave back a Promissory Note and entered into a Repayment Agreement with OYRCC. OYDL also guaranteed the OYRCC indebtedness to the A&G Lenders.

3 It is admitted that the A&G Lenders comprise substantially all of the creditors of OYRCC. In fact, they are the only creditors who have filed proofs of claim in the OYRCC bankruptcy. All of the inspectors in that bankruptcy are representatives of the A&G Lenders.

4 Deloitte & Touche, the trustee in bankruptcy for OYRCC, has filed a proof of claim in the OYDL bankruptcy for the principal amount of the loan -- which remained outstanding in full at the time of the insolvency proceedings -- together with interest. At the same time, the A&G Lenders have also filed a proof of claim in the OYDL bankruptcy, based upon the OYDL guarantee of the OYRCC indebtedness, together with interest.

5 OYDL's Trustee disallowed the claims on the ground that they constitute a double proof of claim against the estate for the same debt. It was, and is, prepared to acknowledge one claim, by either OYRCC or the A&G Lenders. The amount the Trustee is prepared to acknowledge is the sum of $1,759,108,979 (Cdn), representing the outstanding principal on the Jumbo Loan less the sum of $1,281,281,018 (Cdn) recovered by the A&G Lenders on security pledged to it to guarantee the Jumbo Loan by certain OYRCC subsidiaries.[2]

6 Both the A&G Lenders and the Trustee in Bankruptcy of OYRCC appealed the disallowances to the Registrar in Bankruptcy. On May 21, 1998, Registrar Ferron allowed the appeals, Re Olympia and York Developments Ltd., [1998] O.J. No. 2114. OYDL's Trustee now appeals from the decision of Registrar Ferron, and seeks,

(a) an Order setting aside the decision of the Registrar;
(b) an Order that the claims of the A&G Lenders and of OYRCC against the estate of OYDL ("the Claims") constitute a double proof against the estate;
(c) a declaration that the A&G Lenders and OYRCC may rank for payment of one dividend out of the estate of OYDL based on a claim in the sum of $1,759,108,979 (Cdn); and,
(d) costs.

Background

7 In December 1988, OYDL and the A&G Lenders began negotiations in respect of what was to become the $2.5 billion (U.S.) loan facility. A commitment letter from Credit Lyonnais to OYDL, dated December 1988, set out the initially proposed terms. The borrower for purposes of the loan facility was to be a wholly owned subsidiary of OYDL and OYDL was to guarantee the Loan. The proposal was that the Loan Agreement and other documents would contain covenants and other provisions "as are usual in Olympia & York loan agreements". The commitment letter concluded by saying that Credit Lyonnais was "very pleased to have this opportunity to provide this facility to Olympia & York and [looked] forward to the continuation of [their] mutually beneficial relations".

8 The negotiations eventually ripened into the Jumbo Loan transaction -- or, more accurately, series of transactions.[3] Except for US $500 million which was remitted directly to OYDL by one of the lenders upon the direction of OYRCC, the funds were advanced by the A&G Lenders to OYRCC. OYRCC, in turn and on the same day, "onloaned" the monies to OYDL. At the end of the day, OYDL had a loan facility of US $2.5 billion.

9 In exchange, OYDL (a) gave its guarantee of the OYRCC indebtedness to the A&G Lenders (the "OYDL Guarantee") not just as guarantor but also as principal debtor, (b) agreed to maintain a current value net worth of at least US $2.5 billion throughout the life of the facility, (c) executed a Promissory Note in the principal amount of US $2.5 billion in favour of OYRCC, and (d) entered into a Repayment Agreement in that regard with OYRCC. Apart from the OYDL Guarantee, the central underlying security which the A&G Lenders received from the Jumbo Loan consisted of a pledge of the shares that OYDL held (indirectly through subsidiaries) in Abitibi Price Inc. ("Abitibi") and in Gulf Canada Resources Limited ("Gulf").

10 The Jumbo Loan arrangements were somewhat complex, and had their business and tax driven aspects. For a schematic representation of the transaction, reference may be made to the diagram which is attached as Schedule "A" to these Reasons. In narrative terms, the specific arrangements were as follows:[4]

(a) the shares of Abitibi and Gulf, formerly held by a number of corporations in the O&Y Group would be transferred to Olympia & York Forest Holding Limited ("Forest") and Olympia & York Energy Holdings Limited ("Energy"), respectively;
(b) the shares of Forest and of Energy would be wholly owned by A&G Resources Corporation ("A&G Resources");
(c) the shares of A&G Resources would be wholly owned by OYRCC;
(d) the shares of OYRCC would be wholly owned by OYDL;
(e) all existing loans secured prior to that date by Abitibi and Gulf shares owned by the O & Y Group would be repaid in an amount sufficient to release those shares from existing security;

(f) the A&G Lenders would advance the Jumbo Loan;
(g) the A&G Lenders would take indirect security over the Abitibi and Gulf shares by taking a pledge of the shares of A&G Resources from OYRCC;
(h) A&G Resources would (i) guarantee OYRCC's obligations to the A&G Lenders, (ii) provide a negative pledge in respect of the Abitibi and Gulf shares held by Forest and Energy respectively, and (iii) pledge the shares of Forest and Energy in favour of the A&G Lenders;
(i) OYDL would obtain the use of the funds advanced; and,
(j) OYDL would guarantee the obligations of OYRCC to the A&G Lenders.

