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PLAN OF ARRANGEMENT UNDER THE CCAA OR ASSIGNMENT IN BANKRUPTCY UNDER THE BIA: WHICH TAKES PRIORITY?

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WHICH GROUP OF CREDITORS IS ENTITLED TO THE MONEY HELD BY A MONITOR FOR PURPOSES OF CARRYING OUT A PLAN OF ARRANGEMENT UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT* (**"CCAA"**) WHEN THE DEBTOR GOES BANKRUPT PRIOR TO THE DISTRIBUTION: ONLY THE CREDITORS COVERED BY THE PLAN OF ARRANGEMENT, OR ALL OF THE CREDITORS, EVEN THOSE NOT COVERED BY THE PLAN, FOR EXAMPLE, SUBSEQUENT CREDITORS?

THIS CONTROVERSIAL ISSUE WAS CONSIDERED BY JUDGE JEAN-YVES LALONDE IN THE MATTER OF THE BANKRUPTCY OF *RESSOURCES MESTON INC.*[1] HE CONCLUDED THAT SUCH AMOUNTS ARE VESTED EXCLUSIVELY IN THE CREDITORS COVERED BY THE PLAN OF ARRANGEMENT.

FACTS

The debtor, Ressources Meston inc. (**"Meston"**), had been under the protection of the CCAA since June 30, 2005. On June 26, 2006, Meston submitted a plan of arrangement to its creditors, who approved it and, the next day, the plan was sanctioned by the court.

This plan provided that certain transactions were to be completed and implemented in order to convert certain assets into cash and provide liquid assets to Meston, which would be paid to the monitor for distribution under the plan.

On December 1, 2008, after authorization by the court, the monitor proceeded with a first distribution to the creditors of amounts (about $2 million) held by it. Following this distribution, Meston proceeded with new transactions and the monies collected, of about $1 million, were paid to the monitor for a new distribution under the plan.

However, by that time, Meston was indebted to new creditors not covered by the plan to the extent of about $12 million.

Acknowledging its increased indebtedness and the failure of its restructuring, Meston made an assignment into bankruptcy on September 28, 2009, before the amounts still being held by the monitor were distributed.

THE PROBLEM

The monitor, who now became the trustee in bankruptcy, applied to the court for an answer to the following question:

> Should the amounts that were paid to the monitor by Meston [...] during the period of protection (CCAA) be distributed exclusively to the creditors covered by the arrangement (to the extent of their claims, without interest) or to all of the creditors having a provable claim in the bankruptcy of Meston?

[1] *Ressources Meston inc. (Syndic de)*, 2010 QCCS 428 (February 10, 2010)

THE PARTIES' POSITIONS

Two irreconcilable positions were held by distinct groups of creditors in this case: those covered by the plan claimed that the amounts held by the monitor were entirely vested in them, while the other creditors not covered by the plan claimed that the money had to be distributed to all the creditors under the bankruptcy. Each group defended the position most favourable to it.

THE STAKES

If the amounts were only distributed to the creditors covered by, and pursuant to, the plan, their claims (without interest) would be completely paid off. In that case, there would barely be more than a few hundred thousand dollars left to cover the $12 million in claims of creditors not covered by the plan. On the other hand, if the amounts were distributed to all the creditors under the bankruptcy, they would have more than $1 million to divide up between them, but the creditors covered by the plan, like all the other creditors, would in such case receive no more than a fraction of their claims.

LEGAL ARGUMENTS

The legal issue that needed to be resolved was whether the monies held by the monitor at the time of the bankruptcy were still in the debtor's patrimony, in which case they would be available to all the creditors.

The creditors not covered by the plan argued that, yes, they were, for various reasons. They relied on the "well-established" principle that the monitor under the CCAA, as distinct from the trustee in bankruptcy, is not vested with the debtor's assets,[2] and the debtor retains the ownership of its property for the duration of the initial order (whether extended or not).

The proponents of this approach also relied on section 70 of the *Bankruptcy and Insolvency Act* (**"BIA"**) which states that every bankruptcy order and every assignment *"takes precedence over all* [...] *executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or the creditor's representative* [...]".

As for the creditors covered by the plan, they submitted that the amounts received by the monitor under the arrangement left the debtor's patrimony when they were paid and must be distributed to them, that the said amounts were entrusted to the monitor for their sole benefit, and that it was the debtor's firm intention to do so. They added that this distribution was the objective of the plan of arrangement as sanctioned by the court, and that meaning and purpose must be given to this sanction. Furthermore, these amounts no longer met the definition of "property of a bankrupt" within the meaning of section 67 BIA, which states: *"The property of a bankrupt divisible among his creditors shall* [...] *comprise: (c) all property wherever situated of the bankrupt at the date of the bankruptcy* [...]".

