



Insolvency & Restructuring - Canada

Canadian Court Effectively Approves an Arrangement Plan without a Vote

Contributed by ThorntonGroutFinnigan LLP

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On December 20 2005 Calpine Canada Energy Limited, together with certain of its Canadian subsidiaries and affiliates (together, Calpine Canada), obtained an order from the Court of Queen's Bench of Alberta granting it protection from its creditors under the Companies' Creditors Arrangement Act.⁽¹⁾ On that same date, Calpine Corporation, together with its US subsidiaries and affiliates (together, Calpine US), was granted protection from its creditors in the United States under Chapter 11 of the US Bankruptcy Code. Over the past two years, the proceedings have involved a number of inter-company cross-border issues.

In July 2007 both Calpine Canada and Calpine US applied to the Court of Queen's Bench of Alberta and the US Bankruptcy Court of the Southern District of New York respectively, in a joint hearing for approval of a settlement of certain major issues between the two estates. Both courts granted orders approving the settlement agreement and the Honourable Justice Romaine's reasons for judgment were released on July 31 2007.

The settlement agreement purported to resolve all the material issues that existed between Calpine Canada and Calpine US, including:

- the quantification, priority and withdrawal of certain cross-border inter-company claims;
- the payment or reservation of amounts for many of the creditors; and
- the resolution of all material disputes between Calpine Canada and Calpine US, thereby avoiding costly and time-consuming cross-border litigation.

The settlement agreement also provided for the admission by Calpine US of the validity of certain guarantees provided to certain creditors of Calpine Canada.

Certain parties opposed the settlement agreement on the grounds that it amounted to a "plan of compromise or arrangement", and therefore required a vote by Canadian creditors. In simple terms, the settlement agreement put assets of the Canadian estates valued at approximately US\$650 million into the hands of the US parent ahead of the Canadian creditors. These assets would otherwise be available to ensure that Canadian creditors were paid. Instead, the Canadian estates were left in the position that meant some creditors may not be paid in full. Some parties took the position that the Canadian creditors that may receive less than full recovery were being compromised by the settlement agreement, and therefore a vote was required.

The Canadian court stated that the law is clear that "if the settlement were a plan of arrangement or compromise, a vote by creditors would be necessary". In this respect, a court has no discretion to allow for a plan of arrangement unless it has been approved by a vote conducted in accordance with Section 6 of the Companies' Creditors Arrangement Act. However, the Canadian court disagreed with the position of the opposing parties and held that the settlement agreement was not a compromise or arrangement. The Canadian court found that the settlement agreement :

- was not linked to or subject to a plan of arrangement;
- did not compromise the rights of creditors that were not a party to or did not consent to it; and
- did not have the effect of unilaterally depriving creditors of contractual rights without their participation in the settlement agreement.

The Canadian court was satisfied that the claims of creditors which were not a party to the settlement agreement would either be paid in full (and thus not compromised) as a result of the operation of the settlement agreement, or would continue to have claims against the same Canadian debtor entity as had been claimed previously (even if these debtors no longer had all their pre-settlement assets). To the extent that any claims were determined to be valid, the settlement agreement provided a mechanism and financial framework for their full payment or satisfaction by way of acknowledged guarantees by the US parent (with the exception of the possibility of a relatively small discrepancy for some creditors of the Canadian estates whose claims were not guaranteed by Calpine US).

The Canadian court was persuaded that the settlement agreement provided clear benefits to the creditors of Calpine Canada and that, on an individual basis, no creditor was "worse off" as a result of the settlement agreement when it was considered as a whole. The fact that some risk fell upon certain creditors did not make the settlement agreement unfair and, given the monitor's assessment that the risk of less than full payment to certain creditors was remote, the court was satisfied that such risk did not obviate the fairness of the settlement agreement.

In effect, the Canadian court approved a plan of arrangement between the US and Canadian estates, without providing the Canadian creditors with the opportunity to vote upon the plan as is required in all cases where there are compromises proposed, in accordance with the provisions of the Companies' Creditors Arrangement Act.

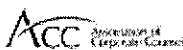
One creditor that was particularly prejudiced by the decision of the Canadian court applied for a stay pending appeal and leave to appeal the order granted on July 24 2007. The application for leave (and the application for a stay) were dismissed by the Alberta Court of Appeal on August 17 2007.

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Endnotes

(1) RSC 1985, c C-36, as amended.

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