11 In accordance with the agreements, OYRCC and its wholly owned subsidiary, A&G Resources, and its wholly owned subsidiaries, Forest and Energy, were all incorporated under the Business Corporations Act (Ontario). OYRCC is a single purpose subsidiary of OYDL, incorporated for the sole intent of giving effect to the Jumbo Loan. It has no source of income other than a 1/16th percentage spread on the interest rate paid by OYRCC to the A&G Lenders. Its only asset, apart from the shares of A&G Resources (which were pledged to the A&G Lenders as security for the Jumbo Loan), is its claim against OYDL. The A&G Lenders, as I have already noted, are substantially the only creditors of OYRCC.

12 The terms of the Jumbo Loan, as between OYRCC and the A&G Lenders are set out in four separate Term Loan Agreements (one for each applicable lender or syndicate of lenders), and, symmetrically, OYDL provided four separate guarantees of OYRCC's obligations under the Jumbo Loan (collectively, "the OYDL Guarantee"). As between OYRCC and OYDL, the transactions are evidenced by the Promissory Note and the Repayment Agreement.

13 The Term Loan Agreements reflect the loan transaction as between the Borrower, OYRCC, and the particular lender or syndicate of lenders in question. They do not refer specifically to the back-to-back loan from OYRCC to OYDL. However, their provisions do reflect a connection with the OYDL Guarantee and with the security afforded by the pledge of the A&G Resources shares (and, indirectly, the pledge of the Abitibi and Gulf shares). These provisions include,

* cross-default clauses (a default under the OYDL Guarantee is a default under the Term Loan Agreements; the insolvency of OYDL is a default under the Terms Loan Agreements);
* a term that the Lenders must consent in writing to any amendment or waiver of any provision not only of the Term Loan Agreements but also of any document referred to therein (e.g., the OYDL Guarantee) and, in addition, must consent in writing to "any departure by the Borrower or any other O&Y Corporation"[5] which is a party to such a document from the terms of such a document; and, in this latter connection specifically, includes,
* a clause requiring written Lender consent to any agreement "to a reduction

> in the Required Net Worth (as that term is defined in the [OYDL] Guarantee").

14 The "Required Net Worth (as that term is defined in the [OYDL] Guarantee") is a reference to the covenant of OYDL that its net worth would not fall below US $2.5 billion, i.e. the amount of the Jumbo Loan advance.

15 The contractual arrangements between OYRCC and OYDL reflect an integration with the Term Loan Agreements. The Repayment Agreement, the Promissory Note and the Term Loan Agreements are all dated on March 21, 1989, the same day the back-to-back loans were advanced. A reading of the Repayment Agreement and the Promissory Note together demonstrates that payments by OYDL under the Promissory Note and payments by OYRCC under the Term Loan Agreements are interrelated. For instance, the preamble to the Repayment Agreement states:

> AND WHEREAS it is the intention of OYDL and [OYRCC] that the unpaid principal amount of the Note shall at all relevant times be equal to the aggregate unpaid principal amounts of the Reference Tranches (as defined in the Note)[6].

16 The Promissory Note provides that the interest rates payable and the timing of the interest payments by OYDL, to OYRCC under the Promissory Note are a function of the interest rates payable by OYRCC under the Term Loan Agreements. The interest rate payable by OYDL to OYRCC is 1/16th% greater than the rate payable by OYRCC to the A&G Lenders. Moreover, the Note also stipulates that OYDL is obligated to pay additional sums to OYRCC that OYRCC itself may be required to pay under the Term Loan Agreements for such things as additional interest owing on account of late payments of principal or amounts owing with respect to an indemnity given to the A&G Lenders by OYRCC for costs incurred as a result of default.

