The Interest Stops Rule: Is *Nortel* the Last Word?

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Overview

In the Supreme Court case *Canada 3000*, Binnie J declared that, "a *CCAA*[1] filing does not stop the accrual of interest."[2] This led the Ontario Court of Appeal in *Stelco* to conclude: "there is no persuasive authority that supports an Interest Stops Rule (the "Rule") in a *CCAA* proceeding."[3] Since the decisions in *Nortel*,[4] which affirmed the Rule's place in *CCAA* proceedings, the authority of the Supreme Court's guidance has been called into question. Justice Newbould even went so far as stating, "it may be fair to say that the statement of Binnie J was *per incuriam*."[5] The Court of Appeal upheld the ruling and dismissed the appeal, revising its previous statement on the Rule as being *obiter*.[6]

What is the rationale for this judicial about-face? Is *Nortel* determinative regarding post-filing interest in *CCAA* proceedings? Under what circumstances does the Rule apply? While there is now undoubtedly a place for it in *CCAA* proceedings, its scope, application, and effect have been narrowly defined and are still very much open to discussion. This paper addresses some of the opportunities to distinguish *Nortel* and related cases.

The Interest Stops Rule

In *Nortel*, bondholders claimed an entitlement to post-filing interest under the terms of their bonds in addition to their claim for principal and pre-filing interest. The *CCAA* judge directed proceedings over whether they were legally entitled "to claim or receive any amounts" beyond the principal and pre-filing interest.[7] Finding against the bondholders, Newbould J accepted that the Rule applied in the *CCAA* context and precluded payment of post-filing interest. The Court of Appeal held that the application of the Rule in *CCAA* proceedings was not in error and that the bondholders were not legally entitled to claim or receive these amounts.[8]

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[1] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].
[2] *Canada 3000 Inc, Re; Inter-Canadian (1991) Inc (Trustee of)*, 2006 SCC 24 at para 96 [*Canada 3000*].
[3] *Stelco Inc (Re)*, 2007 ONCA 483 at para 67 [*Stelco*].
[4] *Re Nortel Networks Corporation et al*, 2014 ONSC 4777 [*Nortel SCJ*]; *Re Nortel Networks Corporation et al*, 2015 ONCA 681 [*Nortel*].
[5] *Nortel SCJ*, *ibid* at para 46.
[6] *Nortel*, *supra* note 4 at paras 8, 91.
[7] *Ibid* at para 5
[8] *Ibid* at paras 7-8.

The Rule is a principle of insolvency law that prohibits the payment of interest on a debt from the date of bankruptcy or winding-up.[9] The Rule was held to be a necessary corollary of the *pari passu* principle,[10] a "governing principle of insolvency law," that requires an insolvent debtor's assets "to be distributed amongst classes of creditors rateably and equally, as those assets are found at the date of insolvency."[11] Canadian courts[12] have sourced these points of law to *Humber Ironworks*, which stated: "in the case of an insolvent estate, all the money […] should be applied equally and rateably in payment of the debts as they existed at the date of winding-up."[13] "Unless this is the case," wrote the court in *Shoppers Trust*, "the principle of *pari passu* distribution cannot be honoured."[14]

The *CCAA* does not expressly address post-filing interest. Prior to *Nortel*, it was generally assumed that while the Rule did apply to proceedings under the *Bankruptcy and Insolvency Act*[15] and the *Winding-up and Restructuring Act*,[16] it did not apply under the *CCAA*.[17] The primary basis for importing the Rule in *Nortel* was recognition of the *CCAA* as being part of an "integrated insolvency regime" which includes the *BIA*.[18] The *BIA* has codified the Rule.[19] In *Nortel*, Rouleau JA referred to *Century Services*, where Deschamps J clarified the relationship between the *CCAA* and *BIA* such that "no 'gap' exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy."[20] She also stressed the avoidance of any "strange asymmetry" that would encourage statute shopping where assets are insufficient to satisfy both secured and unsecured claims.[21] These concerns were confirmed in *Indalex*, where the Supreme Court emphasized the

