

**Has the Door to Equitable Subordination in CCAA Proceedings Been Closed?**

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## **Has the Door to Equitable Subordination in CCAA Proceedings Been Closed?**

### **Introduction**

Twenty-five years ago, the Supreme Court of Canada (the “SCC”) left open the availability of the doctrine of equitable subordination.<sup>1</sup> In the 2016 decision of *Re US Steel Canada Ltd* (“*US Steel*”),<sup>2</sup> the Ontario Court of Appeal (the “ONCA”) held that it lacked the jurisdiction to grant equitable subordination under the *Companies’ Creditors Arrangement Act* (the “CCAA”).<sup>3</sup> The SCC has granted leave to appeal this decision and will ultimately decide whether the doctrine is available in Canada.<sup>4</sup> Although the ONCA closed the door to equitable subordination, the issue remains open until the SCC rules.

In line with the decision of *US Steel*, this paper argues that the doctrine of equitable subordination should not be available in CCAA proceedings. However, the reason I provide differs from that of the ONCA. Equitable subordination should not be adopted in Canada because it is not necessary, given the remedies available under Canadian law.

### **Doctrine of Equitable Subordination**

Equitable subordination is an American bankruptcy law doctrine that allows a court to subordinate a creditor’s claim if the creditor has engaged in inequitable conduct that has conferred an unfair advantage on the creditor or resulted in loss to the other creditors.<sup>5</sup>

The American judiciary developed the principles of equitable subordination and established a

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<sup>1</sup> *Canada Deposit Insurance Corp v Canadian Commercial Bank*, [1992] 3 SCR 558, 1992 CarswellAlta 298 at 97 [Canadian Commercial Bank cited to CarswellAlta].

<sup>2</sup> *Re US Steel Canada Inc*, 2016 ONCA 662 at para 101 [*US Steel*], leave to appeal to SCC granted, 37284 (March 9, 2017).

<sup>3</sup> *Companies’ Creditors Arrangement Act*, RSC 1985, c C-36 [CCAA].

<sup>4</sup> *US Steel*, *supra* note 2.

<sup>5</sup> *Ibid* at para 40.

three-part test in *Re Mobile Steel* (“*Mobile Steel*”).<sup>6</sup> The *Mobile Steel* test has become the framework by which courts analyze equitable subordination. In order for a secured creditor’s claim to be equitably subordinated, three conditions must be satisfied:

- (1) the claimant engaged in inequitable conduct;
- (2) the misconduct injured the creditors or bankrupt, or conferred an unfair advantage on the claimant; and
- (3) the equitable subordination of the claim is not inconsistent with statute.<sup>7</sup>

One year after *Mobile Steel*, the doctrine was codified in the United States *Bankruptcy Code*.<sup>8</sup> Since then, equitable subordination has predominantly been used to rectify misconduct of “corporate insiders”.<sup>9</sup> While the doctrine has received traction in the United States, its status and scope in Canadian insolvency law has not been decided.

### **Canadian Jurisprudence on Equitable Subordination**

Unlike in the United States, the doctrine of equitable subordination is not codified in Canadian bankruptcy or insolvency legislation. Rather, Canadian courts have considered the doctrine on a case-by-case basis.

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<sup>6</sup> *Re Mobile Steel*, 563 F 2d 692 (5th Cir 1977) [*Mobile Steel*].

<sup>7</sup> *Ibid* at 702.

<sup>8</sup> *Bankruptcy Code*, 11 USC 1982, § 510(c)(1) [US Code]. Section 510(c)(1) provides that “after notice and a hearing, the court may ... (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest.”