17 Most significantly for purposes of the Appellant's argument here, sections 3 and 4 of the Repayment Agreement specify that:

> 3. If it becomes known to [OYRCC] that the whole or any part of the principal amount of any Reference Tranche will be paid by it or will become or has become due and payable by it pursuant to [certain provisions in the Term Loan Agreements], then [OYRCC] shall so notify OYDL to the extent that notice of the particulars of such event has not already been given by it pursuant to [another provision of the Term Loan Agreement].
> 4. OYDL shall make payments of principal under the Note to [OYRCC] at such time or times and in such amounts as payments of principal are made by [OYRCC] under the Term Loan Agreements. (emphasis added)

The Registrar's Decision

18 Registrar Ferron held that the two claims did not constitute a double proof. In doing so, he focussed on the following factors as of particular importance (with the results indicated):

(a) whether "a resulting genuine debtor/creditor relationship between OYDL and OYRCC in fact exist[ed] or whether, having regard to the close corporate relationship which existed between the parent and the subsidiary, the circumstances surrounding the genesis of the credit facility, the terms of repayment and the evidence of the loan, such a relationship could not have arisen" (the Registrar found that a genuine debtor/creditor relationship did exist);

(b) whether one payment would discharge both claimants' debts against OYDL (he held it would not);

(c) whether OYRCC had a separate corporate existence (he found that it did).

19 With respect to his finding on the last factor, the Registrar relied on an English decision, Re Polly Peck International plc (in administration) [1996], 2 All E.R. 433 (Ch. Div.) ("Polly Peck"), a case with facts similar to the case at bar.

Positions of the Parties

20 The Respondents argue that the interrelationship which OYDL and OYRCC have set up between the Repayment Agreement, the Promissory Note and the Term Loan Agreements is irrelevant to the proof of claim issue and of no Concern to the A&G Lenders. They contend that there were two separate loans and thus, there are two separate debts. They argue that the Registrar correctly applied the rule against double proof in bankruptcies by concluding that the rule did not apply because the claim of OYRCC (on the OYDL debt) and the claim of the A&G Lenders (on the guarantee of the OYRCC debt) are not claims in relation to the same debt. Furthermore, he properly relied upon and applied the principles set out in Polly Peck.

21 The Trustee of OYDL submits that the Registrar erred in concluding that the OYRCC claim and the A&G claim did not amount to claims for the same debt twice over, thereby constituting a double proof. He says the Registrar misconstrued or failed to consider the constating documents relating to the Jumbo Loan and in particular, the provisions of the Promissory Note and the Repayment Agreement cited earlier in these Reasons. The Registrar erred in requiring a finding that OYRCC had no real separate corporate existence or that there was no genuine debtor/creditor relationship between OYDL and OYRCC before he could find that the claims were based on the same debt. The Trustee states that the substance of the transaction, not the form counts and here there is in substance only one debt, namely the US $2.5 billion Jumbo Loan.

II. LAW AND ANALYSIS

Standard of Review

22 An appeal from the Registrar in Bankruptcy is a true appeal, and not a hearing de novo. The appellant must satisfy this Court that the Registrar arrived at an incorrect result in law. Rosenberg J. summarized this standard of review in the following fashion, in Re Kenny (1997), 149 D.L.R. (4th) 508 (Ont. Gen. Div.), at pp. 514-515:

> An appeal under s. 192(4) of the BIA from an "order" of a Registrar is a true appeal and not a hearing de novo. Accordingly, the appellant must satisfy the court that the Registrar erred in principle or in law in the way he has applied or exercised his discretion or that he omitted the consideration of, or misconstrued some fact (citations omitted).

The Rule Against Double Proof

23 The rule against double proof in bankruptcy matters prohibits two proofs of claim in the same estate for the same debt. That the two claims may be based on separate contracts is of no matter, provided they are in respect of the same debt. Sir G. Mellish L.J. put the concept very succinctly in Re Oriental Commercial Bank; Ex parte European Bank (1871), 7 L.R. Ch. App. 99, where he stated (at pp. 103-104):

> [T]he true principle is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts. (Emphasis added)

24 See also, Barclays Bank Ltd. v. TOSG Trust Fund Ltd., [1984] 1 All E.R. 628 (C.A.), at pp. 636-637, affirmed on different grounds [1984] 1 All E.R. 1060 (H.L.); Houlden & Morawetz, Bankruptcy and Insolvency Law of Canada 3rd ed., at paragraph G-40; Re Melton; Milk v. Towers [1918] 1 Ch 37, at p. 47.

25 There is a reason for this rule. It was developed to ensure the pari passu distribution of the assets of the bankrupt on a pro rata basis amongst the unsecured creditors -- the central tenet of bankruptcy legislation.[7] In the words of Oliver L.J. in Barclays Bank, supra, at p. 653:

> p. 653 ... The purpose of the rule is, of course, to ensure pari passu distribution of the assets comprised in the estate of an insolvent in pro rata discharge of his liabilities. The payment of more than one dividend in respect of what is in substance the same debt would give the relevant proving creditors a share of the available assets larger than the share properly attributable to the debt in question.

26 The Parties do not disagree as to the foregoing statement of the rule against double proof, or as to the rationale underlying it. They simply disagree as to its application in the circumstances of this case.

