Court File No. M32171

COURT OF APPEAL FOR ONTARIO

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, C. C-36, AS AMENDED

AND IN THE MATTER OF ANDROSCOGGIN ENERGY LLC

Applicant

BETWEEN:

PENGROWTH CORPORATION, CANADIAN FOREST OIL LTD., AND ALTAGAS LTD.

Moving Parties
(Applicants for leave to appeal/Appellants)

- and -

ANDROSCOGGIN ENERGY LLC, KPMG INC., IN ITS CAPACITY AS THE INFORMATION OFFICER, CREDIT SUISSE FIRST BOSTON, HUSKY ENERGY MARKETING, INC., NOVA GAS TRANSMISSION LTD., PORTLAND NATURAL GAS TRANSMISSIONS SYSTEMS, AND TRANSCANADA PIPELINES LIMITED

Responding Parties
(Respondents)

FACTUM
OF THE INTERVENER, ISDA

(On Appeal to be Heard February 14, 2005 if Leave to Appeal is Granted)

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PART I - NATURE OF THE APPEAL AND OVERVIEW

1. This Factum of the Intervener, International Swaps and Derivatives Association, Inc. ("ISDA"), is provided as a friend to the Court in support of the appeal by the Appellants concerning the Order of the Honourable Mr. Justice Farley dated January 26, 2005 in the within Action (the "January 2005 Order").

2. ISDA respectfully submits that the Honourable Mr. Justice Farley erred by adopting the interpretation of the defined term "eligible financial contracts" in the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the *"CCAA"*) found in the decision of Mr. Justice LoVecchio in *Blue Range Resources Corp., Re* (1999), 12 C.B.R. (4th) 173 (Q.B.) ("*Blue Range (QB)*") **[Tab 1]** and refusing to follow the decision on appeal (which reversed the decision in *Blue Range (QB)*) from the Alberta Court of Appeal in *Blue Range Resources Corp., Re* (2000), 20 C.B.R. (4th) 187 (C.A.) ("*Blue Range (CA)*") **[Tab 2]**.

3. It is ISDA's position that a transaction that calls for physical delivery of a commodity at a future date at a currently determined price is an "eligible financial contract" within the definition of s. 11.1 of the *CCAA* and that by following the decision in *Blue Range (QB)* and not following the decision on appeal in *Blue Range (CA)*, the Honourable Mr. Justice Farley erred in determining that such transactions are not "eligible financial contracts".

4. This Factum seeks to inform this Honourable Court as to the impact of the January 2005 Order on, among other things, the natural gas industry, as well on the financial institution and natural gas producer members of ISDA.

5. This Factum will not address the particulars of the underlying agreements that exist between the Appellants and the Respondents.

PART II - FACTS

6. ISDA generally adopts the sequence of event described in para. 6 - 33 of the Appellant's Factum, filed. ISDA also seeks to rely on the additional facts set out below.

A. ISDA

7. ISDA is a not-for-profit corporation and a global trade association representing the world's major institutions and other leading participants in the privately negotiated derivatives industry, a business which includes interest rate, currency, commodity transactions and equity swaps, as well as related products such as caps, collars, floors and swaptions. ISDA's membership numbers over 600 major organizations from 48 countries around the world who deal in, as well as leading end-users of, privately negotiated derivatives, as well as associated service providers and consultants.

> Affidavit of Robert Pickel, sworn February 7, 2005 ("Pickel Affidavit") at para. 7, ISDA Motion Record, Tab 2

8. ISDA's mandate includes the promotion of practices conducive to the efficient conduct of the business of its members in swaps and other derivatives, including the development and maintenance of standard documentation for derivatives, and the fostering of high standards of commercial conduct among its members. ISDA carries out its mandate in a number of ways, including taking a leading role in formulating and advocating the industry's position on crucial regulatory and legislative issues affecting both dealers in, and users of, privately negotiated derivatives. Its activities include working with regulators to address policy concerns arising from the evaluation of the derivatives business, meeting with policy makers in the world's

financial centers, testifying at public regulatory and legislative forums, and preparing position papers on, and responses to, regulatory and legislative initiatives.

Pickel Affidavit at paras. 8 and 9, ISDA Motion Record, Tab 2

9. Since the intervention by ISDA in *Blue Range (CA)*, ISDA has been involved with other related associations, including the North American Energy Standards Board ("NAESB") and Edison Electric Institute ("EEI"), to improve documentation related to commodities. These collaborative efforts have resulted in the publication by ISDA in November, 2004 of the North American Gas and Power Annexes, which Annexes provide terms that would apply to transactions involving the purchase or sale of physical gas or power or options on physical gas or power. These Annexes permit users to bring such trades under an ISDA Master Agreement and to elect to incorporate existing credit support arrangements. This development further serves the ISDA mandate, and enhances the transparency, liquidity, and mobility available to the commodity trading market place.

Pickel Affidavit at para. 14, ISDA Motion Record, Tab 2

B. Impact of January 2005 Order

10. The January 2005 Order, in which the Honourable Mr. Justice Farley applied the decision in *Blue Range (QB)* and defined an "eligible financial contract" as excluding those commodity transactions which by their terms call for physical delivery, will impact the business of financial intermediaries and market participants in the natural gas industry, as well as other participants in the Canadian commodity markets, many of whom are Canadian members of ISDA. Two of those greatly affected by the January 2005 Order are Royal Bank of Canada ("RBC") and BP Canada Energy Company ("BP").

Affidavit of Najef Husain, sworn February 7, 2005 ("Husain Affidavit") at para. 10., ISDA Motion Record, Tab 3

Affidavit of Ryan McGeachie, sworn February 7, 2005 ("McGeachie Affidavit") at para. 9, ISDA Motion Record, Tab 4

11. It is the position of ISDA that the distinction in the January 2005 Order between "physical" and "financial" contracts in the commodity derivatives industry is illusory. The effect of the January 2005 Order is fundamentally to defeat in substantial measure the remedial intent of Parliament in creating a regime to govern "eligible financial contracts" across a broad range of insolvency-related statutory provisions.

12. It is, in fact, quite common for ISDA members to enter into hedging transactions by means of contracts that call for physical delivery of natural gas and other commodities. Such "physical delivery" contracts are customarily documented under ISDA Master Agreements or other agreements similar to them. The ISDA Master Agreement and other documentation published by ISDA specifically contemplate the documentation of physically settled commodity contracts. Consequently, the January 2005 Order affects the enforceability of termination and netting rights in an ISDA Master Agreement dealing with commodity forward contracts that by its terms call for physical delivery of the commodity. As such, the January 2005 Order in effect carves out special (and unfavourable) treatment for this subset of transactions routinely carried on by ISDA members.

Pickel Affidavit at paras. 5, 6, and 11, ISDA Motion Record, Tab 2

13. The ISDA Master Agreements, authoritative contracts widely used by industry participants, have established international contractual standards governing privately negotiated derivatives transactions that reduce legal uncertainty and allow for the reduction of credit risk through termination provisions and netting of contractual obligations. Ensuring the enforceability

of the netting provisions of the ISDA Master Agreement has been, and remains, a key initiative for ISDA, because of its importance in reducing the credit risks arising from the business. ISDA's work in this area has resulted in a series of laws being passed in various countries that ensure legal certainty in those nations. ISDA continues to expand its efforts related to the enforceability of netting provisions, working with the relevant legislative and regulatory representatives in a number of jurisdictions.

