IN THE SUPREME COURT OF NOVA SCOTIA
Citation: ScoZinc Ltd. (Re), 2008 NSSC 398

Date: 20081222
Docket: Hfx No. 305549
Registry: Halifax

In the matter of: The *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended.

And in the matter of: A Plan of Compromise or Arrangement of ScoZinc Limited

Judge: Justice Duncan R. Beveridge

Heard: December 22, 2008, in Halifax, Nova Scotia

Released: January 7, 2009

Counsel: John D. Stringer, Q.C. and Ben Durnford, for the Applicant

By the Court:

[1] For reasons that are obvious it is important that I consider and decide this matter today. I will give oral reasons from the bench and reserve the right to make changes in matter of style or form that do not affect the substance of these reasons.

[2] This is an application brought by ScoZinc Limited under s. 11 of the *Companies' Creditors Arrangement Act:* R.S.C. 1985, c. C-36. The company also seeks to have this Court exercise its inherent jurisdiction to give a first priority, sometimes referred to as a supercharge, for administrative expenses and debtor-in-possession financing.

[3] The facts are straight forward. They are set out in a detailed affidavit by the President and Chief Executive Officer of ScoZinc, Mr. William Felderhof. Mr. Felderhof also gave *viva voce* evidence to clarify for the Court a number of factual issues.

[4] ScoZinc has been operating Scotia Mine in Gays River. It started operating that mine and the processing facility in May 2007. The financial statements as of the end of November 2008 show that the operation saw a tremendous growth in sales and production throughout 2008 despite some operational difficulties from flooding which required cut back in production, use of lower grade ore and additional expenditures to compensate or accommodate flooding.

[5] What has caused the company to seek protection under the *CCAA* has been the dramatic decline in commodity prices for its two products it now mines and produces at its Scotia Mine, that is zinc and lead.

[6] On January 1, 2008, zinc and lead prices were $1.08 and $1.23 per pound U.S. respectively. On October 1, 2008, these prices were down to $0.75 and $0.82 per pound respectively. What has changed dramatically is that by December 1, 2008, they declined a further 33% to U.S. $0.50 and lead by 49% to U.S. $0.42 per pound.

[7] Cost of production, as I understand it, is $0.49 per pound based on a certain quantity of ore being produced.

[8] ScoZinc is a wholly owned subsidiary of Acadian Mining. It has assets, as of November 30, 2008, of some $31.6 million. On the other hand, it has liabilities both current and long term of some $37 million. It has two secured creditors. Acadian Mining Corporation is owed approximately $23.5 million. ScoZinc also has a secured creditor in the form of Royal Roads Corp. which is a corporation which has close ties and some interlocking shareholding and directorships. ScoZinc's indebtedness to Royal Roads is $2.5 million. Both of these secured creditors are aware of these applications which are brought here today. The only other significant creditor that has what could be called a security interest is Komatsu who is owed just in excess of $3 million in long term capital leases. In addition, the affidavit material supplemented by Mr. Felderhof's evidence indicates trade payables of $5.4 million.

[9] The evidence demonstrates that ScoZinc is unable to meet its next payroll payment which is due December 24, 2008. It has dramatically scaled back its workforce to a complement of only 70 which is roughly half of what it employed in October 2008. Despite these cost-cutting measures, it is obvious the company is insolvent.

[10] The materials also demonstrate that ScoZinc is not a typical run-of -the-mill debtor. It operates a complicated facility that has significant environmental obligations. Although no creditors have yet given any formal notice of action to enforce payment of their various obligations, it is obvious that there are a large number of creditors who could take action not the least of which would be Komatsu who have an outstanding current liability in excess of $100,000.

[11] If action were taken by the unsecured creditors it may take some time for those effects to be felt. Not so with respect to Komatsu which could in effect shut down any further production.

[12] Under the statute I must be satisfied of a number of matters before relief can be granted. First of all, it is obvious that ScoZinc is a debtor company within the meaning of the *CCAA*. Secondly, there are claims well in excess of $5 million. The *CCAA* gives to the Court the power with or without notice to stay all proceedings that have been taken or might be taken in respect of a company. The ability to grant an order is one that requires the Court to be satisfied that circumstances exist that make it appropriate.