The Authorities

27 Whether or not a "double proof" has been lodged with respect to what is in substance the same debt is a matter to be determined on the facts of each individual case. From my understanding of the authorities, the underlying principles which should frame this analysis in group corporate insolvency situations may be summarized as follows. First, where the interests of different creditors of the various corporate entities come into play, the courts should be careful to respect the axiom regarding separate corporate existence enunciated by the House of Lords in Salomon v. Salomon [1897] A.C. 22. At the same time, however, the courts should strive to give effect to the ethic of pari passu distribution and to the fundamental underlying principle of justice as between all creditors. Balancing these sometimes competing principles calls for a consideration of the true nature of the transaction, and the relationship between, and the presumed common intention of the parties. Finally, in seeking a just solution in novel situations the court may engage in an analysis which, while not ignoring the separate corporate being of the members of the corporate group, nonetheless transcends the mere legal fact of that existence. See in particular, as to the foregoing summary, Ford & Carter Ltd. v. Midland Bank Ltd. (1979) 129 NLJ 543, per Lord Wilberforce at p. 544; Polly Peck, supra, at pp. 444-445; and Barclays Bank, supra, per Kerr L.J., at pp. 645 and 647-648, and per Oliver L.J. at pp. 636 and 640.

28 In insolvency cases -- as in, for example, tax cases -- the court will not allow technicalities to obscure the essence of the transaction. This includes, in my opinion, not being either too dazzled or too immobilized by intricate corporate footwork which is designed to accomplish legitimate business and tax purposes, but which may not be as directly dispositive in resolving insolvency cases. This point was emphasized by Oliver L.J. in Barclays Bank at pp. 640 and 636:

> p. 640: This argument is perfectly intelligible, and indeed almost unanswerable if one regards the payment of those customers who were paid to TOSG as an entirely separate transaction isolated from any other arrangement made with the agency, but to my mind it ignores the reality. If one is to look for analogies, it is, I think, essential first to analyse what the total effect of the arrangements was and the reasoning behind them. All the cases stress that in relation to the rule against double proofs it is the substance and not the form that is to be regarded (see eg Re Melton, Milk v. Towers [1918] 1 Ch 37, at 60, [1916-17] All ER Rep 672 at 683, Re Oriental Commercial Bank (1871) LR 7 Ch App 99). (emphasis added)
>
> p. 636: I accept the submission of counsel for TOSG and the agency that the rule ought more properly to be styled the rule against double dividends, for its object is to absolve the liquidator from paying out two dividends on what is essentially the same debt ... (emphasis added)
>
> Second, it is, I think, a fallacy to argue ... that, because overlapping liabilities result from separate and independent contracts with the debtor, that, by

> itself, is determinative of whether the rule can apply. The tests is in my judgment a much broader one which transcends a close jurisprudential analysis of the persons by and to whom the duties are owed. It is simply whether the two competing claims are, in substance, claims for payment of the same debt twice over. (Italics in original; underlining added)

Application of the Rule in the Circumstances of this Case

29 To adopt the language of Oliver L.J., then, what is "the total effect of the arrangements ... and the reasoning behind them" in the circumstances of this case? In my view, a careful reading of all of the documentation including in particular, the Repayment Agreement, supports the conclusion that the "loan" from the A&G Lenders to OYRCC and the "on-loaning" of the same funds from OYRCC to OYDL are in substance the same debt.

30 Notwithstanding the complex structure of the arrangement from a commercial/corporate/tax perspective, the economic and financial reality of the Jumbo Loan deal -- its substance, if you will -- is simple and clear: a US $2.5 billion loan facility was lent by the A&G Lenders to OYDL on the strength of (a) the OYDL covenant and, (b) the security of the Abitibi and Gulf shares. In my opinion, in the particular circumstances of this case, the legal substance of the transaction is to he same effect[8].

31 The documents in this case demonstrate that, from the perspective of the A&G Lenders, the loan facility was backed by the OYDL covenant and by the security of the Abitibi and Gulf shares. Moreover, while the funds were being advanced, technically, to OYRCC, it is clear from the Credit Lyonnais commitment letter that the lenders were providing the facility to OYDL. The A&G Lenders were not privy to the internal fashion in which the Olympia & York corporations structured the deal. Nevertheless, the structure suggests a closely intended connection between the obligation of OYDL to make payments to OYRCC and the obligation of OYRCC to make payments to the A&G Lenders.

