Lower court's decision upheld by Supreme Court of Canada in CCAA ruling

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In *Her Majesty the Queen v. Canada North Group Inc.*, the Supreme Court of Canada (the Court) held that lower courts can permit the grant of court ordered charges under the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (the CCAA), including the interim lender's charge, in priority to the Minister of National Revenue's (the Minister) statutory deemed trust claims under the *Income Tax Act*, RSC 1985 c 1 (the ITA).

Background

On July 28, 2021, the Court issued its decision in *Her Majesty the Queen v. Canada North Group Inc.* [1] (the Decision) in a 5-4 majority ruling.

At issue, were court ordered superiority charges requested by Canada North Group and six related corporations (together Canada North) pursuant to a CCAA application for initial restructuring proceedings. Specifically, Canada North requested, and were granted, super priority charges in relation to:

1. an administration charge in favour of counsel;
2. a monitor and a chief restructuring officer for the fees incurred;
3. a financing charge in favour of an interim lender; and
4. a directors' charge protecting their directors and officers against liabilities incurred after the commencement of the proceedings.

Case decision

Justice Côté, writing for herself, Chief Justice Wagner and Justice Kasirer, focused on the broad discretion afforded to the supervising court pursuant to section 11 of the CCAA to order super-priority charges to secure restructuring expenses, including the administration charge and the interim lender's charge, ahead of deemed trust claims made by the Crown in respect of employee source deductions under the ITA. Emphasis was placed by Justice Côté on the importance of providing a debtor-in-possession (DIP) lender with certainty that it will be paid in priority. The Court found that such priority is

necessary to ensure a CCAA debtor has every opportunity to restructure under the statute.

At the time of the CCAA application, Canada North was indebted to the Minister for unremitted employee source deductions and GST. The Crown argued that the CCAA judge could not subordinate the Minister's deemed trust and that ordering charges with priority over the deemed trust is contrary to subsection 227(4.1) of the ITA. Importantly, employee source deductions and GST amounts represent monies belonging to employees and customers, not Canada North, which it failed to remit to the Minister on behalf of those employees and customers. The at issue amounts were never for the benefit of Canada North, and were only ever intended to pass through Canada North's accounts on behalf of other taxpayers.

The majority of the Court held that while subsection 227(4.1) provides that the Minister shall be paid proceeds of a debtor's property 'in priority to all such security interests' as defined in subsection 224(1.3), this did not provide priority over court-ordered super-priority charges under section 11 of the CCAA as such orders were not included in the exclusive list set out in subsection 224(1.3). The Court went further, holding that the Minister's rights under subsection 227(4.1) does not provide a proprietary interest in a debtor's property adequate to prevent such a court order as the rights attributed under that provision do not create a beneficial interest which could be considered a proprietary interest.

Instead, the Court held that subsection 277(4.1) only grants the Minister the same interest in property as that of a common law trust. This raises a number of questions regarding the Minister's right over taxes required to be withheld and remitted under the ITA as these were funds of Canada North's employees and customers, which were owed to the Minister, and were never the funds of Canada North nor its creditors.

While the Decision confirms the ability of the chambers judge to subordinate a deemed trust claim under the ITA to an interim lender's (or other) charge, the Court leaves the door open for some uncertainty. For example, Justice Côté states that there may be circumstances where it is not appropriate to subordinate the super-priority charges to the Crown's deemed trust claim. One such instance is when the Crown claim is small or known with a high degree of certainty. In that case, the Court reasons that commercial parties will be able to manage their risks and will not need a super-priority charge.

There is no discussion as to what constitutes "small" or what constitutes a "high" degree of certainty as opposed to 100 per cent certainty, leaving the door open for the Crown to dispute the relative priority of an interim lender's charge or other charges or argue that circumstances exist that do not make the super priority charge appropriate.

Another example of a circumstance in which the Court says it may not be appropriate to subordinate a deemed trust claim under the ITA is in the context of liquidating CCAA proceedings. In a liquidating CCAA proceeding, the Court reasons that because the aim is to maximize returns for creditors (instead of restructuring the debtor company as a going concern), the subordination of the Crown's interest has less justification. This reasoning, however, fails to recognize that an application for interim financing is typically made at the outset of the CCAA proceedings, often times when it is unclear as to whether the process will involve a 'liquidating' CCAA or a process in which the debtor company is restructured as a going concern. It also fails to recognize that a CCAA

proceeding may involve both a liquidation of assets under section 36(3) of the CCAA (and constitute a 'liquidating CCAA'), as well as a plan of compromise or arrangement.[2]

The Court emphasizes throughout the majority decision that interim financing and the ensuing charge is critical to a CCAA proceeding and the debtor's ability to attempt a workout. There is further discussion in the majority decision about the certainty required by interim lenders in respect of their relative priority to others in the process and that to "ensure the integrity, predictability and fairness of the CCAA process, certainty must accompany the granting of such super-priority charges."[3] However, by leaving open the possibility of the subordination of an interim lender's charge in the context of a liquidating CCAA proceeding, the Court has placed the certainty it has regarded as paramount to an interim lender and the process as a whole, at risk.

Takeaways

While the Decision does confirm the ability of lower courts to grant charges in priority to the Crown's deemed trust claim for unremitted source deductions under the ITA, it does not close the door on the issue and gives the Crown the opportunity to argue in certain circumstances that the priority contemplated by the CCAA is not appropriate.

Given the commentary from the Court about the certainty needed to protect the interests of the beneficiaries of the charges – and the restructuring altogether – any such challenge by the Crown to the priority charges would have to be made at the outset of the proceedings, when the charges are granted. Any subsequent subordination would "smack of unfairness."

BLG's Tax and Insolvency & Restructuring groups are available to assist you or your institution on matters involving the *Companies' Creditors Arrangement Act* or *Income Tax Act*. If you have any questions regarding this decision and how it could impact your business, get in touch with any of our lawyers listed below.

[1] *Canada v. Canada North Group Inc.*, 2021 SCC 30 (*Canada North*)

[2] See for example the CCAA proceedings of Gasfrac Energy Services Inc. and the CCAA proceedings of the Walton Group of Companies.

[3] *Canada North* at para 29, as cited in *First Leaside Wealth Management Inc. (Re)*, 2012 ONSC 1299 at para 51.

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