<sup>9</sup> Jeremy Opolsky, “Intercorporate Debt and Equitable Subordination: One Case Forward and One Case Back” in Janis P Sarra ed, *Annual Review of Insolvency Law 2015* (Toronto: Thomson Carswell 2016) 45 at 56 [Opolsky], citing *Re Lifschultz Fast Freight*, 132 F 3d 339 at 343 (7th Cir 1997) at 343 and *Kham & Nate’s Shoes No 2, Inc v First Bank of Whiting*, 908 F 2d 1351 at 1356 (7th Cir 1990). The US Code, *supra* note 4, § 101(31) defines an insider of a corporation to include: “(i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; (iv) partnership in which the debtor is a general partner; (v) general partner of the debtor; or (vi) relative of a general partner, director, officer or person in control of the debtor” or an “affiliate, or insider of an affiliate”.

The case law regarding the availability of equitable subordination in Canadian insolvency or bankruptcy proceedings is inconsistent.<sup>10</sup> Three distinct lines of authority have emerged, whereby the courts have: (i) explicitly rejected the doctrine; (ii) declined to determine whether the doctrine applies, but considered the *Mobile Steel* test based on the facts; or (iii) acknowledged or applied the doctrine.<sup>11</sup>

The doctrine of equitable subordination has been brought before Canada's highest court on two occasions. In both cases, the SCC declined to rule on whether the doctrine should be adopted in Canada. In the 1992 decision of *Canada Deposit Insurance Corp v Canadian Commercial Bank*,<sup>12</sup> a case under the *Winding-up Act*,<sup>13</sup> Justice Iacobucci left the availability of the doctrine "open for another day."<sup>14</sup> The SCC found that based on the circumstances, it was not necessary to decide whether a comparable doctrine should exist in Canadian law.<sup>15</sup> Nevertheless, the Court went on to consider whether the facts satisfied the three requirements established in *Mobile Steel*.<sup>16</sup> Twenty-one years later, the SCC revisited the issue in *Sun Indalex Finance, LLC v United Steelworkers*,<sup>17</sup> this time in the context of a CCAA proceeding. Again, the Court declined to rule on the matter, finding that it was unnecessary to endorse the doctrine based on the facts of the case.<sup>18</sup>

The ambiguous and inconclusive statements by the SCC and several other courts<sup>19</sup> have

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<sup>10</sup> Thomas G W Telfer, "Transplanting Equitable Subordination: The New Free-Wheeling Equitable Discretion in Canadian Insolvency Law?" (2002) 36 Can Bus LJ 36 at 36 [Telfer].

<sup>11</sup> *Ibid* at 45.

<sup>12</sup> *Canadian Commercial Bank*, *supra* note 1.

<sup>13</sup> *Winding-up Act*, RSC 1970, c W-10 (formerly RSC 1985 c W-11).

<sup>14</sup> *Canadian Commercial Bank*, *supra* note 1 at 97.

<sup>15</sup> *Ibid* at 91.

<sup>16</sup> *Ibid* at 92-96.

<sup>17</sup> *Sun Indalex Finance, LLC v United Steelworkers*, 2013 SCC 6, [2013] 1 SCR 271.

<sup>18</sup> *Ibid* at para 77.

<sup>19</sup> E.g., *Olympia & York Developments Ltd v Royal Trust Co* (1993), 14 OR (3d) 1; 103 DLR (4th) 129; 1993 CarswellOnt 200 at 60 (CA); *National Bank of Canada v Merit Energy Ltd*, 2001 ABQB at para 67, 294 AR 15; *674921 BC Ltd v New Solutions Financial Corporation*, 2006 BCCA 49 at para 42, 263 DLR (4th) 290; *Re Pine Valley Mining Corp*, 2007 BCSC 926 at para 42, [2008] 6 WWR 771; *Re I Waxman & Sons Ltd* (2008), 89 OR (3d)

created uncertainty in both legal and commercial sectors. This ambiguity has resulted in additional litigation, as lawyers continue to rely on the doctrine to subordinate creditor claims. This uncertainty also poses risks to the commercial sector. In particular, it may deter lending and consequently increase the cost of capital, as the protection normally afforded to secured creditors becomes eroded by the threat of subordination. Fortunately, this uncertainty may be resolved in the near future. The SCC has granted leave to appeal the ONCA's decision of *US Steel*, where Ontario's Chief Justice Strathy concluded that the Court lacked the jurisdiction to grant equitable subordination under the CCAA.<sup>20</sup>