[13] There has been ample case law throughout the country that has considered what would constitute circumstances that make such an order appropriate. In *Re Canadian Airlines Corp.*, [2000] A.J. No. 1692, the court wrote:

> [19] Finally, in making orders under the CCAA, the court must never lose sight of the objectives of the legislation. These were concisely summarized by the chambers judge and adopted by the British Columbia Court of Appeal in Re Pacific National Lease Holding Corp. (1992), 15 C.B.R. (3d) 265 (B.C.C.A. [In Chambers]):
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> (1) The purpose of the CCAA is to allow an insolvent company a reasonable period of time to reorganize its affairs and prepare and file a plan for its continued operation subject to the requisite approval of the creditors and court.
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> (2) The CCAA is intended to serve not only the company's creditors but also a broad constituency which includes the shareholders and employees.
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> (3) During the stay period, the Act is intended to prevent manoeuvres for positioning amongst the creditors of the company.
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> (4) The function of the court during the stay period is to play a supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure.
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> (5) The status quo does not mean preservation of the relative pre-stay debt status of each creditor. Since the companies under CCAA orders continue to operate and having regard to the broad constituency of interests the Act is intended to serve, the preservation of the status quo is not intended to create a rigid freeze of relative pre-stay positions.

> (6) The court has a broad discretion to apply these principles to the facts of the particular case.

[14] The case law has described a number of tests, mostly in the negative. For example, a stay should be refused if there is no reasonable possibility of the company continuing to operate for the benefit of itself and its creditors. In other words, it is a company doomed to failure.

[15] Wachowich, C.J.Q.B. in *Re Hunters Trailer and Marine Limited,* [2001] A.J. No. 857 quoted with approval the comments by Finlayson J.A. and Krever J.A. He wrote:

> [17] Finlayson J.A. (Krever J.A. concurring) in Elan Corporation v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101 at 120 (Ont. C.A.) agreed with the statement made by Gibbs J.A. in Hongkong Bank of Canada that the Act was designed to serve a "broad constituency of investors, creditors and employees" and instructed that:
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> > Because of that "broad constituency", the Court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest. That interest is generally, but not always, served by permitting an attempt at reorganization: see S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," [(1947) 25 Can. Bar Rev. 587] at p. 593.

[16] I am satisfied based on the materials provided to me that ScoZinc is far from being a company that is doomed to failure. There are a number of options described in Mr. Felderhof's affidavit that certainly set out a number of reasonable opportunities for ScoZinc and its related corporate entity, Acadian Mining, to explore. Not the least of which is the prospect of a rebounding of commodity

prices for lead and zinc. No one has a crystal ball nor is one required. Mr. Felderhof described that even if commodity prices climbed back to where they were in the fall of 2008, the company, although not making a handsome return on its investment, would certainly no longer be insolvent. Based on that prospect alone I am satisfied that the Court should grant the stay as has been requested.

[17] The other options that are described are equally attractive. There are other mining properties close by which could provide the necessary ore to be processed at the Scotia Mine facility. The consequences of not granting the stay are simply far too unattractive not only for the current employees but for the broader public interest including the interest of the tax payers of Nova Scotia which may be called upon to fund the clean-up of an environmental contamination that can be avoided if ScoZinc is given a reasonable opportunity to explore other options and put into place the necessary safeguards. Creditors will also benefit not only from the reasonable prospect of a restructuring and return to solvency, but simply one of safeguarding the assets that are presently on site. In the event the worst happens and liquidation has to occur at least the best value can be achieved in an orderly fashion.

[18] So I will grant the stay that as been requested for an initial period of 30 days.

[19] The company has also requested two orders for debtor-in-possession (DIP) financing. The company recognizes that ordinarily DIP financing is a relief that is applied for subsequent to the initial order and on notice to the creditors. Nonetheless, they have pointed out a number of decisions from other jurisdictions

that have granted DIP financing on an *ex parte* basis along with the application for the initial order. (See *Re Algoma Steel Inc.* (2001), 25 C.B.R. (4th) 194 (Ont. C.A.); *Re Hunters Trailer & Marine Ltd., (supra)*.

[20] Initially the company sought DIP financing first for the administrative charges or expenses that would be incurred by the company in the use of a monitor, and other professionals reasonably required by the monitor, in the fulfilment of the monitor's obligations. This request for priority for administrative charges set a cap of $400,000. In addition, DIP financing is to be provided by two individuals, Terence Coughlan and Mr. William Felderhof in a total amount of $250,000, to rank only behind the administration charges.

[21] Today the company has also requested a second DIP order with respect to financing to be obtained from TCE Capital Corporation in the total principal amount of $1 million.