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[9] *Canada (Attorney General) v Confederation Life Insurance Co*, [2001] OJ No 2610 (Sup Ct) at para 20 [*Confederation Life*].
[10] *Nortel*, *supra* note 4 at para 25.
[11] *Confederation Life*, *supra* note 9 at para 20; quoted at *Nortel*, *supra* note 4 at para 23.
[12] See e.g., *Shoppers Trust Corp (Liquidator of) v Shoppers Trust Co* (2005), 251 DLR (4th) 315 (Ont CA) at para 25 [*Shoppers Trust*]; *Nortel SCJ*, *supra* note 4 at para 14; *Nortel*, *supra* note 4 at para 25.
[13] *In re Humber Ironworks and Shipbuilding Company* (1869), LR 4 Ch App 643 at 657.
[14] *Shoppers Trust*, *supra* note 12 at para 25.
[15] RSC 1985, c B-3 [*BIA*].
[16] RSC 1985, c W-11 [*WURA*].
[17] Jay A Carfagnini and Caterina Costa, "Claims for Post-Filing Interest and Prepayment Premiums in a CCAA Proceeding" (2011) Ann Rev Insolv at 3 (WL).
[18] *Nortel*, *supra* note 4 at para 35.
[19] *BIA*, *supra* note 15 ss 121-122, confirmed in *Canada 3000*, *supra* note 2 at para 96.
[20] *Ted Leroy Trucking [Century Services] Ltd, Re*, 2010 SCC 60 at para 78 [*Century Services*], cited in *Nortel*, *supra* note 4 at para 35.
[21] *Century Services*, *ibid* at para 47.

requirement for "analogous entitlements" where there is a need to avoid "a race to liquidation under the *BIA*."[22]

The approach in *Nortel*

It is tempting to read *Nortel* as a major pronouncement on the Rule's applicability to all *CCAA* proceedings. But a close reading of the reasoning lends itself to the conclusion that, like the cases before it, *Nortel* should be narrowly construed. Together with the other cases touching on the availability of post-filing interest in *CCAA* proceedings, a pattern begins to emerge illustrating that the Rule's applicability depends on the cases' particular circumstances. In *Nortel*, Rouleau JA favoured a narrow reading of *Canada 3000*.[23] He followed Binnie J's own warning in *Henry* against reading "each phrase in a judgment […] as if enacted in a statute," and asking instead, "what did the case decide?"[24] Justice Rouleau expanded on this, emphasizing the importance of case context, which includes "the facts of the case, the issues before the court, the structure of his reasons, the wording used, and what he said as well as what he did not say."[25] It follows that Rouleau JA would have expected an equally specific and narrow reading of *Nortel* in its future application.

The structure and wording of *Nortel* suggest that the court was answering not whether the Rule applies universally, but whether it is available in *CCAA* proceedings and whether it should apply to the instant case. In dispensing with the first issue, the court concluded that, "there are sound reasons for adopting an interest stops rule in the *CCAA* context."[26] The use of such wording implies that it does not always apply or that the default position is that it does not apply unless warranted. Similarly, the court examines in detail the reasons from *Canada 3000*[27] and *Stelco*,[28] distinguishing the contexts within which the Rule does not apply. Justice Rouleau noted that discussion of the Rule in the abstract in *Stelco* should be treated as *obiter*, again implying that its

[22] *Sun Indalex Finance, LLC v United Steelworkers*, 2013 SCC 6 at para 51 [*Indalex*], cited in *Nortel*, *supra* note 4 at para 37.
[23] *Nortel*, *supra* note 4 at para 60.
[24] *R v Henry*, 2005 SCC 76 at para 57.
[25] *Nortel*, *supra* note 4 at para 61.
[26] *Ibid* at para 49.
[27] *Ibid* at paras 57-70.
[28] *Ibid* at paras 71-91.

application is specific to the details of the case.[29] Lastly, the court affirmed that the Rule does not preclude payment of post-filing interest to creditors.[30] Coupled with the discretion afforded to a judge,[31] it appears that it is within the court's discretion to impose or restrict the Rule's application where circumstances warrant or where it sees fit.