The doctrine of equitable subordination has been reviewed in the context of both insolvency and bankruptcy. However, given the highly anticipated appeal of *US Steel* that is scheduled to be heard by the SCC in the fall of 2017,<sup>21</sup> the remainder of this paper focuses on the availability of equitable subordination in the context of the CCAA. In the following sections of this paper I explain why the doctrine should not apply in CCAA proceedings and examine the ONCA's reasoning in *US Steel*.

### **The Doctrine of Equitable Subordination is Not Necessary in CCAA Proceedings**

Although importing a foreign doctrine is inherently dangerous,<sup>22</sup> the primary reason against adopting the doctrine is that it is unnecessary. The Canadian common law, the CCAA, and corporate legislation already equip creditors with mechanisms to manage the types of conduct that the American doctrine seeks to address. Moreover, the Canadian mechanisms may be

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427, 44 BLR (4th) 295, 2008 CarswellOnt 1245 at 34 (SC)[*Waxman*]; *Rompsen Investment Corp v Edgeworthy Properties*, 2012 ONSC 4693 at para 27.

<sup>20</sup> *US Steel*, *supra* note 2 at para 101.

<sup>21</sup> The hearing is scheduled for November 9, 2017.

<sup>22</sup> *Waxman*, *supra* note 19 at 33.

collectively more expansive than the doctrine, as equitable subordination is to be used “sparingly”<sup>23</sup> and under specific circumstances.<sup>24</sup>

Given the narrow scope of the doctrine and the range of remedies in Canada, it is unlikely that a creditor would be prejudiced by a situation that could not be addressed by an existing remedy and would warrant equitable subordination in the United States. If such a situation were to arise, the focus should be on developing the existing remedies rather than “venturing into new and uncertain territory of equitable subordination.”<sup>25</sup>

Rejecting the doctrine on the basis of lacking necessity is in line with judicial and academic commentary. Although Justice Pepall did not reject the doctrine in *Re I Waxman & Sons Ltd*, she stated, “the importation or application of a doctrine such as equitable subordination should respond to a lacuna in our law.”<sup>26</sup> Thus, as suggested by Professor Telfer, equitable subordination must be considered in light of the mechanisms that already exist.<sup>27</sup> Given the remedies currently in place, there is no gap in Canadian law that requires equitable subordination.

### **Common law subordination**

Canadian courts have the inherent jurisdiction to resolve common law priority disputes. Thus, when a statute does not dictate the priorities of creditors’ claims, creditors may rely on common law principles to usurp priority. In this context, a court can consider both common law and equitable principles to achieve a fair assignment of priorities.<sup>28</sup> This situation arose in *Bulut v Brampton (City)*, where a creditor held a secured interest granted by a judicial charge, a claim

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<sup>23</sup> *Re General Chemical Canada Ltd* (2006), 22 CBR (5th) 298, 2006 CarswellOnt 4675 at 92 (SC).

<sup>24</sup> See footnote 9.

<sup>25</sup> Telfer, *supra* note 10 at 59.

<sup>26</sup> *Waxman*, *supra* note 19 at 34.

<sup>27</sup> Telfer, *supra* note 10 at 59.