Pickel Affidavit at para. 10, ISDA Motion Record, Tab 2

14. In its simplest terms, the "eligible financial contract" reforms initiated by Parliament were designed to introduce a basic level of certainty as to the enforceability and operation of hedging and derivative-type contracts in the case of insolvency of a counterparty. The fundamental principle underlying this reform is the recognition of the inter-connectedness of dealings between counterparties to such agreements and the necessity to allow the contracts to operate so as to permit the unhindered termination of all such related agreements and the netting of the obligations. This in turn allows the solvent counterparty to go back into the marketplace and re-hedge the exposure created by the insolvency and termination.

Minutes of Proceedings and Evidence of Standing Committee on Consumer and Corporate Affairs and Government Operations on September 11, 1991, p. 12:7 and 12:28 **[Tab 3]**

Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, First Meeting on Bill C-5 on November 4, 1996, p. 25-26 **[Tab 4]**

Standing Committee on Consumer and Corporate Affairs and Government Operations First Report on Bill C-22 on October 7, 1991, p. 15:13 – 15:14 **[Tab 5]**

15. As will be seen below, the ripple effect of the January 2005 Order, if upheld will be two-fold:

(i) It will limit the availability of hedging as a risk-management tool to Canadian businesses; and

(ii) It will impair the competitiveness of Canadian financial institutions in the international marketplace.

16. By challenging the twin pillars of certainty of termination and certainty of netting, the January 2005 Order ensures that Canadian businesses will have less access to hedging as a risk management tool than their international competitors and that Canadian businesses will be handicapped relative to their foreign competitors.

Pickel Affidavit at paras. 11-12, ISDA Motion Record, Tab 2

Husain Affidavit at paras. 10, 12, 15, 22, and 23, ISDA Motion Record, Tab 3

McGeachie Affidavit at paras. 9, 11, 13, 18, and 19, ISDA Motion Record, Tab 4

C. Why Physically Settled Transactions are "Financial"

17. ISDA's members, such as RBC and BP, participate either directly or indirectly through subsidiaries, in various commodity markets, including natural gas, as financial intermediaries and natural gas market participants, respectively.

Husain Affidavit at para. 3, ISDA Motion Record, Tab 3

McGeachie Affidavit at para. 3, ISDA Motion Record, Tab 4

18. A role of financial intermediaries and market participants in these markets is to provide a financial service or product to their customers, namely a service or product that provides price discovery, liquidity and price risk management. Market intermediaries offer cash settled forwards, options and commodities swaps, as well as physically settled commodity products, to provide these benefits to their customers, who may be producers, end-users or other market intermediaries, in the commodity markets. Market participants often match physically settled and cash settled contracts on a transaction-by-transaction or portfolio basis to minimize exposures. In the natural gas market, typically producers want upside price exposure but a limited downside;

marketers want to protect margins; and local distribution companies, industrials and utilities want certainty as to price. The instruments by which financial intermediaries and other market participants offer these services frequently provide for physical delivery.

Husain Affidavit at para. 3, ISDA Motion Record, Tab 3

McGeachie Affidavit at para. 3, ISDA Motion Record, Tab 4

19. The fact that a contract calls for settlement by delivery of a commodity does not mean that there will necessarily be actual delivery of the commodity. For example, in the natural gas market in Alberta, natural gas is not bought or sold in the usual sense of the term by transferring physical possession of the natural gas. Producers, end-users and other market intermediaries enter into natural gas transactions under contract, but many of the trades simply involve buying and selling the right to take physical delivery of natural gas on a future date. Transactions are settled by "title transfer", whereby participants transact in natural gas, although they may not have the intention of taking physical control of the natural gas in a pipeline or physically removing it from the pipeline. As a result, the total volume of natural gas traded far exceeds the amount of natural gas that actually flows through the system. For example, BP estimates that the average daily volumes of natural gas traded in North America in 2003, for prompt month contracts alone, was approximately 6 to 10 times higher than the total volume of natural gas consumed for those months. This is similar to the active trading that takes place in typical financial markets with respect to many other types of assets, such as securities, foreign currencies, other commodities, and other highly commoditized assets. The liquidity of the marketplace is enhanced by this trading capacity.

Husain Affidavit at paras. 4-8, ISDA Motion Record, Tab 3

McGeachie Affidavit at paras. 4-7, ISDA Motion Record, Tab 4

20. By executing such transfers of natural gas, financial institutions, such as RBC, do not become owners of natural gas, nor do they become end-use purchasers or suppliers. They look to access liquidity in the Canadian natural gas markets to improve the pricing of their derivative product line, and offer physically settled derivative transactions to their customers as a risk management alternative. They seek to improve their ability to manage their own risk in the natural gas markets. RBC does not intend to take physical delivery or possession of natural gas. In fact, they intend to have no net position on delivery day. Financial intermediaries, such as the RBC, manage their books so that the amount purchased, or transferred into their accounts, offsets the amount of gas sold or transferred out of their accounts. It is critical for these financial intermediaries to be able to manage their exposure in respect of trades such that the net obligations to deliver and receive natural gas balance to nil at the end of every day during the delivery month.

Husain Affidavit at paras. 7-8. ISDA Motion Record, Tab 3

21. Thus, while each individual natural gas contract traded may call for physical delivery (and thus be excluded from the "eligible financial contract" regime by reason of the January 2005 Order), the net effect of similar contracts (whether between the same counterparties or otherwise) is managed so as to generally balance to zero. By reason of the risk management activities of one counterparty to a "physical" contract, a "physical" obligation is in effect transformed into a "financial" one and the supposed distinction between "physical" transactions and "financial" transactions that formed the foundation of the January 2005 Order proves entirely illusory. The effect of the January 2005 Order on the derivatives market, however, is immediately apparent. Without certainty as to the enforceability of termination rights and netting, a financial intermediary's daily effort to balance its exposure would itself be put at risk.

The result would inevitably be both a reduction in access to the market itself (greater credit risk equates to higher entry requirements) and an increase in the cost of doing business in the market (as financial intermediaries and other market participants pass on the cost of the added risk).

Husain Affidavit at paras. 9-10 and 14-15, ISDA Motion Record, Tab 3

McGeachie Affidavit at paras. 9 and 12-13, ISDA Motion Record, Tab 4

22. Outside of credit considerations, there are very few differences between a master gas purchase agreement settled through the transfer mechanism described above and a futures contract traded on the New York Mercantile Exchange (NYMEX) or the Commodity Exchange in New York (COMEX). All the exchange traded commodity contracts utilized by the commodity-trading desks of RBC and BP imply physical obligations on maturity. As such, all of these contracts have the possibility of physical delivery and have roughly the same settlement mechanics as the aforementioned natural gas transfers. Although a futures contract represents an obligation to deliver or accept delivery of an underlying asset, in virtually all futures trades, that obligation is terminated prior to the delivery period through what is known as an "offsetting trade".

Husain Affidavit at paras. 9 and 16, ISDA Motion Record, Tab 3

McGeachie Affidavit at paras. 8 and 14, ISDA Motion Record, Tab 4

D. Effect of the January 2005 Order on Customers

23. If financial institutions and other market participants are not permitted to terminate and net, then credit lines available to customers, including producers, will decrease, to the competitive disadvantage of these customers. Credit limits are established for each counterparty with which financial intermediaries, such as RBC, or other market participants, such as BP, transact. Credit usage, or the dollar amount at risk for an intermediary, in the case of derivatives

transactions, is a function of the intermediary's exposure under outstanding transactions with a counterparty. Exposure is calculated in part based on the mark-to-market values of all of the transactions with a counterparty calculated on a net basis. If transactions are governed by enforceable termination and netting provisions, with resulting close-out netting, the exposure and, therefore, the credit usage, can be reflected as a single amount which is the net difference between the "in the money" and "out of the money" transactions.