32 In this latter regard, particular reference may be made to the requirement in the Repayment Agreement that payments of principal under the Note are to be made "at such time or times and in such amounts as payments of principal are made by [OYRCC] under the Term Loan Agreements". Furthermore,

> * The funds were initially advanced by the A&G Lenders and "on-loaned" to OYDL on the same date that the Term Loan Agreements, the Promissory Note, the Repayment Agreement were executed;
>
> * OYRCC was incorporated for the sole purpose of receiving the funds from the A&G Lenders and forwarding those funds to OYDL, and, apart from the receipt of the 1/16th% spread on the interest rate, OYRCC did not transact any other

business;

* the timing and rate of interest payments under the Promissory Note were directly tied to the interest payments to be paid by OYRCC under the Term Loan Agreements;

* OYDL agreed under the Promissory Note to pay additional sums to OYRCC that may be payable by OYRCC to the A&G Lenders in certain circumstances such as default in interest; and, finally,

* the Repayment Agreement states in its recitals that it was the intention of OYDL and OYRCC that the unpaid principal amount of the Promissory Note would be equal to the aggregate unpaid principal amounts under the Term Loan Agreements.

33 There is thus an "inseparable nexus"[9] between the obligation of OYRCC to pay the A&G Lenders and the obligation of OYDL to make payments to OYRCC. The agreements contemplate the former will occur before the latter are called for. The circle is closed, it seems to me, with OYDL's agreement to be bound as principal debtor and by the fact that, for all practical purposes, the A&G Lenders are the only creditors of OYRCC.

34 To my mind these circumstances lead to the inescapable inference that the parties intended that there would be a single US $2.5 billion loan facility made available to OYDL on the strength of the OYDL covenant and the security of the Abitibi and Gulf shares, and that the A&G Lenders would look to OYDL ultimately and primarily, if not solely, for payment. It was not the common intention of the parties that in the event of the bankruptcy of both OYDL and OYRCC, the A&G Lenders would be able to recover a dividend based upon 200% of their claim, which would be the effect if the claims put forward by ARCH and the A&G Lenders are both allowed to stand.

The Registrar's Decision and the "Genuine Debtor-Creditor", "Separate Corporate Existence", and "Group Enterprise" Issues

35 Registrar Ferron concluded that there existed a genuine debtor-creditor relationship between OYDL and OYRCC and that there was nothing in the circumstances which would allow him to disregard the separate corporate existence of OYRCC. In my view, these conclusions are simply mirror images of each other. Registrar Ferron said:

> If one acceded to the position taken by the trustee of OYDL and concluded that OYRCC's loan to its parent company was of no significance, the transaction involving the loan from the A&G Lenders would have to be seen as something of

> a sham and that [the] A&G Lenders were misled in loaning funds to OYRCC which until this point no one denied. [OYRCC] had a corporate existence separate and distinct from its parent including the capacity to borrow and loan funds.

36 While the latter observation is accurate, it is not conclusive; and, in my respectful view, the learned Registrar erred in law in deciding that once he found the existence of a separate corporate entity and a debtor-creditor relationship between parent and subsidiary, the same-debt-in-substance test could not be met. The case law illustrates that the existence of separate and distinct claims or liabilities is not determinative of the double proof issue. The crucial question is whether or not the separate and distinct claims relate in substance to the same debt. For the reasons that I have outlined, I am satisfied that they do.

37 In concluding that a separate corporate existence was dispositive of the double proof issue, the Registrar relied heavily upon the decision of the English Court of Chancery in Polly Peck. This decision warrants careful consideration, although in the end I am satisfied that it is distinguishable from the circumstances of this case and, in any event, not dispositive or the issues to be determined.

38 The factual situation in Polly Peck, on the surface, is remarkably similar to this case. It involved a large multi-national group of companies (the "PPI Group"), the use of a special purpose subsidiary as a financial vehicle for the raising of funds for the Group ("PPIF"), a resulting intra-corporate indebtedness with the initial loan to the special purpose subsidiary being guaranteed by the parent ("PPI") and the funds being "on-loaned" to the parent by the subsidiary. It also involved the insolvency of both the parent company and the special purpose subsidiary. Robert Walker J. reviewed all of the arguments which have been put forward in this case. He rejected the argument that the special purpose subsidiary had no separate corporate existence and was in effect an agent or nominee of the parent, or, that it was a mere façade, on the basis of the well-known principles of separate legal identity established in Salomon v. Salomon, supra. He also rejected the argument that in circumstances such as these, a closely-integrated group of companies should be considered as a single economic unit -- saying that he found those submissions of counsel "most persuasive", but concluding that he was "not ultimately persuaded by them": supra, p. 447. His reasons in this regard are carefully considered, and I quote them in full (supra, pp. 447-448):

> The arguments for considering a closely-integrated group of companies as a single economic unit were fully considered (principally in the context of corporate presence as founding jurisdiction) in Adams v. Cape Industries plc [1991] 1 All ER 929 at 965, [1990] Ch 433 at 476-477, both by Scott J and, with a full citation of authority, in the judgment of the Court of Appeal (see [1991] All ER 929 at 1016-1020, [1990] Ch 433 at 532-537). Both passages merit careful study. The Court of Appeal concluded that --

> 'save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of Salomon v. Salomon & Co Ltd, [1897] AC 22, [1895-9] All ER Rep 33 merely because it considers that justice so requires.' (See [1991] 1 All ER 929 at 1019, [1990] Ch 433 at 536.