<sup>28</sup> *Bulut v Brampton (City)* (2000), 48 OR (3d) 108, 185 DLR (4th) 278, 2000 CarswellOnt 1063 at 89 (CA).

outside the statutory priority regimes.<sup>29</sup> The ONCA applied common law and equitable principles to determine the priorities of the charge holder and two creditors with security interests registered prior to the judicial charge.<sup>30</sup> In its decision, the Court acknowledged the “first in time” common law rule that applies between secured interests.<sup>31</sup> However, the Court went on to confirm that a *prima facie* rule may be overridden by statute or equity, whereby a person with a legal interest may be postponed due to fraud, gross negligence, or estoppel.<sup>32</sup> Justice MacPherson, writing for the majority, dismissed the appeal, agreeing with the motions judge that the prior secured creditors’ misconduct disentitled them from obtaining priority over the charge holder.<sup>33</sup> Justice MacPherson clarified that, in the present case, the competing claims fell outside any statutory regime. Therefore, subordinating the secured creditors’ claims did not modify statutory priorities.<sup>34</sup> While relying on the common law, the courts effectively achieved the same result as equitable subordination.

### **Remedies under the CCAA**

The 2009 amendments to the CCAA sought to expand the courts’ power to review, invalidate, or subordinate creditors’ claims.<sup>35</sup> This was achieved by establishing two mechanisms.<sup>36</sup> First, codifying the doctrine of recharacterization and the common law rule that shareholder equity claims are subordinate to general creditors’ claim in insolvency proceedings.<sup>37</sup>

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<sup>29</sup> *Ibid* at 12.

<sup>30</sup> *Ibid* at 73, 89.

<sup>31</sup> *Ibid* at 74.

<sup>32</sup> *Ibid* at 75-77.

<sup>33</sup> *Ibid* at 84.

<sup>34</sup> *Ibid* at 87-89.

<sup>35</sup> *US Steel*, *supra* note 2 at para 63.

<sup>36</sup> *Ibid* at paras 64-67.

<sup>37</sup> *Re Sino-Forest Corporation*, 2012 ONCA 816 at para 30, 114 OR (3d) 304 [*Sino-Forest*].

Second, by incorporating the *Bankruptcy and Insolvency Act*'s (the "BIA") rules for reviewing transactions.<sup>38</sup>

The doctrine of recharacterization is an alternative means of subordinating a debt claim. It achieves this result by recharacterizing the debt as equity. Section 6(8) of the CCAA stipulates that a compromise or arrangement cannot be sanctioned unless all non-equity claims are paid in full before any equity claim is paid.<sup>39</sup> An "equity claim" is defined under section 2(1) of the CCAA as a claim in respect of an equity interest,<sup>40</sup> which includes, but is not limited to dividend payments, return of capital, retraction obligations, losses resulting from the ownership, purchase or sale of securities, and claims for contribution and indemnity in respect of claims of this nature. Canadian courts have applied these provisions to subordinate alleged debt claims that are, in substance, equity claims.<sup>41</sup> While the outcomes in these cases are ostensibly indistinguishable from equitable subordination, the doctrines can be distinguished. Unlike equitable subordination, recharacterization does not require inequitable conduct or proof of harm by the claimant.<sup>42</sup> Thus, recharacterization may apply to situations where equitable subordination would not apply. Furthermore, recharacterization avoids the uncertainty associated with the "inequitable conduct" requirement from *Mobile Steel*.<sup>43</sup> While American courts have established categories to help

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<sup>38</sup> *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, ss 95-96 [BIA].

<sup>39</sup> CCAA, *supra* note 3, s 6(8).

<sup>40</sup> *Ibid*, s 2(1). Equity interest means (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt.

<sup>41</sup> For example, in *Sino-Forest*, *supra* note 37 at paras 19, 59, the underwriters and auditors filed proofs of claim against the debtor company seeking contribution and indemnity for any amounts they might be ordered to pay as damages resulting from misrepresentations made by the debtor company. The ONCA agreed with the supervising judge that the claims for contribution and indemnity were within the expansive definition of "equity claims" under the CCAA, and thus will be treated as subordinated equity claims.

<sup>42</sup> Opolsky, *supra* note 9 at 48.