[22] Counsel for the company points out that the two secured creditors, Acadian Mining and Royal Roads, consent to the Court creating a first priority or super charge in relation to the administrative charge request and the first DIP order and no secured creditor is realistically harmed by the granting of either the first or the second DIP order. He reasonably points out that Acadian Mining holds a debenture in the amount of essentially $23.5 million and Royal Roads of $2.3 million.

[23] The appropriate principles to be applied in exercising the inherent jurisdiction of the Court were extensively reviewed by MacAdam J. in *Re Federal Gypsum Company* 2007 NSSC 347. He adopted with approval a number of statements of principle from *Re Manderley Corp.* (2005), 10 C.B.R. (5th) 48 at para. 18 where Campbell J. wrote:

> [18] The operative legal principles are set out in the following quotations from Houlden & Morawetz' Bankruptcy & Insolvency Analysis (Carswell, 2004), section N16 - Stay of Proceedings - CCAA - at page 18:
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> > Although the C.C.A.A. makes no provision for DIP financing, it seems to be well established that, under its inherent powers, the court may give a priority for such financing and for professional fees incurred in connection with the working out of a C.C.A.A. plan.
> >
> > For the court to authorize DIP financing, there must be cogent evidence that the benefit of the financing clearly outweighs the prejudice to the lenders whose security is being subordinated to the financing: ...
> >
> > The court can create a priority for the fees and expenses of a court-appointed monitor ranking ahead of secured creditors so long as they are reasonably incurred in connection with the restructuring of the debtor corporation and there is a reasonable prospect of a successful restructuring: ...

[24] To like effect are the comments by Wachowich C.J.Q.B. in *Hunters Trailer & Marine Ltd. (Re), (supra).*

> [32] Having reviewed the jurisprudence on this issue, I am satisfied that the Court has the inherent or equitable jurisdiction to grant a super-priority for DIP financing and administrative charges, including the fees and disbursements of the professional advisors who guide a debtor company through the CCAA process. Hunters brought its initial CCAA application ex parte because it was insolvent

> and there was a threat of seizure by some of its major floor planners. If super-priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively would be denied a debtor company in many cases.
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> [33] I am aware, however, that administrative costs and DIP financing can erode the security of creditors. LoVecchio J. in Re Smoky River Coal Ltd. (2000), 19 C.B.R. (4th) 281 at 290 (Alta. Q.B.), raised a caution flag in this regard, stating at p. 290:
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> > While the CCAA requires a large and liberal interpretation in order to be effective, the need for caution arises when the Court exercises its inherent jurisdiction under this statute. Although the CCAA serves a vital and important role in a reorganization, the general statutory scheme of priorities of creditors must not be overlooked. As the Court is altering this scheme, the exercise of the power of the Court to create classes of creditors with a super-priority status should not be taken lightly. Especially in light of the fact that this action could prejudice the recovery of creditors who would, but for the Order, enjoy a priority if a receivership or bankruptcy ultimately ensues.
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> [34] It is preferable that priority for administrative costs and DIP financing be dealt with on notice to all interested parties. However, if the circumstances warrant, priority may be granted on the initial application, but on a limited basis only until the matter is considered on notice to those affected by the order. That is precisely what occurred in this case. Hunters brought an application on November 8th for an extension of the stay of proceedings. This application was made on notice to the secured creditors. If they had wanted to challenge the initial Order before that date, they could have done so on two days' notice.

[25] I am satisfied that there is cogent evidence that the benefit of the first DIP order clearly outweighs any potential prejudice to secured creditors whose security is being eroded. I will grant the order that has been requested for the administrative charges and for the first DIP financing.

[26] In relation to the requested second DIP order, I am not, today, going to grant this order. Both of the requests for DIP orders are without notice to the other creditors. The first one is of some urgency. The second one is not so much of an emergency today. The two secured creditors who have provided their consent to the initial DIP financing of $250,000 have not yet signed off on providing their consent in relation to the $1 million credit facility that apparently has been negotiated with TCE Capital Corporation.

[27] Although the *CCAA* specifically gives the Court jurisdiction to act *ex parte* by abridging or waiving notice to individuals or corporations who may be affected by its order, DIP financing, in my opinion, is considerably different. Here, the company seeks to have the Court exercise its inherent jurisdiction. It is a fundamental principle that where the rights of others could conceivably be impacted, notice should be provided to them so they will have the opportunity to see the materials, present argument, be informed of what the Court is being asked to do, and to provide submissions. And for that reason, I have declined to make the second DIP order today, but certainly have indicated to the company my willingness on short notice to deal with this application with notice being given to the secured creditors and all unsecured creditors whose indebtedness exceed $100,000.

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Beveridge, J.