

CANADA / JUDGMENT

Skeena Cellulose Inc. (Re)

2001 BCSC 1423

COURT

Supreme Court of British Columbia

DECIDED

23 October 2001

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2001BCSC1423 Citation: In the Matter of Skeena Cellulose Inc. et al Date: 20011023 2001 BCSC 1423 Docket: L012405 Registry: Vancouver IN THE SUPREME COURT OF BRITISH COLUMBIA IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT R.S.C. 1985, c. c-36 AND IN THE MATTER OF THE CANADA BUSINESS CORPORATIONS ACT, R.S.C. 1985, C. C-44, AS AMENDED AND IN THE MATTER OF THE COMPANY ACT, R.S.B.C., 1966, C.62, AS AMENDED AND IN THE MATTER OF SKEENA CELLULOSE INC. ORENDA FOREST PRODUCTS LTD. ORENDA LOGGING LTD. AND 9753 ACQUISITION CORP. PETITIONERS REASONS FOR JUDGMENT OF THE HONOURABLE CHIEF JUSTICE BRENNER Counsel for the Petitioners D.I. Knowles, Q.C. C. Emslie Counsel for Her Majesty the Queen in Right of the Province of British Columbia and 552513 British Columbia Ltd. C.S. Bird R.L. Bozzer Counsel for the T.D. Bank R.J. Kearns Counsel for Arthur Andersen Inc. Monitor D.R. Leigh Counsel for The District of Port Edward R. Macquisten Counsel for Pacific Northern Gas Inc. T.D. Timberg Counsel for Pulp, Paper and Woodworkers of Canada, Local 4 W.E. Skelly Counsel for Slocan Forest Products Ltd. C.M. Baron Counsel for the City of Prince Rupert G. Anderson Counsel for Alstom Canada Inc. T.V. Martin Counsel for The City of Terrace J.J. Talstra Counsel for Jock's Excavating Ltd. and William Scott Milne B.J. Brown Date and Place of Hearing/Trial: October 5, 2001 Vancouver, BC

- [1] On September 5, 2001, I granted the Petitioners' application for an initial stay pursuant to the provisions of the Companies' Creditors Arrangement Act ("CCAA"). At the comeback hearing on October 5, 2001, I extended that stay for 30 days to November 5, 2001. These are the written reasons for that Order.
- [2] Skeena Cellulose Inc. ("SCI") is an integrated forest company operating in Northwestern British Columbia. It has a two-line pulp mill on Watson Island near Prince Rupert, sawmills in Terrace, South Hazelton, Smithers and one sawmill near Kitwanga. It has numerous timber tenures held either directly or through subsidiary companies.
- [3] After accumulating operating losses through much of the 1990s, the owner of Repap British Columbia (as Skeena was previously known) abandoned the operation in 1996. The company filed for CCAA protection. In early 1998 SCI formally emerged from CCAA protection with the Province of British Columbia and the Toronto Dominion Bank ("TD Bank") acting as the company's major lenders and shareholders.