<sup>43</sup> *Mobile Steel*, *supra* note 6 at 702.

identify inequitable conduct,<sup>44</sup> Canadian courts have struggled to determine what conduct will satisfy this element and whether inequitable conduct is even required for equitable subordination in Canada.<sup>45</sup>

Section 36.1(1) of the CCAA incorporates provisions of the BIA that enable a court to void a security interest that was granted by the debtor corporation before entering into bankruptcy or insolvency proceedings.<sup>46</sup> Section 95 of the BIA invalidates preferential transactions, including a charge on property, depending on whether the person is dealing at arm's length with the debtor.<sup>47</sup> Section 96 of the BIA addresses prior transactions that were made for conspicuously less than fair market value, or for no consideration at all.<sup>48</sup> These provisions allow a CCAA monitor to challenge transactions of this nature. If the monitor is successful, the court will set the transaction aside. Thus, creditors can rely on these provisions to invalidate competing creditors claims if there have been unscrupulous pre-bankruptcy transactions. As proposed by Justice

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<sup>44</sup> Common categories of misconduct include: (1) fraud, illegality, or breach of fiduciary duties; (2) undercapitalization; and a claimant's use of the debtor as a mere instrumentality: *Re Clarke Pipe and Supply Co*, 893 F 2d 693 (5th Cir 1990) at 698-99; *Re Fabricators Inc*, 926 F 2d 1458 (5th Cir 1991) at 1467.

<sup>45</sup> See Opolsky, *supra* note 9 at 67-83.

<sup>46</sup> CCAA, *supra* note 3, s 36.1. Sections 38 and 95 to 101 of the BIA apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

<sup>47</sup> BIA, *supra* note 38, ss 95(1), 95(2). Subsection 95(1) provides that a transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person is void as against - or, in Quebec, may not be set up against - the trustee if it is made, incurred, taken or suffered, as the case may be (a) in favour of a creditor who is dealing at arm's length, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor during the period beginning on the day that is 3 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and (b) in favour of a creditor who is not dealing at arm's length, or a person in trust for that creditor, that has the effect of giving that creditor a preference over another creditor during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy. Subsection 95(2) provides that in the case of a transaction with an arm's length creditor that has the effect of giving the creditor a preference, in the absence of evidence to the contrary, it is presumed to have been made with a view to giving the creditor the preference, even if it was made under pressure, and evidence of pressure is not admissible to support the transaction.

<sup>48</sup> *Ibid*, s 96(1). Subsection 96(1) provides that the trustee may apply to the court for a declaration that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor. The criteria used to determine whether a transfer at undervalue can be declared void as against the trustee is different for a party dealing with the debtor at arm's length party with the debtor, s 96(1)(a), and not at arm's length, s 96(1)(b).

Reilly in *Unisource Canada v Hongkong Bank of Canada*, equitable subordination may be unnecessary, given that many of the equitable principles that form the basis for the American doctrine are incorporated into these provisions of the BIA.<sup>49</sup>

### **Oppression remedy in corporate statute**

The oppression remedy embedded in federal<sup>50</sup> and provincial<sup>51</sup> corporate statutes allow a complainant to seek a court order against a corporation or its affiliates for conduct that is “oppressive, unfairly prejudicial, or which unfairly disregards the interests of a shareholder, creditor, director or officer”.<sup>52</sup> In order to grant an oppression remedy, a court must be satisfied that the complainant had a reasonable expectation of certain treatment, and that the conduct complained of breached that reasonable expectation and amounted to oppression, unfair prejudice, or unfair disregard.<sup>53</sup>

While no Canadian court has assessed whether conduct that leads to a successful oppression claim would be equitably subordinated in the United States, case law suggests that the two may overlap.<sup>54</sup> Thus, creditors can rely on the oppression remedy when faced with these situations.<sup>55</sup>

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<sup>49</sup> *Unisource Canada Inc v Hongkong Bank of Canada* (1998), 43 BLR (2d) 226, 14 PPSAC (2d) 112, 1998 CarswellOnt 5122 at 128 (ON SC).

