

focus

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ENERGY DERIVATIVES IN AN INSOLVENCY REORGANIZATION

The Ontario Court of Appeal recently adopted the reasoning used by Alberta's Court of Appeal in the *Blue Range* decision, confirming that **physically settled derivative products are eligible for protection as eligible financial contracts (EFCs) under Canadian insolvency legislation.** A derivative instrument is considered to be "physically settled" if the underlying commodity of the derivative is to be physically delivered on settlement of the transaction. A physically settled derivative is different from a financially settled derivative (such as an interest rate or currency swap) in that the latter is settled by a cash payment. EFCs have special status under the *Companies' Creditors Arrangement Act (CCAA)* and under the proposal provisions of the *Bankruptcy and Insolvency Act*, in that no order can be granted under the CCAA which stays the right of a non-defaulting party to an EFC to terminate it in accordance with its terms.

In *Re: Androscoggin LLC*, the Ontario Court of Appeal applied the same general approach to the consideration of EFCs as found in *Blue Range*. The Court suggested that the hallmarks of such contracts include the right to terminate the agreement in the event of a bankruptcy or reorganization filing, the right to net out obligations arising under the arrangement, and the ability to re-enter the market to re-hedge the solvent counterparty's position.

FMC represented the International Swaps and Derivatives Association (ISDA), who intervened in the appeal. The decision seemed to restore

a common approach to physically settled derivatives in Canada — an approach that has seen the marketplace flourish since the initial *Blue Range* decision. Like the American treatment of forward contracts under Chapter 11 of the *U.S. Bankruptcy Code*, this approach renders physically settled derivatives eligible for protection from insolvency stay provisions.

For a case comment providing further examination of the *Androscoggin* decision, please access www.fmc-law.com and refer to "Library" and then "Newsletters - Insolvency and Workout." For further information, please contact **Tom Pepevnak** at (403) 268-7198.

REMOVAL OF DIRECTORS IN CCAA PROCEEDINGS

In a recent decision in the Stelco CCAA proceedings, the Ontario Court of Appeal said that **a Judge overseeing a proceeding under the CCAA does not have unlimited power to remove directors from the board of a debtor corporation,** although removal would be allowed where there were actions by directors that could be said to be oppressive. In so doing, the Court of Appeal overturned Farley J.'s decision to remove two board members who were appointed by Stelco on the same day the board was to begin considering bids received through Stelco's capital raising process.

The shareholders, who wished to have the two new directors appointed, owned or controlled approximately 20% of Stelco's outstanding shares and had additional shareholder support. They had bought the shares after Stelco's CCAA filing at distressed prices, and had publicly championed recovery for shareholders in a Stelco restructuring or sale. Other Stelco stakeholders objected to the appointment of these directors, arguing that they would be biased towards bids that favoured shareholder recovery at the expense of recovery to other stakeholders (including employees who had significantly underfunded pensions). They argued that the involvement of one stakeholder group on the board when it was considering which bid to accept was unfair.

The Court of Appeal said that the Court had no inherent jurisdiction to remove directors. Such a right was only available under the oppression remedy found in many corporation statutes. Even if there was such a right, the Court's use of discretion was not unlimited and had to be guided by the objects of the CCAA and the legal principles that govern corporate law issues. Removal of directors is to be seen as an exceptional remedy. The mere possibility of bias or risk of misconduct was not sufficient. What was not considered and may yet become an issue is whether, in a CCAA proceeding, a court could obtain the same result by imposing terms on the board as a condition of allowing it to continue to control the restructuring. Stay tuned.

If you would like more information on this decision, please contact **Dan Dowdall** at (416) 863-4700 or **Jane Dietrich** at (416) 863-4467, both of our Toronto office.

CHOICE OF LAW AND GUARANTEES

Recently, the British Columbia Court of Appeal confirmed that **the proper law governing a guarantee (when the guarantee is silent on the point) depends on the law governing the debt obligation it guarantees.** In *Canaccord Capital*, the guarantor disputed his liability for the indebtedness of a corporation on the grounds that his personal guarantee was invalid under the laws of Alberta (the province where the guarantor was located) because the guarantee was not notarized as required by the Alberta *Guarantees Acknowledgment Act*. The guarantee itself did not state by which law it was governed. The transactions which were guaranteed were governed by British Columbia law.

The parties agreed that **the legal test for determining the proper law of a contract is the law which appears to have the closest and most substantial connection after considering the contract as a whole in light of all the circumstances.** The guarantor argued

that the trial judge placed too much weight on the business purpose of the transaction and failed to recognize that the guarantee was a contract separate and apart from the primary debt obligation.

The Court rejected the guarantor's argument and found that commercial reality suggests that both contracts, the debt and the guarantee, are integral parts of a single transaction. As liability under the guarantee is dependent on liability under the primary debt obligation, the Court found that it made sense that both contracts would be governed by the same law - the law of British Columbia. While the Court will consider all the circumstances surrounding the contract, the purpose of the business transaction is a controlling factor in the choice of applicable law.

Similarly, the Court rejected the guarantor's argument that the place a guarantee will be performed or enforced is a significant factor in determining the proper law. The Court noted that it could be expected that Alberta courts would enforce any judgment provided that the guarantee was found to be enforceable in the jurisdiction in which judgment was given.

If you would like to discuss the *Canaccord Capital* case, please contact **Jennifer Dezell** of our Vancouver office at (604) 443-7146.

WHO AND WHAT IS NEW AT FMC?

FMC recently welcomed **Heather Lawson** to the Toronto Financial Services Group. Heather joins us from the Royal Bank Group's Legal Department and specializes in commercial lending and secured loan transactions.

Tom Pepevnak of our Calgary office has recently been appointed Chair of the Canadian Legal & Regulatory Committee of the International Swaps & Derivatives Association (ISDA) and is also a member of ISDA's Canadian Steering Committee. Tom heads up FMC's Derivatives Practice Group.

FMC's Tax Lawyers have recently authored a new book titled *Corporation Capital Tax in Canada*. It is the only publication in Canada dealing with corporation capital taxes federally and provincially. The latest version of the book is edited by **Tony Schweitzer** and **Graham Turner** and includes contributions from a number of tax lawyers from across the firm.

FMC Partner **Malcolm MacKillop** authored a new book titled *Damage Control: An Employer's Guide to Just Cause Termination, 2nd Ed.* The book offers Canadian companies valuable and timely information on current trends in the law of just cause termination.