- [4] As noted by the Monitor, poor markets combined with a number of unforeseen operational delays have required SCI's lenders to advance further funding on a number of occasions to maintain operations.
- [5] The enterprise again filed for CCAA protection on September 5, 2001. SCI was unable to meet its obligations after the TD Bank issued a payment demand on August 31, 2001, and froze the company's bank accounts.
- [6] As a condition of the TD Bank's involvement following the 1997 reorganization, the Province guaranteed a proportion of the TD debt. The functioning of this arrangement is described in the Monitor's report as follows: Virtually all of the funding provided to Skeena since the Company emerged from CCAA protection has been loaned directly or indirectly, by the Province, with TD Bank providing additional advances only if the Province provided its guarantee. Prior to this hearing on October 5, 2001 the Province paid much of this guaranteed debt to the TD Bank. In the result, SCI currently owes \$410 million to the secured lenders. Of this \$94.2 million or 23% of the secured debt is owed to the TD Bank while the balance is owed to the Province. Approximately \$100 million is owed to unsecured creditors.
- [7] At page 24 of his Report, the Monitor sets out the status of the restructuring plan. It is wholly dependent on a purchaser being found. The two major shareholders, the Province and the TD Bank, have been seeking a new owner for SCI since 1998 when they engaged Goepel and McDermid Inc. (now Raymond James Limited ("RJL")) for this purpose.
- [8] The history of RJL's efforts is set out in the Monitor's Report. Since 1998 RJL has actively exposed the assets of SCI to the worldwide market. Since September 6, 2001 RJL has held discussions with numerous parties and written proposals were requested by September 27, 2001. This produced two proposals, one of which has been withdrawn. SCI also advises that a third party has approached it and has outlined its intentions and a written presentation that it wishes to discuss further.
- [9] The Monitor has reviewed the remaining proposal and the written presentation and comments as follows:
1. Neither of the documents constitute a formal offer but rather a basis of further discussion between the parties;
 2. Each proposal requires changes to the forest practices for the region in which Skeena operates and requires indemnities from the Province for certain potential liabilities;
 3. Each proposal is dependent upon the parties raising funds in excess of 100 million to complete the transaction and provide funding for working capital and proposed capital investment programs aimed at enhancing the competitiveness of Skeena; and
 4. The purchase prices are less than the projected net realizable values of Skeena's working capital assets at September 30, 2001.

- [10] The Monitor notes that SCI and the Province have indicated that they intend to continue discussions with both parties to determine whether an agreement for the sale of the shares of SCI can be reached as part of its restructuring plan. A share sale is critical if a purchaser is to be able to take the benefit of what I understand to be significant SCI tax losses.
- [11] The Monitor also states that a sale of the Company's shares under the current proposals will not maximize the recovery to the secured creditors given the current estimates of the net realizable value of the working capital assets. However, the Monitor does note if an agreement can be reached and a restructuring plan approved the employee and supplier stakeholders to the CCAA process stand to realize a significant benefit through ongoing employment and supply business. If a sale of shares cannot be achieved, a sale of SCI's assets through a bankruptcy or receivership process will likely be done on a piecemeal basis. The likely result will be that various components of SCI's operations will be dismantled and discontinued.
- [12] Apart from the TD Bank, which opposed this application, all parties before the court on October 5, 2001 supported a 30-day extension of the Stay Order. As noted by counsel for the TD Bank, any extension will effectively be financed by the secured lenders. While the Province is prepared to bear its share, the TD Bank is not. The cost of a 30-day extension to the Bank is approximately \$3.5 million.
- [13] The burden of proof on this application rests on the Petitioners. S. 11 (6) of the CCAA provides that: The court shall not make an order under subsection (3) or (4) unless
- (a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
 - (b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.
- [14] It is important to note the distinction between an initial stay under the CCAA, which the court can grant for a period of up to 30 days and any subsequent extensions. To have a stay extended past the period of the initial stay, the petitioner must meet the test set out in s.11(6).
- [15] Here the TD Bank says SCI has failed to meet the tests in both subsection (a) and (b). It complains about SCI's lack of good faith and due diligence in the delays in laying off both salaried and non-salaried personnel. These were steps recommended by the Monitor to conserve cash. In the TD Bank's view SCI did not act with sufficient alacrity. Its counsel submits that SCI's failure to carry out the layoffs on the timetable recommended by the Monitor constitutes a lack of good faith and due diligence.