<sup>50</sup> *Canada Business Corporations Act*, RSC 1985, c C-44, s 241 [CBCA].

<sup>51</sup> With the exception of Prince Edward Island, all provinces have a similar provision of the oppression remedy in their corporate statutes. E.g., *Business Corporations Act*, RSO 1990, c B16, s 248.

<sup>52</sup> CBCA, *supra* note 52, s 241(2). Subsection 241(2) stipulates that if “the court is satisfied that in respect of a corporation or any of its affiliates (a) any act or omission of the corporation or any of its affiliates effects a result, (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.”

<sup>53</sup> *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 56, [2008] 3 SCR 560 [BCE].

<sup>54</sup> Telfer, *supra* note 10 at 58, provides the example where the directors or controlling shareholders “misconduct the business or affairs of the corporation, and render it impossible (or exceedingly unlikely) for the corporation to perform its obligations”, citing *Prime Computer of Canada Ltd v Jeffrey* (1991), 6 OR (3d) 733, 30 ACWS (3d) 993 (Gen Div), *Sidaplex-Plastic Suppliers, Inc v Elta Group Inc* (1998), 40 OR (3d) 563, 162 DLR (4th) 367 (CA), and *Downtown Eatery (1993) Ltd v Ontario* (2000), 54 OR (3d) 162, 200 DLR (4th) 289 (CA).

<sup>55</sup> CBCA, *supra* note 52. Section 241(1) gives a complainant the right to apply for an order under the oppression remedy. Although creditor is not listed under the definition of “complainant”, section 238(d) gives the court the

Moreover, the oppression remedy may extend to situations that equitable subordination does not and is arguably an lower threshold to satisfy. As previously addressed, the doctrine of equitable subordination is used in limited circumstances and requires satisfying the three elements of the *Mobile Steel* test.<sup>56</sup>

In addition to its broad scope, the oppression remedy is broad in that a court is given the power to grant “any interim or final order it thinks fit”. Thus, in theory, a CCAA court could subordinate a claim to rectify a creditor’s oppressive conduct. However, the orders permitted under the CCAA are limited to those that further the remedial purpose of the statute.<sup>57</sup> The Court of Queen’s Bench of Alberta in *Re Lightstream Resources Ltd* (“*Lightstream*”) recently affirmed this limitation when assigning an oppression remedy.<sup>58</sup> In this case, the remedy sought by the plaintiffs to rectify the alleged oppressive conduct of the debtor<sup>59</sup> was an order directing an exchange of securities,<sup>60</sup> whereby the plaintiffs’ unsecured claims would be elevated to secured claims.<sup>61</sup> Justice Macleod, writing for the Court, explained that granting such relief would be

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discretion to grant any person the right to make an application under the oppression remedy. See *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68, [2004] 3 SCR 461 at para 51.

<sup>56</sup> See footnote 9. *Mobile Steel*, *supra* note 6 at 702.

<sup>57</sup> *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at para 70, [2010] 3 SCR 379; *Re Stelco Inc* (2005), 75 OR (3d) 5, 253 DLR (4th) 109, 2005 CarswellOnt 1188 at 44 (CA); *US Steel*, *supra* note 2 at para 82.

<sup>58</sup> *Re Lightstream Resources Ltd*, 2016 ABQB 665 at paras 48-51 [*Lightstream*]. The oppression remedy was provided for in section 242 of the *Alberta Business Corporations Act*, RSA 2000, c B-9 [ABCA].

<sup>59</sup> *Lightstream*, *supra* note 60 at paras 3, 20, 36. The debtor, Lightstream, participated in an earlier transaction with two other creditors, Apollo and GSO, who exchanged their unsecured notes for secured notes and additional capital (“Note Exchange”). The plaintiffs claimed that they were oppressed because they were not given the opportunity to participate in the Note Exchange, particularly in light of the alleged misrepresentations whereby Lightstream maintained that it did not intend a debt exchange, and if such a transaction were to occur, it would be offered to all unsecured note holders.