DECISION

Justice Lalonde primarily considered what meaning was to be given to the word "payment" referred to in section 70 BIA to determine at what time monies cease to form part of the debtor's patrimony.

Firstly, he noted that numerous decisions, but primarily before the 2000's, held in favour of the creditors not covered by the plan who argued "... [translation] *that unless a complete and final payment has been made to a creditor or its representative, any amount available for purposes of the execution of a judgment or a settlement remained the "property of a bankrupt" when the bankruptcy occurred. This is because of the primacy which the bankruptcy order (or assignment) gives to the body of creditors over any enforcement measures.*" According to this jurisprudence, an amount deposited with the court or held by a lawyer for purposes of a settlement still forms part of the bankrupt's patrimony.

On the other hand, the judge referred to two more recent decisions of the Quebec Court of Appeal, in the cases of *McGilton*[3] and *BigKnowledge*,[4] which departed from this line of cases and did not apply this principle with the same rigidity. These decisions, together with a previous decision in British Columbia,[5] focused rather on the "finality or randomness of the deposit" and the degree of control that the debtor might still have on the amounts. Where the debtor has divested itself of and no longer controls the amounts, they are no longer in the debtor's patrimony and cannot be vested in the trustee, "[translation] *as he has no more rights with respect to this property than did the debtor.*"

[2] On this point, see *Syndicat national de l'amiante d'Asbestos inc. c. Mine Jeffrey inc.*, J.E. 2003-346 (C.A.), cited by the judge

[3] *McGilton (Syndic de)*, 2006 QCCA 1561

[4] *Entreprises BigKnowledge inc. (Syndic de)*, 2008 QCCA 1613

[5] *McGrgor (Trustee of)*, 1990 CanLII 1295 (BC S.C.)

Therefore, deferring to the more contemporary decisions of the Court of Appeal, the judge held in favour of the creditors covered by the plan:

> [translation]
>
> [71] one can discern an unequivocal intention on the part of Meston to pay the proceeds of disposition of the assets sold to the monitor strictly for purposes of distribution under the plan.
>
> [72] According to the arrangement, once the money was in the monitor's hands, Meston clearly lost control thereof in favour of the creditors under the plan. In these circumstances, this constituted a partial payment of the creditors' claims under the plan, in which the monitor played the role of the creditors' collector or agent for purposes of completing a transaction, once the plan of arrangement was sanctioned. [...]
>
> [75] I conclude that once the money was in the monitor's hands, it was impossible for Meston to get it back. As soon as it was cashed by the monitor, Meston relinquished the amounts paid to the monitor and lost the ownership thereof in favour of the creditors under the plan.
>
> [76] As for the monitor, it became the simple disbursing agent and monitor of the proofs of claim. No provision of the plan would have permitted RC to return the funds received to Meston's operating account.
>
> [77] Today, it is an uncontested principle that the trustee in bankruptcy has no more rights over the disputed funds than Meston did.
>
> [78] And, Meston is only entitled to the undistributed balance, if any (clause 3.1(b) *in fine*), in accordance with the plan of arrangement as sanctioned.

COMMENTS

Some may criticize this decision on the basis that it departs from the more traditional approach which holds that where the payment to the creditor is not "effective", the money remains in the bankrupt's patrimony and is vested in the trustee in bankruptcy. They will condemn this decision for weakening or ignoring the paramountcy of bankruptcy orders over other recourses that may target the debtor's property. They will also condemn the fact that the criteria developed by the court on the control of the amounts open the door to new arguments over the issue, rather than providing a simple and clear solution. Finally, they may deplore the fact that fairness, i.e. the equal treatment of all the creditors of a bankrupt debtor, is not being upheld.

On the other hand, others think that this decision is wise both in terms of the principles and the result. Indeed, rather than proposing a rigid and uniform principle that could lead to incongruities, the reasoning applied will enable judges to assess the facts and render decisions suited to each specific situation. Furthermore, this reasoning will also strengthen plans of arrangement in practice, where they have been duly accepted by the creditors and sanctioned by the court, and recognize the binding force and stability of judicial decisions rendered under their purview.

Finally, far from causing injustices, this decision will allow creditors who have made compromises and entered into a judicial "contract" with the debtor through a plan of arrangement to ensure that this contract is upheld, giving them the confidence necessary to enter into such compromises. After all, if the debtor has been able to continue in business, sometimes for many years, it is first and foremost thanks to this compromise. In some cases, it will lead to the successful restructuring of the company, while in others, bankruptcy will, unfortunately, be the final outcome. But the creditors under the plan of arrangement, who have given the debtor a chance to get back on its feet, must not be made to bear a disproportionate share of the burden of this failure.

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