Husain Affidavit at para. 14, ISDA Motion Record, Tab 3

McGeachie Affidavit at para. 12, ISDA Motion Record, Tab 4

24. Conversely, if netting is not allowed, a customer would quickly "use up" its available credit limit since the financial intermediary or market participant would need to account for all "out of the money" transactions without decreasing credit usage by giving its customer credit for the "in the money" transactions. The effect of not allowing netting will be to limit access to the market for users by reducing in a potentially dramatic way the credit available.

Husain Affidavit at para. 15, ISDA Motion Record, Tab 3

McGeachie Affidavit at para. 13, ISDA Motion Record, Tab 4

25. The fact that financial intermediaries and other market participants will face different risks in insolvency between contracts that call for physical delivery and those that either provide for cash settlement or which are swaps, means that financial intermediaries and other market participants will not be indifferent between which contracts they offer their customers. The result will be an increase in the cost of using physical settlement structures or the loss of access to this market.

Husain Affidavit at para. 15, ISDA Motion Record, Tab 3

McGeachie Affidavit at para. 13, ISDA Motion Record, Tab 4

E. Effect of the January 2005 Order on Canadian Financial Intermediaries

26. In addition to the impact of the January 2005 Order on the credit lines that market intermediaries may make available to customers, there is a separate effect of the January 2005 Order on Canadian financial institutions. Financial institutions hedge their own risks in international markets. Parties who deal with Canadian financial intermediaries also want comfort that they can terminate and net for the same reason that Canadian financial institutions want valid termination and netting rights. Because the January 2005 Order impacts the similar eligible financial contract definitions in the *Bankruptcy and Insolvency Act* ("*BIA*"), the *Winding-Up and Restructuring Act,* ("WURA"), the *Canada Deposit Insurance Corporation Act* ("CDIC Act"), and the *Payment Clearing and Settlement Act* ("*PCSA*"), the January 2005 Order will put Canadians at a competitive disadvantage in seeking business internationally when their non-Canadian competitors do not face a similar handicap to the enforceability of their termination and netting agreements in their home jurisdictions.

Husain Affidavit at para. 13, ISDA Motion Record, Tab 3

27. The Capital Adequacy Requirements Guideline released by the Office of the Superintendent of Financial Institutions ("OSFI") in January 2001 (the "Guideline") requires that Canadian banks meet prescribed capital adequacy standards. Canadian banks (and all other foreign banks subject to Bank for International Settlement ("BIS") capital requirements - some of which participate in the Canadian market) are required to meet both an assets to capital multiple test, as well as a capital to risk-weighted assets and risk-weighted off-balance sheet items test. The Guideline allows banks to net forwards, swaps, purchased options and other similar off-balance sheet derivatives instruments in calculating bank assets, provided that certain conditions are satisfied, including the following:

(a) The bank must have an agreement in place with its counterparty which provides for the netting of all positive and negative mark-to-market values of all transactions with that counterparty in the event of default, bankruptcy, liquidation or similar circumstances; and

(b) The bank must have a legal opinion that confirms that the netting provisions of the agreement would be enforced by a court.

Husain Affidavit at para. 19, ISDA Motion Record, Tab 3

28. RBC and other financial institutions in the Canadian market have taken the view that transactions that call for physical delivery of commodities constitute an "eligible financial contract" under the *CCAA* and other insolvency legislation, which can be terminated and netted to arrive at a net termination value in an insolvency proceeding. The effect of the January 2005 Order is that the conditions for terminating and netting these transactions, with respect to natural gas and other commodities where delivery of the underlying commodity may be made, will no longer be met for the purpose of the Guideline, with the result that RBC and other such Canadian financial institutions will no longer be able to net positive and negative mark-to-market values of such transactions in calculating assets for the purposes of OSFI's capital adequacy standards. Also, foreign banks who deal with Canadian banks and who are also subject to the BIS standards will not be able to net for their own capital adequacy requirements, which will impact their ability to deal with the Canadian banks.

Husain Affidavit at paras. 20-21, ISDA Motion Record, Tab 3

29. Capital is an extremely scarce resource, and its availability determines whether certain businesses can be undertaken at all by a financial institution, or whether existing businesses can be maintained or expanded. Financial intermediaries and other market participants employ their capital where its returns are highest. If the January 2005 Order stands, then these parties will

have to allocate more of their capital to this business. This means "prices" will have to rise to provide an adequate return for this capital or these parties may simply exit the market.

Husain Affidavit at para. 22-23, ISDA Motion Record, Tab 3

PART III - ARGUMENT

30. The effect of the January 2005 Order is to potentially restrict "future, forward and other commodity contract" in s. 11.1(1)(h) of the *CCAA* to certain types of contracts, namely commodity swaps that derive value from the price of a commodity, but do not call for delivery of a commodity. In effect, the January 2005 Order interprets "commodity contracts" as contracts based upon the value of a commodity rather than contracts dealing in the commodity itself. It is submitted that this gloss is both unwarranted and wrong in law.

31. The distinction drawn in the January 2005 Order between contracts that are *financial* in nature and those which are merely *supply contracts* was an over-simplification of the industry, as it is quite common for parties to hedge risk by entering into contracts that call for physical delivery. In fact, Justice LoVecchio in *Blue Range (QB), supra* at para. 33 **[Tab 1]** recognized that a physical transaction could have a hedging purpose. It is submitted that to draw a distinction between "financial" contracts and "physical" contracts on the basis of whether the contract calls for physical delivery of gas, or other commodities, is inconsistent with:

(a) Legislative history of s. 11.1 of the *CCAA*;

(b) Intention of Parliament;

(c) Intentions of the parties entering into these transactions;

(d) Plain wording of the *CCAA* and other legislation;

(e) U.S. *Bankruptcy Code*;

(f) Decision of the Alberta Court of Appeal in *Blue Range (CA);* and

(g) Industry practices.

32. Each of these inconsistencies will be discussed in detail below.

A. The Legislative History of Section 11.1(1) of the CCAA

33. Prior to 1992, neither the *CCAA*, nor the *BIA*, made special provision for eligible financial contracts. In 1992, Parliament passed a sweeping reform of the former *Bankruptcy Act.* That reform included a provision protecting the right to terminate and net exposures under eligible financial contracts in the context of a *BIA* proposal proceeding, which otherwise imposes an automatic stay on the termination of contracts by reason of the *BIA* filing having been made. Prior to the passage of these reforms, the Standing Committee on Consumer and Corporate Affairs scrutinized Bill C-22. Members of the Canadian Bankers' Association made submissions to the Standing Committee on the issue of eligible financial contracts. The following excerpt is relevant to this issue:

> A recent amendment to Chapter 11 of the U.S. *Bankruptcy Code* does permit counterparties to terminate or close out hedging contracts during a stay period if one of these parties becomes insolvent. Similar legislation we feel is needed in Canada to ensure the continued competitiveness of Canadian financial markets and their ability to be part of these contracts when the other party is in fact a U.S. entity or a U.S. citizen.
> ...
> The contracts being discussed, which we have called eligible financial contacts, are, however, important in their limited sphere. They help Canadian and other corporations world wide to manage risks such as changes in interests rates and in currency exchange rates.
>
> Now the markets here are highly volatile and it is important that parties be able to terminate their relationship immediately, if performance by the other party is in doubt, without fear of any stay, to avoid exposure in future market uncertainties.
>
> In the United States the solution we propose has been adopted, as an exception to their very pro-debtor legislation. It has enabled troubled U.S. debtors, and especially those in the financial

> community, to continue to be able to access these risk-controlling markets at a time when they have needed such protection the most.
>
> In Canada, on the other hand, the proposed stay provisions under the *Bankruptcy Act* go in exactly the opposite direction. They introduce uncertainty into eligible financial contracts entered into by Canadian corporations. We think this is undesirable, because it would make eligible financial contracts unavailable to weak Canadian businesses at a time when they can least afford to be excluded from the market. It would also effect the position of those business with their competitors in the United States and in other countries, and could lead to some Canadian financial business being done outside of Canada.