<sup>60</sup> Listed under the oppression remedy is the court’s power to make “an order directing an issue or exchange of securities” to rectify oppressive conduct: ABCA, *supra* note 60, s 242(3)(e); CBCA, *supra* note 52, s 241(3)(e).

<sup>61</sup> *Lightstream*, *supra* note 60 at para 37.

contrary to the remedial purpose of the CCAA because it would adversely affect creditors who have done nothing wrong.<sup>62</sup>

The decision in *Lightstream* suggests that CCAA courts are unwilling to elevate a creditor's unsecured claim to a secured claim due to the debtor's oppressive conduct. However, what has not been determined is whether CCAA courts are willing to subordinate the claim of a creditor who has acted oppressively. In such instances, the Court's concern in *Lightstream* of adversely affecting innocent creditors would not apply. Rather, unsecured creditors who have been subject to oppressive conduct by another creditor would benefit from the subordination of that creditor's claim.<sup>63</sup> Although subordination has not yet been used to rectify oppressive conduct, this remedy holds promise in future CCAA proceedings for the following reasons. First, as previously discussed, the court is given broad discretion to grant any order under the oppression remedy. Second, the CCAA is "skeletal in nature",<sup>64</sup> which provides the CCAA courts significant scope for exercising judicial discretion and crafting creative solutions. Last, this remedy may be an appropriate option for creditors in situations that fall outside of the circumstances that would trigger a remedy under section 36.1 of the CCAA.

### **Current Developments: US Steel**

The ONCA in *US Steel* appears to have closed the door on equitable subordination in CCAA proceedings. In this case, creditors sought to subordinate debt claims of the debtor's parent company based on its actions. The Court had to determine whether section 11 of the CCAA

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<sup>62</sup> *Ibid*, at paras 88-90. The remedy sought would adversely affect: (1) Appollo and GSO, who insisted on exclusivity in the Note Exchange, and (2) the remaining unsecured note holders because only the plaintiff's unsecured claims would be recognized as secured.

<sup>63</sup> For example, subordinating a secured claim to an unsecured claim would preserve the funds that remain to be distributed among unsecured claims *pari passu*. Furthermore, pursuant to section 6(8) of the CCAA, *supra* note 3, subordinating a secured or unsecured claim to equity requires that all non-equity claims be paid in full before to the subordinated equity claim.

<sup>64</sup> *Re Metcalfe & Mansfield Alternative Investments II Corp*, 2008 ONCA 587 at para 44, 92 OR (3d) 513.

granted it the authority to subordinate claims of a creditor for its misconduct. Section 11 of the CCAA gives the courts a general power to “make any order that it considers appropriate in the circumstances”, “subject to the restrictions set out in” the CCAA.<sup>65</sup> The ONCA upheld the decision of the Ontario Superior Court of Justice, where Justice Wilton-Siegel held that CCAA courts do not have jurisdiction to apply the doctrine of equitable subordination under section 11.<sup>66</sup> However, the ONCA provided different reasons. Justice Wilton-Siegel explained that Parliament’s failure to include equitable subordination in the 2009 amendments was indicative of its intention to exclude the operation of the doctrine under the CCAA.<sup>67</sup> Conversely, the ONCA applied principles of statutory interpretation to establish the CCAA courts’ jurisdiction.<sup>68</sup>

### ***Reasons provided by the ONCA***

The ONCA found that nowhere in the words of the CCAA is there authority, express or implied, to apply the doctrine of equitable subordination.<sup>69</sup> In the analysis, Chief Justice Strathy considered the purpose and scheme of the CCAA before interpreting provisions of the statute.<sup>70</sup> It is well established that the purpose of the CCAA is to facilitate compromises and arrangements between companies and their creditors in order to avoid the devastating social and economic effect of bankruptcies.<sup>71</sup> When interpreting the language of section 11, Chief Justice Strathy was of the view that the words “appropriate in the circumstances” meant that any court order made must further the remedial purpose of the CCAA.<sup>72</sup> He found that the appellant failed to

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<sup>65</sup> CCAA, *supra* note 3, s 11.