What surfaces is a Rule that is as flexible as the *CCAA* itself.[32] While the Rule is clearly available in *CCAA* proceedings, the circumstances under which it applies are not fully understood. Commentators, including counsel for the *Nortel* monitor, have opined that it applies unless proven otherwise.[33] The language in *Stelco* makes the same suggestion: "there might be circumstances" for inclusion of post-filing interest.[34] However, the court in *Abacus* was adamant that the Rule might make sense in some cases, but not in others, and that interest freezes should not be extended "automatically and necessarily" to all proposals.[35] But these statements were made prior to *Nortel*. The reasons in *Nortel*, read against the foregoing cases, support the view that there should be no such presumption as there are sufficient considerations either way. *Nortel* "does not purport to change or limit the powers of *CCAA* judges."[36] As the various circumstances below illustrate, the Rule presents enough of a grey area that its default application should be avoided.

Secured creditors

Secured creditors are not subject to the Rule. The *BIA* does not prevent a secured creditor from claiming post-filing interest. The priority of claims outlined in the *BIA* is, "subject to the rights of secured creditors".[37] Rights of secured creditors also take precedence over any *BIA* order and assignment,[38] and a debtor's bankruptcy does not prevent a secured creditor from "dealing with his or her security in the same manner as he or she would have been entitled to realize or deal

[29] *Ibid* at para 78.
[30] *Ibid* at para 93.
[31] See "How much of a "rule" is the interest stops rule?" below.
[32] *Century Services*, *supra* note 20 at para 14: the *CCAA* is "a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations."
[33] Carfagnini and Costa, *supra* note 17 at 5-6.
[34] S*telco*, *supra* note 3 at para 59.
[35] *AMIC Mortgage Investment Corporation v Abacus Cities Ltd*, 1992 ABCA 57 at para 26 [*Abacus*]. N.B. this was a *BIA* proceeding.
[36] *Nortel*, *supra* note 4 at para 99.
[37] *BIA*, *supra* note 15 s 136(1).
[38] *Ibid* s 70(1).

with it."[39] Such a security must have been perfected.[40] Applying the Rule to *CCAA* secured creditors would create the strange asymmetry Deschamps J cautioned against and would encourage statute shopping. For the Rule to be properly imported, an exception for secured creditors must accompany it. The fact that this important exception is not articulated in either the trial or appeal decisions of *Nortel* supports the argument that *Nortel* was not intended to be a blanket pronouncement. Had the courts meant to rule on the unavailability of post-filing interest in all *CCAA* proceedings, they would have at least made mention of this notable exclusion.

Unsecured creditors

The Rule applies to unsecured creditors where at least one creditor's claim to post-filing interest grows while at least one unsecured creditor has no such claim. Justice Rouleau's conclusion in *Nortel* was that, "allowing one group of unsecured creditors to accumulate post-filing interest, even for a relatively short period of time, would constitute unfair treatment vis-à-vis other unsecured creditors whose right to convert their claim into an interest-bearing judgment is stayed."[41] The conclusion follows from the *pari passu* principle, which requires the rateable and equal treatment of creditors among a class,[42] which Rouleau JA further interpreted as being rooted in the need to treat all creditors fairly.[43] This element of fairness manifests itself in the ultimate requirement that a plan of arrangement be "fair and reasonable" before qualifying for court approval.[44]

But fairness and reasonableness are in the eye of the beholder. In *Central Guaranty*, the court approved a plan that provided for payment of post-filing interest to some creditors on the grounds that "a vote by sophisticated lenders speaks volumes as to fairness and reasonableness."[45] "It is clear," the court continued, "that equitable treatment need not necessarily involve equal treatment."[46] Thus, notwithstanding the Rule serving the purpose of ensuring an unsecured creditor is treated fairly against another, a certain amount of discretion is