Minutes of Proceedings and Evidence of Standing Committee on Consumer and Corporate Affairs and Government Operations on September 11, 1991, p.12:7 and 12:28 **[Tab 3]**

January 2005 Order at p. 2-3, ISDA Motion Record, Tab 6

34. The *CCAA* was amended in 1997, in part in order to harmonize the *CCAA* with the *BIA*. At this time, the "eligible financial contracts" provisions of the *BIA* were imported into the *CCAA* and the broad discretion that the courts had assumed to interfere with such contracts (in proceedings such as those involving *Confederation Treasury Services v. Hees International Bank Corp. Inc., infra)* was curtailed.

35. It is submitted that the January 2005 Order in effect defeats the intent of Parliament in introducing this reform and does so without the benefit of the broad considerations reviewed by Parliament.

Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, First Meeting on Bill C-5 on November 4, 1996, p.13:77 **[Tab 4]**

Confederation Treasury Services v. Hees International Bank Corp. Inc. (1997), 45 C.B.R. (3d) 204 (Ont. Gen. Div.) **[Tab 6]**

B. Statutory Interpretation and Intention of Parliament

36. It is submitted that the wording of s. 11.1(h) of the *CCAA* given its plain and ordinary meaning and read in the context of the other contracts listed in s. 11.1, does not support the "reading in" of the proposed distinction between financial and physical contracts. The plain meaning of terms such as "commodity contract" clearly includes a contract for sale of a commodity — indeed it includes this much more obviously than it includes a contract whose value is derived from the price of a commodity.

37. The Honourable Mr. Justice Farley, by following the reasons of Mr. Justice LoVecchio in *Blue Range (QB)*, focused on the interpretation of the terms "future, forward or other commodity contract" within the definition of s. 11.1 of the *CCAA*. The Court did not, however, look to the other categories in the definition of an eligible financial contract to inform the analysis of the types of contracts to be included in "future, forward or other commodity contracts" as was done by the Alberta Court of Appeal in *Blue Range (CA)*. It is respectfully submitted that there are other relevant categories within s. 11.1, that the Court should have considered such as "a cap, collar or floor transaction" (s. 11.1(d)), "a commodity swap" (s. 11.1(e)), and "any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i)" (s. 11.1(j)).

38. These other categories encompass the typical kinds of transactions involving commodities that would be characterized as "financial in nature". In fact, the transaction described in *Blue Range (QB), supra* at paras. 34-37 **[Tab 1]** as the quintessential commodity contract is a "commodity swap", already covered by s. 11.1(e). However, if the category of "a spot, future, forward or other commodity contract" is defined as it was in the January 2005 Order, then the category would not include any type of contract that would not otherwise fall

within the other categories mentioned in s. 11.1(d), (e), and (j) referred to above. This would result in s. 11.1(h) "a spot, future, forward or other commodity contract" being redundant, a result that Parliament could not have intended.

39. As well, the interpretation given to "eligible financial contract" in the *CCAA* runs counter to the fact that many of the other types of contracts listed as "eligible financial contracts" in s. 11.1 are contracts that in fact call for physical delivery. For example, "future contracts" trading on an exchange, such as NYMEX, call for the physical delivery of the commodity. The obligation to deliver the commodity is a real obligation, although it may be met by the purchase of an offsetting exchange contract, just as the obligation to deliver the commodity under a forward contract can be. Therefore, the potential for physical delivery cannot be the relevant distinction between a "physical" and "financial" contract because futures are covered by s. 11.1 of the *CCAA* and all futures contracts provide for physical delivery. The only difference between a forward and a future is that a future is entered into over an exchange. The January 2005 Order therefore either renders the inclusion of futures in the list of eligible financial contracts meaningless (because there will be no types of futures that meet this definition) or will draw a completely unwarranted and nonsensical distinction between futures and forwards.

40. A "spot commodity contract" is also understood in the industry to refer to a contract to deliver the commodity at the spot price. There is no such thing as a non-physical spot commodity contract. The trading that takes place in the natural gas market is typical of that which takes place in other markets that are clearly financial market places, such as the securities markets and foreign currency markets, and these are contracts that are clearly covered by the definition of an "eligible financial contract" in the *CCAA*.

41. Repurchase and reverse repurchase agreements and agreements to buy, sell, borrow, or lend securities are eligible financial contracts and these transactions clearly require the physical delivery of a security.

42. Including contracts that call for physical delivery of commodities as eligible financial contracts recognizes the direct or indirect relationship between physical and financial contracts that is frequently part of commodity traders' risk management controls. Participants in commodity trading often match physical and financial contracts to minimize financial exposure. It is submitted that, given the interrelationship of physical and financial transactions, it would be unfair and inappropriate to allow the financial side of a transaction the rights and protections under the *CCAA* that are not available to the physical side. To do so would be to effectively deprive participants in commodity trading transactions of the very risk management protections that the *CCAA* was intended to provide.

43. The Alberta Court of Appeal in *Blue Range (CA)* noted these other categories of "eligible financial contract", and concluded that "an across-the-board interpretation of eligible financial contracts that excludes physically-settled transactions cannot stand." It is submitted that the approach described above and adopted in *Blue Range (CA)* should be considered and applied by this Honourable Court in reversing the January 2005 Order.

> *Blue Range (CA), supra* at para. 35 **[Tab 2]**

C. The Intention of the Parties

44. The Honourable Mr. Justice Farley determined that if the purpose of the contract is to lead to the actual delivery of the commodity, then the contract is "physical", not "financial". This conclusion was based on the reasons in *Blue Range (QB),* where the Court concluded at para. 30

[Tab 1] that the distinction between physical and financial contracts is resolved by the intention of the parties. This reasoning does not recognize that the "financial" purpose of a transaction may be a very important, if not predominant, reason for entering into the transaction, even where the contract calls for physical delivery of the commodity. The fact that transactions which call for physical delivery are essentially financial is proven by the fact that entities such as Canadian banks, which are in the business of providing financial services in accordance with the *Bank Act,* are active in this market and consider offering these types of contracts simply as offering a financial service to their customers. Moreover, since *Blue Range (CA),* the principal regulator of banks in Canada, the Office of the Superintendent of Financial Institutions ("OFSI") has issued a ruling confirming that when banks engage in physically settled commodity transactions, they are providing a financial service under the *Bank Act* and as such, they need to have appropriate risk management policies and procedures for physically settled commodities similar to those in place for financially settled derivatives. Physically settled products provide the same benefits, price discovery, price risk management and liquidity, as cash settled forwards and commodity swaps: institutions offer them to their customers indifferently and in order to provide these benefits.