Mr. Kosmin seeks to add to these exceptions (turning on particular statutes or contracts) a further exception where a rule of law founded in public policy (the rule against double proof) would be frustrated by ignoring the economic reality of the single group. In that submission Mr. Kosmin can and does call in aid the words of Oliver LJ in Barclays Bank Ltd. v. TOSG Trust Fund Ltd [1984] 1 All ER 628 at 636-7, [1984] AC 626 at 636 that the test is 'a much broader one which transcends a close jurisprudential analysis of the persons by and to whom the duties are owed'.

Nevertheless I am not persuaded by the argument. I can accept that as a matter of economic reality the bondholders (whose presumed intentions may be material) must have intended to rely on the credit-rating and covenant of PPI, whether as guarantor or (after substitution) as principal obligor. It is doubtful whether even the most farsighted of them can have calculated that in the event of a crash, PPIF might have fewer unsecured creditors than PPI, and a claim against PPI on the loan. It was perfectly possible, consistently with each prospectus, that the proceeds of some or all of the bond issues would be loaned on, not to PPI, but to other group subsidiaries. It is also possible, though less likely, to imagine a situation in which PPIF lent on to another subsidiary, with PPI guaranteeing that borrowing also, and the second subsidiary then lending on to PPI. Each of those sequences of events would be likely to produce a different result in the event of a crash of the whole group, whether or not the rule against double proof has any application. The possibility of there being subsidiaries which were not wholly owned subsidiaries adds to the range of imaginable variations.

Were I to accede to Mr. Kosmin's submission it would create a new exception unrecognised by the Court of Appeal in Adams v. Cape Industries plc and that is not open to me. Moreover I think that Mr. Kosmin is in one sense assuming what he seeks to prove, since the unjust or inequitable result which he asserts does not occur unless the group is recognised as being in substance a single economic entity, whose constituent members' internal rights and obligations are to be disregarded. But the authorities to which I have already referred show that substance means legal substance, not economic substance (if

> different), and that legal existence of group companies is particularly important when creditors become involved. Injustice may be in the eye of the beholder, but I do not perceive any obvious injustice -- certainly not such as the court can remedy -- the unpredictable consequences that may follow from the unforeseen insolvency of a large international group of companies such as the Polly Peck group.

39 Polly Peck is distinguishable from this case in a number of ways, however. In Polly Peck, Robert Walker J. specifically noted the exception alluded to in Adams v. Cape Industries plc, supra, involving "cases which turn on the wording of particular statutes or contract". In that case, there was no evidence of an inseparable legal nexus between the two loans in the structure of the transaction. Thus, the parent's obligation to pay under the "onloaned" transaction was not dependent upon the subsidiary's payments being made under the underlying transaction structured between the lender and the subsidiary, which is the situation in this case. Additionally, while in Polly Peck the parent had the option of substituting itself as a principal obligor, it was not obliged to do so. Here OYDL had committed itself as a principal obligor in the Jumbo Loan, and accordingly, as a matter of law it had become a "full-fledged principal debtor with all of the duties and obligations that term implies": Manulife Bank of Canada v. Carlin, supra, pp. 436-437. Finally -- and significantly -- the lenders in Polly Peck were not the only substantial creditors of the subsidiary corporation, PPIF, whereas in this case, under the structure of the transaction, the A&G Lenders would only ever be the substantial creditors of OYRCC.

40 In my view, it is not necessary to be overly concerned in this case about "piercing the corporate veil", "separate corporate entity", or whether concepts such as a "group enterprise theory" or a "single economic unit" theory should be considered. The case does not fall to be decided on any of these bases. It falls squarely into one of the recognized exceptions to the principle of Salomon v. Salomon. It is a case which turns on the wording of a particular contract, or contracts.

41 Moreover, the reality flowing from the fact that the A&G Lenders are the only creditors of OYRCC for these purposes (and for practical purposes would only ever be) is that the A&G Lenders will recover a dividend in the OYDL bankruptcy on the basis of 200% of the debt owing to them whereas other creditors of OYDL will be obliged to accept solace on the basis of only the amount of their claims. This result is fundamentally contrary to the foremost underlying principal of bankruptcy legislation, and should be resisted. It is in reality, a double proof, and accordingly cannot be allowed.