<sup>66</sup> *Re US Steel Canada Inc*, 2015 ONSC 5103; *US Steel*, *supra* note 2 at para 2.

<sup>67</sup> *Ibid* at paras 49-51.

<sup>68</sup> *US Steel*, *supra* note 2 at para 101.

<sup>69</sup> *Ibid*.

<sup>70</sup> *Ibid* at para 46.

<sup>71</sup> *Ibid* at para 47.

<sup>72</sup> *Ibid* at para 81.

demonstrate how equitable subordination would further this purpose.<sup>73</sup> Chief Justice Strathy also found that the doctrine did not fall within the scheme of the CCAA.<sup>74</sup> The CCAA provides for the implementation of plans of arrangement or compromises, and not a scheme of priorities or distribution.<sup>75</sup> Lastly, the Court found that there was “no ‘gap’ in the legislative scheme to be filled by equitable subordination through the exercise of discretion, the common law, the court’s inherent jurisdiction or by equitable principles”.<sup>76</sup>

While the ONCA may have precluded the use of equitable subordination in future CCAA proceedings, it left the door open for bankruptcy cases. Chief Justice Strathy suggested that if the doctrine became part of Canadian law, it was better suited to the BIA. According to Chief Justice Strathy, section 183 of the BIA<sup>77</sup> provides a bankruptcy court broader jurisdiction to grant an equitable remedy and the legislative purpose of the BIA is more relevant to the potential reordering of priorities.<sup>78</sup>

### ***Criticisms of US Steel***<sup>79</sup>

The ONCA provided adequate reasons for rejecting the doctrine of equitable subordination in the context of the CCAA. However, the Court’s analysis focused on whether the doctrine fell within the scheme and purpose of the CCAA, rather than if equitable subordination is a necessary remedy. While Chief Justice Strathy found that there was no gap in the CCAA to be filled by equitable subordination, he did not consider the mechanisms already available to creditors under Canadian law. If this line of reasoning were pursued, the Court would have

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<sup>73</sup> *Ibid* at para 102.

<sup>74</sup> *Ibid* at para 101.

<sup>75</sup> *Ibid* at para 101.

<sup>76</sup> *Ibid* at para 104.

<sup>77</sup> Section 183 of the BIA, *supra* note 38, invests the bankruptcy court with “such jurisdiction at law and in equity”.

<sup>78</sup> *Ibid* at para 104.

<sup>79</sup> *Ibid*.

reached the same decision, but avoided the uncertainties that will inevitably transpire when a court considers the doctrine under the BIA. Like in the context of the CCAA, creditors in bankruptcy proceedings can seek relief through the oppression remedy,<sup>80</sup> the invalidation of fraudulent preferences and undervalued transaction,<sup>81</sup> and the postponement of equity claims.<sup>82</sup> Thus, the ONCA could have rejected the doctrine, in both CCAA and BIA contexts, on the basis that it is not required with the mechanisms that are already established and have the potential to evolve.

### **Conclusion**

Up until recently, the availability of the doctrine of equitable subordination in CCAA proceedings has been questioned. The ONCA in *US Steel* reached the correct decision in finding that the doctrine of equitable subordination is not available in the context of the CCAA, but erred in its reasoning. Equitable subordination should not be adopted in Canada because it is not necessary, given the remedies that already exist under Canadian law. The SCC will revisit the matter in the fall of 2017, and should close the door that it has left open for twenty-five years.

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<sup>80</sup> CBCA, *supra* note 52, s 241.

<sup>81</sup> BIA, *supra* note 38, ss 95, 96.

<sup>82</sup> *Ibid*, s 140.1. Section 140.1 provides that “[a] creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity claims have been satisfied.”