Husain Affidavit at para. 18 and Exhibit "A", ISDA Motion Record, Tab 3

45. "Physical" and "financial" transactions are not mutually exclusive types of transactions, particularly with respect to sales of natural gas, where the market is highly liquid and the distinction between physical and financial contracts does not really exist (except in rare circumstances). Given the liquidity of natural gas markets, purchasers can readily off-load their obligations to take delivery of gas under a physical contract by entering into a contract to make delivery of the same quantity of gas at the same point of delivery. These offsetting arrangements can be made with either the original seller or a new party. By entering into these arrangements,

purchasers need never take delivery of gas. In this sense, the market operates like an exchange in that parties agree to make or take delivery, but can and often do settle their obligations by entering into offsetting contracts. Financial intermediaries and other market participants often enter into physical gas contracts with no intention of ever taking possession of the commodity, although their agreements are identical in material respects to the agreements that would be entered into between producers and either end-users or gas marketers. In these circumstances, the financial intermediaries or other market participants would be in exactly the same position if the contracts allowed for cash settlement as opposed to physical delivery or as an alternative to physical delivery.

Husain Affidavit at paras. 4-8, ISDA Motion Record, Tab 3

McGeachie Affidavit at paras. 4-7, ISDA Motion Record, Tab 4

46. If the January 2005 Order is to be interpreted as requiring an investigation as to the subjective intention of the parties in terms of whether or not they intended to make or take delivery, the distinction suggested by the January 2005 Order would also be unworkable. Reducing s. 11.1 to such a subjective level would be to re-introduce precisely the sort of unpredictability into these sorts of transactions that Parliament was seeking to avoid. In any event, it is not possible in many cases to discern a single subjective intention of the parties. A producer may intend to deliver its gas, but the financial intermediary or other market participant counterparty may not intend to take physical control of that commodity. A market participant, such as BP, may have either intention or may change its intention with respect to a particular contract during the life of the contract. Having a common intention in this regard is simply not relevant in this type of market.

47. It is submitted that it is inappropriate to rely on the parties' intentions either as evidenced by the written contracts or based on other subjective evidence as the determinative factor as to whether a contract is of a "financial" or "physical" nature.

D. The Object of the CCAA

48. One of the concerns raised by Mr. Justice LoVecchio in *Blue Range (QB)* (which reasoning was followed by Mr. Justice Farley in the January 2005 Order) was that by construing the term "eligible financial contract" to include contracts that provide for physical delivery, the restructuring objective of the *CCAA* would be defeated. It is submitted that this concern is unwarranted generally, and particularly in the circumstances of the case at bar.

49. Where a party who has entered into hedging arrangements becomes insolvent and seeks *CCAA* protection, no legitimate purpose is served by allowing the debtor to seek to selectively interfere with termination and netting provisions. If a party can unilaterally prevent termination, it exposes the solvent counterparty to involuntary and potentially unlimited risk. The debtor would be entitled to speculate for free on its "out of the money" transactions, improving in value while knowing that it will not be able to pay in any event if the market moves in the other direction. Conversely, the debtor might "cherry pick" or selectively repudiate "in the money" transactions in order to trigger a cash payment from the non-defaulting party. An example of cherry picking is found in *Nesi Energy Marketing Canada Ltd. (Trustee of) v. NGL Supply (Gas) Co.* (2001), 27 C.B.R. (4th) 131 (C.A.) **[Tab 7]**. In that case, the Court found that each schedule or transaction under a master agreement constituted a distinct contract, unrelated to each other transaction or "contract". Since these distinct contracts were not "eligible financial contracts", the Court of Appeal permitted the debtor to cherry pick or terminate the "in the money"

transactions without having to set-off against the "out of the money" transactions, which were stayed by the *CCAA*. The Court permitted a windfall to the debtor through this permissible cherry picking.

50. Where contracts for commodities for which there is an active spot market are allowed to be terminated, the debtor suffers no loss. It receives full value for the beneficial contracts and merely crystallizes the losses on the out of the money ones. If the contracts were in the money for the debtor (meaning that the spot market price is lower or now predicted to be lower than the contract price), then it will receive a payment from the counterparty that will make up for the lower spot price. If the contracts were out of the money, then it will owe an amount but will be able to sell the commodity against at the now higher price. Where the contracts are used for hedging, losses ought to offset gains. Production which had been committed to forward contracts can readily be re-sold on the spot market if need be and the over-all liquidity of such markets will be enhanced by the existence of a healthy and unhindered derivatives marketplace.

E. U.S. Comparative Legislation

51. The wording in the U.S. *Bankruptcy Code* differs from the wording in both the *BIA* and the *CCAA*, in that it is narrower. Under the U.S. *Bankruptcy Code*, special protection is available to "forward contract merchants", stockbrokers and financial institutions to terminate, net and set-off "forward contracts" when the counterparty to the forward contract files a petition in bankruptcy. A "forward contract" is defined as follows:

> a contract (other than a commodity contract) for the purchase, sale, or transfer of a commodity...or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade...with a maturity date more than 2 days after the date the contract has been entered into ...

52. This provision of the U.S. *Bankruptcy Code* has been recently considered in *In Re Mirant Corporation et al,* 310 B.R. 548 (U.S. Bankr. Ct.) **[Tab 8]**. In that case, the Court concluded that various agreements (including a Gas Master Service Agreement and Netting Agreement) constituted "forward contracts" under the *Bankruptcy Code.* However, the Court noted that the intention of the legislation is not to provide the special protection to the class of transactions of "forward contracts", but rather, to only provide protection to certain persons, namely "forward contract merchants". This term is defined as follows in s. 101(26) of the *Bankruptcy Code:*

> "forward contract merchant" means a person whose business consists in whole or in part of entering into forward contracts as or with merchants in a commodity...or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade.

53. The Court considered the definition of this term, and concluded that not every person who entered a "forward contract" (being a very broad defined term) was a "forward contract merchant". This would be far too expansive, and a narrower meaning was intended by restricting the relief to only a small class of persons. The Court concluded that the moving party could only be considered a "forward contract merchant" if it entered into the subject agreements "as a participant seeking profit in the forward contract trade". On the facts of that case, this test was not satisfied. However, the Court did note:

> That Kern [the moving party] was an end-user of the gas supplied pursuant to the Agreements does not require that the court conclude it is not a forward contract merchant. Producers and customers may engage in the forward contract trade and may do so (even with respect to contracts based on their own production or consumption) seeking a profit.
>
> *In Re Mirant Corporation et al, supra* **[Tab 8]**.

54. The effect of the January 2005 Order is to limit the application of s. 11.1(1) of the *CCAA* to derivative instruments and in short, seek an interpretation of the language in s. 11.1(1) that is

far narrower than the language in the American legislation. This flies in the face of the fact that the language used in s. 11.1(1) of the *CCAA* is much broader than its American counterpart. Parliament, with the benefit of the precedent of the American legislation, chose to enact the provisions of s. 11.1(1) using the broad and inclusive language of s. 11.1. If the narrow reading of such inclusive language advocated by the January 2005 Order is allowed to stand, s. 11.1 will ironically have been made much narrower than the American precedent that Parliament was clearly attempting to improve upon.

55. Under the U.S. *Federal Deposit Insurance Act,* (the "*FDIA*"), as amended by the *Financial Institutions Reform, Recovery, and Enforcement Act of 1989,* an entity that qualifies as a forward contract merchant, stockbroker, securities clearing agency or a financial institution can enforce close-out netting provisions in a commodity contract if the financial institution counterparty is in an insolvency situation. As a result of the fact that U.S. financial intermediaries are not subject to an insolvency regime with similar restrictions on close-out netting, U.S. financial intermediaries can hedge their own risks more easily than their Canadian counterparts because any counterparty a U.S. institution deals with will be able to net against it. Therefore, if the much narrower interpretation of the January 2005 Order is allowed to stand, it may well render Canadian financial intermediaries less competitive in the market than their U.S. competitors who provide similar services. This in turn will significantly impair the ability of Canadian producers and marketers to enter into hedging arrangements because Canadian producers and marketers have less access to U.S. banks than to Canadian banks and, therefore, Canadian producers and marketers will generally have less access to these products than entities they compete with in the U.S. If financial institutions, such as RBC and other Canadian banks, cannot rely on having termination and netting rights under their Master Purchase and Sale

Agreements that call for physical delivery, then these products may simply not be available in the Canadian marketplace. This is an untenable result, which it is submitted this Honourable Court ought not uphold.