42 Notwithstanding that this motion may be determined on the particular wording of the overall governing contractual documentation, I do not hesitate to say that in my view it is appropriate for the Court to have regard to the intra-corporate group aspects of the Jumbo Loan for purposes of assessing the overall nature of the transaction from a legal perspective. This is not a case of piercing the corporate veil, of arguing agency or sham, or of denying the existence of separate corporate vehicles in the same group enterprise. It is not a question of attempting to fasten some corporate

entity with a liability attributable on Salomon v. Salomon principles to some other corporate entity simply because they both belong to the same enterprise of economic unit. It is simply a question of looking at the total picture in order to determine "total effect of the arrangements", or, to put it another way, to determine the legal substance of the transaction.

43 This approach is well accepted, for instance, in tax cases, where it is necessary for the Court to sort out what is the essence of a transaction: see, for example, De Salaberry Realties Ltd. v. Minister of National Revenue (1974), 46 D.L.R. (3d) 100 (Fed.Ct., T.D.); Alberta Gas Ethylene Co. v. R. (1988), 41 B.L.R. 117 (Fed.Ct., T.D.). In the latter case, where the facts were strikingly similar to those here, Reed J., in refusing to ignore the separate corporate entity of a subsidiary made the following observation:

> ... I do not interpret the jurisprudence as ignoring the existence of subsidiary corporations per se. Rather, it seems to me that the jurisprudence proceeds on the basis that in certain circumstances, consequences will be drawn despite the legal existence of separate subsidiary corporations. (Emphasis added)

44 I agree. Here, at least for purposes of assessing proofs of claim in the parent company's bankruptcy, the consequences of the circumstances as they exist -- the "total effect of the arrangements" -- are that the Jumbo Loan is a same debt transaction "despite the legal existence" of the separate subsidiary, OYRCC.

Other Issues

One Payment for Discharge of Both Debts

45 In Barclays Bank, supra, Oliver L.J. postulated, as a test for determining whether there was a double proof, "the question whether two payments are being sought for a liability which, if the company were solvent, could be discharged as regards both claimants by one payment". (Emphasis added)

46 Registrar Ferron considered this test for determining whether the rule against double proof had been contravened, and concluded that the test was not met on the facts of this case. He said:

> If OYDL were to pay the A&G Lenders under the guarantee this could not affect the loan due to OYRCC under its note. Similarly, if OYDL were to pay OYRCC and thus discharge the Promissory Note, the obligation under the guarantee would still exist and be enforceable. One payment would not discharge both claimants' debts against OYDL and accordingly, on the test suggested by Oliver, L.J. the rule is not offended.

47 I respectfully disagree. The Registrar's conclusion flows from a misunderstanding of the constating documents which frame the Jumbo Loan deal. Suppose, for example, that OYDL

remained solvent, but that OYRCC had become insolvent and unable to pay the A&G Lenders. One payment by OYDL to the A&G Lenders would satisfy its liability on the OYDL Guarantee, and would eliminate the liability as between the A&G Lenders and OYRCC. There would accordingly be no further payments to be made by OYRCC under the Term Loan Agreements; and, since OYDL's obligation under the Note is to pay interest on the principal at the times provided in the Term Loan Agreements, and under the Repayment Agreement is "to make payments of principal under the Note to [OYRCC] under the Term Loan Agreements", OYDL could have no more liability to OYRCC under the Promissory Note. Thus, one payment would discharge both debts, having regard to the total contractual framework of the arrangement.

48 Working the single payment analysis from the other direction, namely by means of a payment by OYDL to OYRCC on the Note is a little less clear and more cumbersome. From a practical point of view, however, the effect would have been the same. No payment of principal was called for by OYDL to OYRCC until, and to the extent that, OYRCC had made payments on the loan. Accordingly, the liability of OYDL to the A&G Lenders on the OYDL Guarantee would have been reduced in the same amount. Even though OYDL technically had the right to prepay OYRCC under the terms of the Promissory Note and there is nothing specific in the agreements requiring OYRCC to remit payment to the A&G Lenders in return in such event, one payment would unquestionably discharge all debts if made by OYDL via the A&G Lender route, as I have indicated, and that, in my view, is sufficient to meet the "same debt" test. I see nothing in the decision in Barclays Bank mandating a contrary conclusion.

Creating a 'Double Proof' in the OYRCC Bankruptcy?

49 The Respondents argue that to accede to the "double proof' submissions of OYDL's Trustee would be to sanction a double proof situation in the OYRCC bankruptcy. This would be so because OYDL would in effect be receiving full credit for its indebtedness down to its subsidiary, OYRCC. This would deprive OYRCC's creditors (including those other than the A&G Lenders) of a right to share in that asset of OYRCC; and, at the same time, it would unjustifiably advantage OYDL's creditors by providing more money for them at the parent level.