[39] *Ibid* s 69.3(2).
[40] *Personal Property Security Act*, RSO 1990, c P.10 s 20(1)(b), confirmed in *Giffen (Re),* [1998] 1 SCR 91.
[41] *Nortel*, *supra* note 4 at para 96. See also para 43.
[42] *Confederation Life*, *supra* note 9 at para 20.
[43] *Nortel*, *supra* note 4 at paras 24, 43.
[44] *Algoma Steel Corp v Royal Bank* (1992), 93 DLR (4th) 98 (Ont CA).
[45] *Re Central Guaranty Trustco Ltd* (1993), 21 CBR (3d) 139 (Ont Ct J (Gen Div)) at para 3 [*Central Guaranty*].
[46] *Ibid* at para 8.

afforded to judges to determine how far it extends.

Moreover, reading into what the court in *Nortel* did not say, Rouleau JA made no mention of the Rule applying where all unsecured creditors *do* have an ability to accrue and claim post-filing interest. It can only be inferred that where unsecured creditors all have the ability to accrue post-filing interest, they are not legally precluded from making such claims because there would be no inherent unfairness.

Inter-creditor relations

The Rule does not extend to inter-creditor relations. *Nortel* distinguished *Stelco* on the basis that post-filing interest was paid from one creditor to another because they are bound by their own agreement, and because payment of such interest does not need to be based on a claim against the debtor.[47] *Stelco* involved two parties in a *CCAA* restructuring after a plan of arrangement had already been approved. The debentureholders were senior in priority to the noteholders. A note indenture between them required that any payment to the noteholders be held in trust until the principal and interest on the senior debentures were paid in full.[48] The noteholders disputed the payment of interest beyond the *CCAA* filing date, asserting that any claim must be based on a claim they have against Stelco for interest, of which there was none.[49] The Court of Appeal disagreed. The *CCAA* does not change the relationship among creditors where it does not directly involve the debtor. The noteholders "agreed to be bound by the deal they made" and agreed to pay "the full amount that would have been owing had there been no *CCAA* filing."[50] Therefore, *CCAA* proceedings do not stay claims as among creditors.

Going concerns

The Rule applies in liquidating *CCAA* proceedings, but not necessarily in going concern restructurings. In *Re Savin*, a foundational case for the *pari passu* principle and for the Rule, James LJ wrote: "I should agree with the rule, seeing that the theory in bankruptcy is to stop all things at the date of the bankruptcy, and to divide the wreck of the man's property as it stood at

[47] *Nortel*, *supra* note 4 at paras 89-90.
[48] *Stelco*, *supra* note 3 at para 6.
[49] *Ibid* at paras 56-58.
[50] *Nortel*, *supra* note 4 at para 90.

that time."[51] Bankruptcy "supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful."[52] What if there is no "wreck of a man's property" to divide? What if reorganization has a high probably of success?

The court in *Abacus* acknowledged these concerns: the Rule might make sense in some contexts but not others, such as ongoing commercial activity by the debtor.[53] *Nortel* dealt with a liquidated company and made no mention of whether post-filing interest is at all available in a going concern's restructuring. Justice Rouleau held that, without the Rule, creditors with no claim to post-filing interest would have an incentive to proceed to bankruptcy.[54] Conversely, if there is an incentive to restructure or disincentive to liquidate—such as a full recovery from a solvent debtor—then the Rule becomes unnecessary and inappropriate.

The purpose of the *CCAA* is to "[create] conditions for preserving the *status quo*" while working out a solution.[55] What makes the *CCAA* unique from the *BIA* or the *WURA* is its flexibility and greater judicial discretion, "making it more responsive to complex reorganizations."[56] In *Canwest*,[57] the court sanctioned a plan that provided for post-filing interest on the basis that the preservation of the going concern would benefit all stakeholders more than a liquidating *CCAA* proceeding.[58] Analogously, the granting of post-filing security for debtor in possession financing, when necessary to preserve the going concern, is a similar concept: the granting of priority over a portion of the debtor's assets—much like the granting of priority in the form of post-filing interest—was positively deemed by the Supreme Court to be "the most creative use of *CCAA* authority."[59] *CCAA* flexibility makes it more likely that a court would sanction a plan with post-filing interest for a going concern's restructuring.