F. Decision of Alberta Court of Appeal in Blue Range (CA)

56. In careful and detailed reasons, the Alberta Court of Appeal in *Blue Range (CA)* concluded that physically settled derivatives were included in "forward commodity contracts" under s. 11.1 of the *CCAA*. The Court based this conclusion upon basic principles of derivatives and an understanding of credit risk management in that industry. The need for effective credit risk management in the derivatives industry and the results of the loss of this risk management if the stay was not lifted for these physically settled derivatives was clearly understood and appreciated by the Court:

> Without enforceable termination and netting out provisions, the insolvent company maintains complete control and may repudiate a contract at any time without notice. Because the non-defaulting party cannot count on performance, it cannot effectively re-hedge its risk by entering into an offsetting contract incorporating similar terms. Given the volatility of the market, the non-defaulting part is exposed to excessive and unmanageable risk.
>
> Quite apart from the unfairness of cherry picking, other undesirable consequences follow. In order to determine credit availability, risk management companies account for "out of the money" transactions by deducting the value of "in the money" transactions. This practice is only appropriate if termination and netting out provisions are enforceable, and unaffected by an insolvency. If forward gas contracts are not exempt from the *CCAA* stay provisions and no offsetting deductions are permitted, available credit quickly will be gobbled up. As a result, risk management companies will limit the capital they can allocate to this market, or ask cash-strapped gas producers to put up additional security to cover any short-falls. The unfortunate effect will be reduced availability of physical forward gas sales contracts to small producers, who are most in need of hedges to manage price risks. It will also encourage business to migrate to the United States, where physically-settled transactions are protected under United States bankruptcy law, putting Canadian risk management companies at a competitive disadvantage. These results weaken the risk management structure within

> the derivatives market, and are contrary to the object of the eligible financial contract amendment.
>
> *Blue Range (CA), supra* at para. 28-29 **[Tab 2]**.

57. The Court of Appeal considered these concepts and determined that physically settled commodity contracts were "forward commodity contracts" and therefore eligible financial contracts:

> Like the other items in s. 11.1(1), forward commodity contract are financial hedges and risk management tools. Interpreting them in the context of the rest of the section requires that they share certain traits. The contracts listed in s. 11.1(1) deal with units that are the equivalent of any other unit. Therefore commodities must be interchangeable, and readily identifiable as fungible commodities capable of being traded on a futures exchange or as the underlying asset of an over-the-counter derivative transaction. Commodities must trade in a volatile market, with a sufficient trading volume to ensure a competitive trading price, in order that forward commodity contracts may be "marked to market" and their value determined. This removes from the ambit of s. 11.1(1)(h) contracts for commercial merchandise and manufactured goods which neither trade on a volatile market nor are completely interchangeable for each other.
>
> *Blue Range (CA), supra* at para. 44 **[Tab 2]**

58. It is submitted that this Honourable Court should follow this analysis of the Alberta Court of Appeal in *Blue Range (CA)*.

G. Impact of the January 2005 Order on the Derivatives Industry

59. The importance of termination and netting rights for financial intermediaries and other market participants cannot be understated. This is explained by M.E. Grottenthaler and P.J. Henderson in their text, *The Law of Financial Derivatives in Canada,* as follows:

> The most important features of a derivatives master netting agreement are the provisions which allow a party to terminate all transactions upon an event of default or other termination event, to

> calculate the value of all transactions as of the termination date and to net the positive and negative values to determine a lump sum termination amount payable by one party to the other (i.e. close-out netting provisions).
>
> ...
>
> It is of the utmost importance to parties that the termination and close-out netting provisions are enforceable against the other party. Unlike the case with many commercial transactions, parties are not willing to accept the risk that these provisions may not be fully enforceable in an insolvency situation. There are several reasons for this. First, many entities that participate in the derivatives market are subject to regulatory requirements that they maintain a certain asset level in relation to their liabilities (i.e. adequate capital). For this purpose, it is desirable to account for their derivatives transactions with their various counterparties on a net basis. Generally regulators will permit netting for capital adequacy purposes only if the party obtains a favourable and largely unqualified legal opinion to the effect that termination and close-out netting are effective in insolvency. The Office of the Superintendent of Financial Institutions in its Guideline with respect to Capital Adequacy Requirements for Banks (Guideline A) states that banks that wish to net transactions will need to satisfy OSFI that they have written and reasoned legal opinions that in the event of any legal challenge that relevant courts and authorities would find the exposure to be the net amount under (a) the law of the jurisdictions where the counterparties are chartered and the laws of any jurisdiction applicable to breaches; (b) the law governing the individual transactions and (c) the law governing any contracts or agreements required to effect netting.
>
> Secondly, because the marketplace for derivatives transactions is a highly competitive and global marketplace, entities governed by the laws of a jurisdiction that does not recognize the effectiveness of termination and close-out netting in an insolvency situation are put at a serious competitive disadvantage.

M.E. Grottenthaler and P.J. Henderson, *The Law of Financial Derivatives in Canada,* (Toronto: Carswell, 1999) at 5.1-5.2.1 **[Tab 9]**

60. The January 2005 Order will have similar implications under other insolvency and reorganization regimes that exempt a so-called "eligible financial contract", which is defined in

exactly the same terms, from statutory provisions preventing termination of contracts, such as the *BIA* (s. 65.1(8)), *CDIC* (s. 39.15(7)) and the *WURA* (s. 22.1(2)).

H. Conclusion

61. The result of the January 2005 Order is to throw into doubt whether any transaction that requires or allows for the physical delivery of a commodity is entitled to the termination and netting protections in Canadian insolvency legislation. As a consequence, this will cause an increased risk exposure in the event of counterparty insolvency for parties that deal in any commodity contract that may be settled by physical delivery, whether documented under an ISDA agreement or any other form of master agreement. If financial intermediaries and other market participants that deal in natural gas and other commodity markets, in the context of physically-settled transactions, cannot rely on the termination and netting rights set out in their master agreements, then these products may simply not be available. Also, the competitive position of financial intermediaries and other market participants in this competitive market may be compromised.

62. The importance of enforcing rights of termination and netting in financial and hedging transactions was recognized by the Honourable Mr. Justice Farley in *Confederation Treasury Services v. Hees International Bank Corp. Inc.* where he stated:

> Derivative contracts have become increasingly popular as a legitimate method of managing risk. It would seem as a matter of public policy that such a valuable tool which has become fundamental for the interlocking financial activities of virtually every major financial and many major non-financial corporations in Canada (and have international links) should not be dealt with in such a manner as to seriously affect its efficiency. Not only is this the situation in non-insolvency situations but as well it is in insolvency situations as Anthony C. Gooch and Linda G. Klein, *A Review of International U.S. case Law Affecting Swaps and Related Derivative Products*, August 1, 1992 stated at pp. 38 - 39:

> If the right to terminate contemplated in the agreement, or the selected measure of damages upon early termination, is not enforceable, the whole structure of risk management for the swaps and other transactions is weakened or may fall apart.

Confederation Treasury, supra at para. 48 **[Tab 6]**

63. It is respectfully submitted that this Court should not sacrifice the stability of such an important part of the Canadian derivatives market on the basis an over-reaching decision concerning the specific facts of this case.