- [16] However, in my view, the simple failure of SCI's management to comply with the Monitor's recommended timetable does not constitute, in and of itself, a lack of either good faith or due diligence. This is not a case where a management has completely ignored a Monitor's recommendations. Here SCI's management is being criticized only for the delay in carrying out the Monitor's recommendations. Given all the stakeholders in this matter and their respective interests, such a delay did not represent a lack of due diligence or good faith.
- [17] The TD Bank's principal objection is that the Petitioners have failed the test in s. 11(6)(a) and that they have failed to establish that there are circumstances that make an extension of the stay appropriate. In the case at bar, SCI's restructuring plan is wholly dependent upon SCI finding a purchaser. Without a purchaser, there will be no plan and the stay will terminate.
- [18] An affidavit was filed by Mark Lofthouse, Director, Financial and Project Evaluation Branch of the Ministry of Competition, Service and Enterprise, of the Province of British Columbia. Mr. Lofthouse is also a director of SCI. He deposed as to information he has received from Daniel D. Veniez, who is the CEO of a company involved in the written presentation. His group has raised \$10 million for this purpose. In addition, members of the group were to travel to New York on October 8, 2001 for meetings to raise the additional financing. Lofthouse further deposes that following the New York meetings, Mr. Veniez and his group intend to travel to British Columbia to outline their business plan to SCI.
- [19] With respect to the one proposal, Mr. Lofthouse deposes that it contains requirements for significant provincial government financial support that the Province has determined is not feasible. He deposes that discussions with this proposer are continuing to see if the existing proposal can be further amended in a way that is acceptable to both parties.
- [20] One cannot overstate the economic impact of SCI's operations in the communities of Northwestern British Columbia. For example, in the District of Port Edward, SCI constitutes 43% of the general municipal tax base. As set out in the affidavit of Ron Bedard, the District's Chief Administrative Officer, the loss of SCI's tax revenue will mean that the taxes for the owner of a \$100,000 home will have to increase from \$539.45 to \$980.33 per year.
- [21] In addition to losing the SCI municipal tax payments, the District has also been required to make substantial payments to other agencies in the form of school taxes, regional and hospital district assessments based on taxes SCI ought to have paid.
- [22] The position of the District of Port Edward is replicated in the many other Northwestern communities in which SCI has its operations.
- [23] There are also many unpaid SCI contractors. In addition to suffering the loss of their SCI receivables, they are out-of-pocket for the necessary expenses they have incurred to provide their services to SCI, which in turn has enabled SCI to earn revenue. Many employees of SCI have also been directly affected.

- [24] I have earlier stated that the effect of the additional 30-day stay that is sought will be to erode the position of the TD Bank by some \$3.5 million.
- [25] In his affidavit of October 3, 2001 Robert Allen, the President and Chief Executive Officer of SCI states: In my opinion, if the stay of proceedings is continued for a further 30 days, this will allow for a more full consideration of the two outstanding proposals and put the Petitioners in a position of being able to place a more complete and comprehensive plan before the court.
- [26] In my view the extraordinary nature of this case justifies a 30-day extension to the Stay Order. When it decided to continue financing SCI at the time of the last CCAA re-organization, the TD Bank negotiated substantial protections for its position by obtaining indemnities from the Provincial Government. It has called on these indemnities and shortly before this hearing was paid some \$125 million pursuant to those guarantees.
- [27] The consequences of terminating the CCAA protection will be severe. The liquidation of SCI will have a drastic impact on Northwestern British Columbia. This will be felt directly by the employees, contractors and suppliers of SCI. It will also be felt by many of the other residents, including each and every property taxpayer. These far reaching consequences are appropriate matters for the court to weigh and consider when determining whether to extend a Stay Order under the CCAA.
- [28] In my view, circumstances did exist on October 5, 2001 that made it appropriate to extend the stay to November 5, 2001.
- [29] However, I also want to state my view that a further extension of the Stay Order past November 5, 2001 will likely require the Petitioners to demonstrate measurable and substantive progress towards a plan.
- [30] In this case the Petitioners are not looking to reorganize the companies and continue to operate. Everyone agrees that the only viable plan of arrangement open to SCI is a sale to a purchaser that can take advantage of the accumulated tax losses. The company at this stage is almost completely shutdown; it is now operating only one sawmill. The tenuous nature of SCI's position was, no doubt, a consideration in the Petitioners' decision to apply for an extension of only 30 days and not a longer period at the comeback hearing.
- [31] Accordingly, if there is an application for a further stay I would expect the Petitioners to place before the court evidence that measurable and demonstrable progress towards a plan of arrangement has been made. "D.I. Brenner, C.J.S.C." The Honourable Chief Justice D.I. Brenner

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