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[51] *Re Savin* (1892), 7 Ch 760 (CA) at 764, cited in *Confederation Life*, *supra* note 9 at para 20, cited in *Nortel*, *supra* note 4 at para 12.
[52] *Century Services*, *supra* note 20 at para 23.
[53] *Abacus*, *supra* note 35 at para 26.
[54] *Nortel*, *supra* note 4 at para 38.
[55] *Century Services*, *supra* note 20 at para 77.
[56] *Ibid* at para 14.
[57] *Re Canwest Global Communications Corp*, 2010 ONSC 4209 [*Canwest*].
[58] Carfagnini and Costa, *supra* note 17 at 10.
[59] *Century Services*, *supra* note 20 at para 62.

Statutorily imposed interest

Interest on a claim imposed by statute does not necessarily cease accruing interest after filing. In *Canada 3000*, two airlines under *CCAA* protection were required to pay interest on unpaid airport and navigation charges, as per the *Airports Act*[60] and *CANSCA*.[61] The Supreme Court ruled that the Rule did not apply to these charges and that interest continued to accrue beyond the *CCAA* filing.[62] *Nortel* distinguished *Canada 3000* on the basis that the court's consideration of the Rule was limited to the context of the specific statutes applied.[63] It remains to be seen whether the Rule applies to post-filing interest for other statutory charges.

Plans providing for post-filing interest

The Rule neither precludes creditors from seeking recovery of post-filing interest, nor does it prohibit post-filing interest being paid under a plan.[64] Notwithstanding the prejudice a ruling on entitlement would have on a creditor's bargaining power, there is deference to what creditors decide is fair and reasonable. Courts can and have sanctioned plans that provide for post-filing interest.[65] Together with surplus scenarios, a plan that specifically provides for post-filing interest is recognized as the main exception to the Rule being applied or enforced.[66] This principle has been held to apply in *BIA* proceedings as well,[67] meaning that the exception likely applies to both liquidating and going concern restructurings.

Surpluses

In liquation proceedings, an asset surplus provides an exception to the Rule. This is another more universally accepted exception.[68] Both the *BIA* and the *WURA* provide for the payment of post-filing interest at statutorily imposed rates in situations where a debtor's assets satisfy all pre-

[60] *Airport Transfer (Miscellaneous Matters) Act,* SC 1992, c 5 [*Airports Act*].
[61] *Civil Air Navigation Services Commercialization Act*, SC 1996, c 20 [*CANSCA*].
[62] *Canada 3000*, *supra* note 2 at para 96.
[63] *Nortel*, *supra* note 4 at para 69.
[64] *Ibid* at paras 93-94.
[65] See e.g. *Canwest*, *supra* note 57; *Central Guaranty*, *supra* note 45.
[66] See e.g. *Agro Pacific Industries Ltd (Re)*, 2001 BCSC 708 at para 16 [*Agro*]; Carfagnini and Costa, *supra* note 17 at 8.
[67] See e.g. *Abacus*, *supra* note 35.
[68] See e.g. *Agro*, *supra* note 66 at para 16; Carfagnini and Costa, *supra* note 17 at 8.

filing claims.[69] In *Nortel*, the bondholders hypothetically claimed that the Rule could result in a situation where shareholders benefit while claims for post-filing interest go unpaid. While not addressing the issue directly, Rouleau JA did assure that where such unfairness results, *CCAA* courts have employed innovative interpretations and exercises of authority.[70] Nevertheless, this is a likely exception to the Rule.