PART IV - ORDER REQUESTED

64. ISDA respectfully requests that the appeal be allowed insofar as the Honourable Mr. Justice Farley interpreted s. 11.1(1) of the *CCAA* to follow the decision in *Blue Range (QB)*. ISDA respectfully submits that this Honourable Court should clearly reject any suggestion that "eligible financial contracts" excludes contracts that provide for physical delivery of commodities and further, should follow the decision in *Blue Range (CA)*.

65. ISDA submits that there be no cost award for or against ISDA in respect of this appeal.

February 10, 2005 ALL OF WHICH IS RESPECTFULLY SUBMITTED

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Barbara L. Grossman

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David W. Mann

Of Counsel for the Intervener, ISDA.

CERTIFICATE

Counsel for the Intervener certifies that .75 hours will be required for the Intervener's oral argument.

SCHEDULE "A" – LIST OF AUTHORITIES CITED

1. *Blue Range Resources Corp., Re* (1999), 12 C.B.R. (4th) 173 (Q.B.).

2. *Blue Range Resources Corp., Re* (2000), 20 C.B.R. (4th) 187 (C.A.).

3. Minutes of Proceedings and Evidence. House of Commons Standing Committee on Consumer and Corporate Affairs and Government Operations on September 11, 1991, p.12:7 and 12:28.

4. Proceedings Standing Senate Committee on Banking, Trade and Commerce on November 4, 1996, p.13:77.

5. Minutes of Proceedings and Evidence. House of Commons Standing Committee on Consumer and Corporate Affairs and Government Operations on October 3, 1991, p. 15:13-15:14.

6. *Confederation Treasury Services v. Hees International Bank Corp. Inc.* (1997), 45 C.B.R. (3d) 204 (Ont. Gen. Div.).

7. *Nesi Energy Marketing Canada Ltd. (Trustee of) v. NGL Supply (Gas) Co.* (2001), 27 C.B.R. (4th) 131 (C.A.)

8. *In Re Mirant Corporation et al,* 310 B.R. 548 (U.S. Bankr. Ct.).

9. M.E. Grottenthaler, P.J. *Henderson*, *The Law of Financial Derivatives in Canada,* (Toronto: Carswell, 1999) at 5.1-5.2.1.

SCHEDULE "B" – RELEVANT STATUTES

Companies' Creditors Arrangement Act, Section 11.1

11.1(1) Definitions

In this section,

"eligible financial contract" means

(a) a currency or interest rate swap agreement,

(b) a basis swap agreement,

(c) a spot, future, forward or other foreign exchange agreement,

(d) a cap, collar or floor transaction,

(e) a commodity swap,

(f) a forward rate agreement,

(g) a repurchase or reverse repurchase agreement,

(h) a spot, future, forward or other commodity contract,

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i),

(k) any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j),

(l) any master agreement in respect of a master agreement referred to in paragraph (k),

(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l), or

(n) any agreement of a kind prescribed;

"net termination value" means the net amount obtained after setting off the mutual obligations between the parties to an eligible financial contract in accordance with its provisions.

11.1(2) No stay, etc., in certain cases

No order may be made under this Act staying or restraining the exercise of any right to terminate, amend or claim any accelerated payment under an eligible financial contract or preventing a member of the Canadian Payments Association established by the Canadian Payments Act from ceasing to act as a clearing agent or group clearer for a company in accordance with that Act and the by-laws and rules of that Association.

11.1(3) Existing eligible financial contracts

For greater certainty, where an eligible financial contract entered into before an order is made under section 11 is terminated on or after the date of the order, the setting off of obligations between the company and the other parties to the eligible financial contract, in accordance with its provisions, is permitted, and if net termination values determined in accordance with the eligible financial contract are owed by the company to another party to the eligible financial contract, that other party shall be deemed to be a creditor of the company with a claim against the company in respect of the net termination values.

Bankruptcy and Insolvency Act, Section 65.1

65.1(1) Certain rights limited

If a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement with the insolvent person, by reason only that

(a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

65.1(2) Idem

Where the agreement referred to in subsection (1) is a lease or a licensing agreement, subsection (1) shall be read as including the following paragraph:

"(c) the insolvent person has not paid rent or royalties, as the case may be, or other payments of a similar nature, in respect of a period preceding the filing of

(i) the notice of intention, if one was filed, or

(ii) the proposal, if no notice of intention was filed."

65.1(3) Idem

Where a notice of intention or a proposal has been filed in respect of an insolvent person, no public utility may discontinue service to that insolvent person by reason only that

(a) the insolvent person is insolvent;

(b) a notice of intention or a proposal has been filed in respect of the insolvent person; or

(c) the insolvent person has not paid for services rendered, or material provided, before the filing of

(i) the notice of intention, if one was filed, or

(ii) the proposal, if no notice of intention was filed.

65.1(4) Certain acts not prevented

Nothing in subsections (1) to (3) shall be construed

(a) as prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the filing of

(i) the notice of intention, if one was filed, or

(ii) the proposal, if no notice of intention was filed; or

(b) as requiring the further advance of money or credit.

65.1(5) Provisions of section override agreement

Any provision in an agreement that has the effect of providing for, or permitting, anything that, in substance, is contrary to subsections (1) to (3) is of no force or effect.

65.1(6) Powers of court

The court may, on application by a party to an agreement or by a public utility, declare that subsections (1) to (3) do not apply, or apply only to the extent declared by the court, where the applicant satisfies the court that the operation of those subsections would likely cause it significant financial hardship.

65.1(7) Eligible financial contracts

Subsection (1) does not apply

(a) in respect of an eligible financial contract; or

(b) to prevent a member of the Canadian Payments Association established by the Canadian Payments Act from ceasing to act as a clearing agent or a group clearer for an insolvent person in accordance with that Act and the by-laws and rules of that Association.

65.1(8) Definitions

In subsections (7) and (9),

"eligible financial contract" means

(a) a currency or interest rate swap agreement,

(b) a basis swap agreement,

(c) a spot, future, forward or other foreign exchange agreement,

(d) a cap, collar or floor transaction,

(e) a commodity swap,

(f) a forward rate agreement,

(g) a repurchase or reverse repurchase agreement,

(h) a spot, future, forward or other commodity contract,

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i),

(k) any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j),

(k.1) any master agreement in respect of a master agreement referred to in paragraph (k),

(l) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (k.1), or

(m) any agreement of a kind prescribed; ("contract financier admissible") "net termination value" means the net amount obtained after setting off the mutual obligations between the parties to an eligible financial contract in accordance with its provisions. ("valeurs nettes ...")

65.1(9) Application of paragraphs 69(1)(a) and 69.1(1)(a)

For greater certainty, where an eligible financial contract entered into before the filing in respect of an insolvent person of

(a) a notice of intention, or

(b) a proposal where no notice of intention was filed,

is terminated on or after that filing, the setting off of obligations between the insolvent person and the other parties to the eligible financial contract, in accordance with its provisions, shall be permitted, and if net termination values determined in accordance with the eligible financial contract are owed by the insolvent person to another party to the eligible financial contract, that other party shall be deemed, for the purposes of paragraphs 69(1)(a) and 69.1(1)(a), to be a creditor of the insolvent person with a claim provable in bankruptcy in respect of those net termination values.

***The Winding-Up and Restructuring Act*, Section 22.1**

22.1(1) Termination of certain contracts not precluded

Nothing in this Act or an order made under this Act prevents or prohibits the termination of an eligible financial contract and the setting off of obligations between a company in respect of which winding-up proceedings under this Act are commenced and the other parties to the eligible financial contract in accordance with its provisions, and if the net termination values determined in accordance with the eligible financial contract are owed by the company to another party to the eligible financial contract, that other party shall be deemed to be a creditor of the company with a claim provable against the company in respect of the net termination values.

