

# COURT OF APPEAL CONFIRMS THE "INTEREST STOPS RULE" APPLIES IN CCAA PROCEEDINGS

Posted on November 14, 2015

**Categories:** [Insights](#), [Publications](#)

On October 13, 2015, the Ontario Court of Appeal (the "Court of Appeal") upheld [\[1\]](#) a CCAA judge's decision that the "interest stops rule" applies in CCAA proceedings, which significantly limits unsecured creditors' ability to recover interest accrued after the date of a debtor's insolvency.

## Background

In January 2009, Nortel Networks Corporation and its Canadian affiliates (collectively, the "Canadian Nortel debtors") filed for and obtained protection under the *Companies' Creditors Arrangement Act* (Canada) ("CCAA"), while Nortel Network Inc. and other U.S. affiliates (collectively, the "U.S. Nortel debtors") filed petitions in Delaware under Chapter 11 of the *United States Bankruptcy Code* ("Chapter 11").

Under the claims procedures in both the CCAA and Chapter 11 proceedings, holders of Nortel bonds (the "Bondholders") made claims for principal and pre-filing interest against the Canadian and U.S. Nortel estates. The Bondholders also claimed post-filing interest and other related claims under the terms of the bond indentures. The monitor and the Canadian Nortel debtors, with the support of Nortel's pensioners and former employees, objected to any distribution of the proceeds from Nortel's asset sales to the Bondholders in payment of post-filing interest, on the basis that the interest stops rule at common law disallows post-filing interest. The Bondholders argued that the interest stops rule does not apply in CCAA proceedings, relying on the Supreme Court of Canada's decision in *Re Canada 3000* [\[2\]](#) and the subsequent decision of the Court of Appeal in *Re Stelco* [\[3\]](#) as binding authorities for the proposition that the interest stops rule does not apply in CCAA proceedings.

The CCAA judge, Justice Newbould of the Ontario Superior Court of Justice, held that the common law interest stops rule applies in CCAA proceedings.

## Decision on Appeal

A three-member panel of the Court of Appeal unanimously dismissed the Bondholders' appeal and upheld Justice Newbould's decision.

### *Origin and scope of interest stops rule*

According to the Court of Appeal, the interest stops rule originated as "a necessary corollary" of the *pari passu* principle at common law. That principle states that the insolvent debtor's assets are to be distributed among classes of unsecured creditors rateably and equally in payment of the debts as they existed at the date of insolvency. Two purposes underpin the *pari passu* principle: fairness to creditors and orderly administration of an insolvent debtor's estate.<sup>[4]</sup> These two purposes cannot be achieved, the Court of Appeal reasoned, if creditors holding interest-bearing debts are entitled to accrual of interest on their claims in the course of the insolvency proceedings, while other creditors whose debts carry no interest do not have the same right.

### *Reasons for applying the interest stops rule under the CCAA*

The Court of Appeal recognized, as did Justice Newbould, that there is no case where the interest stops rule was applied under the CCAA. Pointing to the consistent application of the rule in proceedings under the *Bankruptcy and Insolvency Act* ("*BIA*") and under the *Winding-Up and Restructuring Act*, and the Court of Appeal gave five reasons for why the rule should also apply in the CCAA context.

1. The CCAA and the *BIA* are part of an "integrated insolvency regime" in which "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."<sup>[5]</sup>
2. Absent the interest stops rule, creditors with no contractual right to post-filing interest would have skewed incentives against reorganization proceedings under the CCAA.
3. The CCAA imposes conditions with the goal of preserving the status quo amongst creditors as of the date of insolvency. This goal would be undermined absent the interest stops rule.
4. Absent the interest stops rule, creditors who have a contractual right to post-filing interest would have less incentive to compromise under the CCAA than creditors without such a right. The asymmetrical incentive to compromise would increase the delays in and difficulty of achieving successful restructuring.
5. The principle of fairness supports the application of the interest stops rule.

### **Observations**

The Court of Appeal confirms the applicability of the interest stops rule in the CCAA context, without distinction between liquidating and restructuring CCAA proceedings. The Court of Appeal is clear that creditors in a CCAA proceeding do not have a right to interest accrued after the date of insolvency of the debtor notwithstanding any contractual claims the creditors may have as against the debtor. However, the Court of Appeal is explicit in limiting the scope of its holding in *Nortel* so as to leave creditors free to bargain amongst themselves for a CCAA plan of compromise or arrangement that provides for post-filing interest payments to some creditors.<sup>[6]</sup>

It remains to be seen whether the parties will seek leave to appeal to the Supreme Court of Canada on this issue.

by Andrea St. Bernard and David Zhou, Student-at-Law

1 *Re Nortel Networks Corp.*, 2015 ONCA 681 [*Nortel*].

2 *Re Canada 3000*, 2006 SCC 24, [2006] 1 SCR 865 [*Canada 3000*].

3 *Re Stelco*, 2007 ONCA 483, 35 CBR (5th) 174 [*Stelco*].

4 *Nortel* at para 24, 27.

5 *Re Ted Leroy Trucking [Century Services] Ltd.*, 2010 SCC 60, [2010] 3 SCR 379 at para 78 [*Century Services*].

6 *Ibid* at para 93.

#### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2015