50 The short answer to this submission is that it is premised on the proposition OYRCC had or might have had other creditors. However, that is not the case. The A&G Lenders are the only creditors of OYRCC, for these purposes. Given the contractual framework established for the Jumbo Loan, there would never be any other creditors of OYRCC with claims of any significance relative to those of the A&G Lenders, since OYRCC was limited in its ability to create further indebtedness which would exceed 1% of the Jumbo Loan. Thus, in the circumstances of this case, the "double proof" lies in the OYDL estate and not in the OYRCC estate.

Reduction of Claims on Account of Recoveries from Third Parties

51 The A&G Lenders have recovered the sum of $1,281,281,018 (Cdn) through their efforts to realize on the security pledged in relation to the Abitibi and Gulf shares. On a motion for directions

which resulted in orders made on February 13 and April 14, 1997, Farley J. required the A&G Lenders to deduct such amounts from their claims on the OYDL Guarantee. His orders were affirmed on appeal. It is therefore accepted that these sums must be deducted from the A&G Lenders side of the claim in the OYDL bankruptcy.

52 The Respondents submit, however, that if the claim of OYRCC in the OYDL estate is permitted to proceed -- even if the A&G Lender claim on the OYDL Guarantee is not -- it should be permitted to proceed without any similar deduction being made. This result might well follow, I think, if the view to be taken of the matter were that expressed by the learned Registrar. For the reasons I have outlined above, however, I am respectfully of the opinion that the view of the Registrar constituted an error in law and reflected a misapprehension of the factual and contractual basis underlying this case.

53 Because the amount still owing to the A&G Lenders has been reduced by the amount of the recovery on its other security, OYRCC's obligations to the A&G Lenders have been reduced by a similar amount. Under the Repayment Agreement, OYRCC is only able to call upon OYDL to make payments under the Promissory Note when, and to the extent that, it has itself made payments under the Jumbo Loan. In the circumstances now existing, it cannot be called upon to make payments which have already been made in the form of recovery on other security. Thus, it cannot have a claim against OYDL for more than what remains as the outstanding amount of the Jumbo Loan.

54 Therefore, in my view, to the extent that the OYRCC Claim in the OYDL bankruptcy is put forward it must be reduced by the amounts recovered by the A&G Lenders on their other security.

III. CONCLUSION

54a Accordingly,

a) the order of the Registrar is set aside;
b) an order is granted directing that claims of A&G Lenders and of OYRCC against the estate of OYDL constitute a double proof against the estate;
c) a declaration is granted that the A&G Lenders and OYRCC may rank for payment of one dividend out of the estate of OYDL based on a claim in the sum of $1,759,108,979.00 (Cdn.); and,
d) the Appellant is entitled to its costs of the appeal and of the proceeding before the Registrar.

[The Court did not number this paragraph. QL has assigned the number 54a.]

BLAIR J.

[Editor's note: Schedule "A" could not be reproduced online.]

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1 The bankruptcies followed an earlier re-structuring of OYDL and some 28 of its directly and indirectly owned subsidiaries, under the Companies' Creditors Arrangement Act (the "CCAA").

2 In separate proceedings and by Orders dated February 13 and April 14, 1997, Farley J. held that the A&G Lenders were required to deduct the sums recovered on such security from the amount of their claim. His Orders were upheld by the Court of Appeal in a decision released on September 1, 1998, Olympia & York Developments Ltd. (trustee of) v. National Bank of Canada, [1998] O.J. No. 3482 (C.A.).

3 The lending syndicate was comprised of the following lenders, to the extent of the following advances: Credit Lyonnais and other European lenders (US $1.25 billion); Hongkong and Shanghai Banking Corporation (US $ 750 million); Dai-Ichi Kango Bank, Ltd. (US $250 million); Royal Bank of Canada (US 250 million).

4 Summary taken from the admitted recitation of facts in the Appellant's factum.

5 A defined term in the Term Loan Agreement, meaning OYDL, or any of its subsidiaries, or any successor guarantors (or their subsidiaries).

6 Reference Tranches" as defined in the Note are portions of the advances made under the Term Loan Agreements.

7 As contemplated in section 141 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended (the "BIA").

8 See, Polly Peck, supra, at p. 444 and Tokyo Ltd. v. Karoon [1986] 3 All ER 468 at p. 486, for the general proposition that courts are concerned the law and not with economics when looking at the substance of matters.

9 To borrow a phrase used by Gonthier J. in Husky Oil Operations Ltd. v. M.N.R. [1995] 3 S.C.R. 453, at p. 491, albeit in a slightly different context. Husky Oil was a constitutional case, but Gonthier J. drew upon "double proof" concepts in considering the claims of a creditor and a statutory surety, who had made payments to the creditor on behalf of the debtor, against the estate of a principal debtor. The particular question he addressed was whether the statutory suretyship created a joint and several liability as between the debtor and the statutory surety for the debt (he concluded it did not).