22.1(1.1) Application to authorized foreign banks

In its application to authorized foreign banks, subsection (1) only applies to the eligible financial contracts and obligations between the authorized foreign bank, in respect of its business in Canada, and another party.

22.1(2) Definitions

In subsection (1),

"eligible financial contract" means any of the following agreements, namely,

(a) a currency or interest rate swap agreement,

(b) a basis swap agreement,

(c) a spot, future, forward or other foreign exchange agreement,

(d) a cap, collar or floor transaction,

(e) a commodity swap,

(f) a forward rate agreement,

(g) a repurchase or reverse repurchase agreement,

(h) a spot, future, forward or other commodity contract,

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraph (a) to (i),

(k) any master agreement in respect of any agreement or contract referred to in paragraph (a) to (j),

(l) any master agreement in respect of a master agreement referred to in paragraph (k),

(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l), and

(n) any agreement of a kind prescribed by the regulations;

"net termination value" means the net amount obtained after setting off the mutual obligations between the parties to an eligible financial contract in accordance with its provisions;

22.1(3) Regulations

The Governor in Council may make regulations prescribing kinds of agreements for the purposes of paragraph (n) of the definition "eligible financial contract" in subsection (2).

***The Canada Deposit Insurance Corporation Act*, Section 39.15**

39.15(1) Stay of proceedings

Where an order is made under subsection 39.13(1),

(a) no action or other civil proceeding may be commenced or continued against the federal member institution or in respect of its assets other than a proceeding under the Winding-up and Restructuring Act commenced by the Corporation;

(b) no attachment, garnishment, execution or other method of enforcement of a judgment or order against the federal member institution or its assets may take place or continue;

(c) no creditor of the federal member institution has any remedy against the federal member institution or its assets;

(d) no creditor has any right of set-off against the federal member institution, which, for greater certainty, does not include the consolidation of accounts maintained in the normal course for the purpose of providing clearing and settlement services or the services referred to in paragraph (5)(c); and

(e) no person may terminate or amend any agreement with the federal member institution or claim an accelerated payment under any such agreement with the federal member institution by reason only of

(i) the federal member institution's insolvency,

(ii) a default, before the order was made, by the federal member institution in the performance of its obligations under the agreement, or

(iii) the making of the order.

39.15(2) Agreements overridden

Where an order is made under subsection 39.13(1), any stipulation in an agreement is of no force or effect if it

(a) has the effect of providing for, or permitting, anything that, in substance, is contrary to paragraph (1)(e) or 39.13(3)(b); or

(b) provides, in substance, that on

(i) the federal member institution's insolvency,

(ii) the default by the federal member institution in the performance of an obligation, or

(iii) the making of the order

the federal member institution ceases to have the rights to use or deal with assets that the federal member institution would otherwise have.

39.15(3) Clearing arrangements

Subsections (1) and (2) do not apply so as to prevent a member of the Canadian Payments Association from acting or ceasing to act as a clearing agent for a federal member institution in accordance with the Canadian Payments Act and the by-laws and rules of that Association.

39.15(4) Rights subject to set-off

A federal member institution in respect of which an order is made under subsection 39.13(1) may not enforce against a person a right to receive an amount against which the person, but for paragraph (1)(d), would have a right of set-off.

39.15(5) Further supplies and advances

Nothing in subsection (1) or (2) shall be construed

(a) as prohibiting a person from requiring payments to be made in cash for goods, services, use of leased or licensed property or other valuable consideration provided after the making of the order;

(b) as requiring the advance to a federal member institution in respect of which an order is made under subsection 39.13(1) of money or credit after the making of the order; or

(c) as requiring the provision to a federal member institution in respect of which an order is made under subsection 39.13(1) of any of the following services where to do so would be likely, in the reasonable opinion of the person providing the service, to result in that person advancing money or credit to the federal member institution after the making of the order or to give rise, after the making of the order, to a claim of that person against the federal member institution, namely,

(i) cash management services,

(ii) services related to the redemption of debt instruments,

(iii) services related to the issuance of letters of credit or guarantees,

(iv) cheque certification services,

(v) currency supply services,

(vi) funds transfer services and remittance order services,

(vii) securities delivery and settlement services,

(viii) charge, credit, debit and payment card services,

(ix) automated banking and teller machine services,

(x) electronic funds transfer at point of sale services,

(xi) consignment cheque services,

(xii) other services similar to those referred to in subparagraphs (i) to (xi),

(xiii) any service of a kind prescribed by the regulations, and

(xiv) a guarantee of liabilities in respect of any of the services referred to in subparagraphs (i) to (xiii).

39.15(6) Security agreements

Paragraphs (1)(b) to (e) and subsection (2) do not apply in respect of a remedy under, or a stipulation of, a security agreement creating a security interest in assets of a federal member institution if

(a) an obligation secured by the security agreement is to the Bank of Canada or the Corporation; or

(b) the Superintendent, on the application of the federal member institution, exempted the security agreement from the application of those paragraphs and that subsection before the making of an order under subsection 39.13(1).

39.15(7) Financial contracts

Nothing in subsection (1) or (2) prevents the termination of any of the following agreements in accordance with their terms or the setting off of an amount payable under or in connection with any of the following agreements, namely,

(a) a currency or interest rate swap agreement;

(b) a basis swap agreement;

(c) a spot, future, forward or other foreign exchange agreement;

(d) a cap, collar or floor transaction;

(e) a commodity swap;

(f) a forward rate agreement;

(g) a repurchase or reverse repurchase agreement;

(h) a spot, future, forward or other commodity contract;

(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities;

(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i);

(k) any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j);

(l) any master agreement in respect of a master agreement referred to in paragraph (k);

(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l); and

(n) any agreement of a kind prescribed by the regulations.

39.15(8) Regulations

The Governor in Council may make regulations prescribing

(a) kinds of services for the purposes of subparagraph (5)(c)(xiii); and

(b) kinds of agreements for the purposes of paragraph (7)(n).

***Payment Clearing and Settlement Act,* Section 13**

13(1) Termination

Notwithstanding anything in any law relating to bankruptcy or insolvency or any order of a court made pursuant to an administration of a reorganization, arrangement or receivership involving insolvency, where a financial institution or the Bank is a party to a netting agreement, the financial institution or the Bank may terminate the agreement and determine a net termination value or net settlement amount in accordance with the provisions of the agreement and the party entitled to the net termination value or settlement amount is to be a creditor of the party owing the net termination value or net settlement amount for that value or amount.

13(2) Interpretation

In subsection (1),

"financial institution" means

(a) a financial institution within the meaning of section 2 of the Trust and Loan Companies Act,

(b) such other entity or entity within a class of entities engaged primarily in the business of providing financial services as may be designated by order of the Governor in Council to be a financial institution for the purposes of this section,

(c) a trustee, manager or administrator of a pension fund maintained to provide benefits under a pension plan registered under the Income Tax Act,

(d) the Canada Pension Plan Investment Board, or

(e) the Public Sector Pension Investment Board;

"net termination value" means the net amount obtained after setting off or otherwise netting the obligations between the parties to a netting agreement in accordance with its provisions; ("reliquat net")

"netting agreement" means an agreement between two or more financial institutions or between the Bank and one or more financial institutions that is

(a) an eligible financial contract within the meaning of section 22.1 of the Winding-up and Restructuring Act, or

(b) an agreement that provides for the netting or set-off of present or future obligations to make payments against the present or future rights to receive payments.