Broader public interests

Where broader public interests are engaged, a court may be more likely to apply the Rule. While the primary obligation of a *CCAA* court is to provide the conditions under which a debtor can attempt reorganization, the Supreme Court recognized that in so doing it must recognize and consider the broader public interest when impacted.[71] The various interests at stake that must be considered include: "employees, directors, shareholders, and even other parties doing business with the insolvent company."[72] In *Nortel*'s case, though the court did not state so explicitly, the granting of post-filing interest to bondholders would have been detrimental to pensioners' recoveries. Justice Rouleau was mindful of the gravity of the case from the outset: the bondholders' post-filing claim amounted to US$1.6 billion (over and above the pre-filing claim of $4.092 billion), a figure that grew steadily against the available $7.3 billion from asset sales.[73] Nortel's 10,600 pensioners would have been disadvantaged even further in a process that generated considerable public frustration and anger over public policy.[74] Whether the court considers the public interest more overtly,[75] or more subtly as it did in *Nortel*, it is still a consideration to be addressed.

How much of a "rule" is the Interest Stops Rule?

All things considered, the Rule is not so much a rule as it is a tool in the *CCAA* toolbox. The *CCAA* grants the court the authority to "make any order that it considers appropriate in the

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[69] *BIA*, *supra* note 15 s 143, see e.g. *Olympia & York Developments Ltd., Re (1997)*, 143 DLR (4th) 536; *WURA*, *supra* note 16 ss 95(2), 158.1(2), see e.g. *Shoppers Trust*, *supra* note 12 at para 25.
[70] *Nortel*, *supra* note 4 at paras 46, 48.
[71] *Century Services*, *supra* note 20 at para 61.
[72] *Ibid*.
[73] *Ibid* at para 4.
[74] See e.g. Bob Baldwin et al, "Nortel's painful pension lessons", Opinion/Commentary (21 October 2015) online: Toronto Star <http://www.thestar.com/opinion/commentary/2015/10/21/nortels-painful-pension-lessons.html>.
[75] See e.g. *Canwest*, *supra* note 57 at para 26; *Sino-Forest Corporation (Re)*, 2012 ONSC 7050 at para 65.

circumstances."[76] Coupled with the skeletal nature of the statute,[77] there is a great deal of discretion afforded to the court. Accordingly, the Rule has been recognized as a starting point that determines legal entitlement. This starting point "does not dictate how the proceeding will progress thereafter."[78] Where it risks working some unfairness, Rouleau JA noted that exceptions might necessitate innovative interpretations and exercises of authority.[79] So even where the Rule is deemed to apply, a proceeding's outcome may still be directed the other way.

Conclusion

"The history of *CCAA* law," noted Farley J, "has been an evolution of judicial interpretation."[80] The Rule has developed considerably, and *Nortel* raised or highlighted more potential issues than it settled. The Rule applies in *CCAA* proceedings, but not absolutely. It does not apply to secured creditors. It does apply to unsecured creditors, but only insofar as it prevents unfairness. It does not apply to intra-creditor disputes. It applies in liquidation proceedings, but probably not to going concerns. It does not apply to some statutory claims, to plans that explicitly include post-filing interest, or to plans distributing a surplus. Broader public interests are a factor, as is judicial discretion. Above all, the Rule can and should be argued on a case-by-case basis. In this way practitioners have an opportunity to further refine the Rule in advocacy. Just as *Nortel* distinguished previous cases, it can likewise be distinguished. Although leave to appeal to the Supreme Court was dismissed,[81] *Nortel* is far from being the last word on the matter.

[76] *CCAA*, *supra* note 1 s 11.
[77] *ATB Financial v Metcalfe & Mansfield Alternative Investments II Corp*, 2008 ONCA 587 at para 44.
[78] *Nortel*, *supra* note 4 at para 99.
[79] *Ibid* at para 48.
[80] *Dylex Ltd, Re* (1995), 31 CBR (3d) 106 (Ont Sup Ct) at para 10.
[81] *Ad Hoc Group of Bondholders v Ernst & Young Inc in its capacity as Monitor, et al*, 2016 CanLII 24877 (SCC).