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Supreme Court of Canada expands discretion of the Courts to allow pre-post compensation in 'rare' cases

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Introduction

On December 10, 2021, the Supreme Court of Canada (SCC) released its written reasons in *Montréal (City) v. Deloitte Restructuring Inc*.

In a 6-1 decision, co-written by Chief Justice Wagner and Justice Côté, with Justices Moldaver, Karakatsanis, Rowe and Martin concurring, the SCC upheld both the Court of Appeal of Quebec (QCCA) and Quebec Superior Court's decisions which dismissed the attempt by the City of Montréal (the City) to compensate (set-off)[1] its post-filing debt owed to SM Group (SM) against SM's pre-filing debt owed to the City.

In rendering its decision, the SCC overruled the principle established by the QCCA in *Agence du revenu v. Kitco Metals Inc.*[2] (Kitco) which categorically prohibited pre-post compensation and preserved the ability for first instance judges sitting in matters under the Companies' Creditors Arrangement Act (the CCAA) to exercise their broad discretionary powers to allow it in appropriate but rare circumstances.

Background

In the context of the notorious Charbonneau Commission on collusion and corruption in the award and management of public contracts, SM, a consulting engineering firm that had serviced the City over several years, and the Minister of Justice, acting on behalf of the City, entered into a settlement agreement (without admission of guilt) under the Voluntary Reimbursement Program (the VRP), established under the Act to ensure mainly the recovery of amounts improperly paid as a result of fraud or fraudulent tactics in connection with public contracts (Bill 26).

SM made payments under the settlement until it ran into financial difficulties, and in August 2018, SM filed for protection under the CCAA and Deloitte Restructuring Inc. (Deloitte) was appointed as monitor.

Following the issuance of the initial order, SM continued to perform its obligations under its various contracts with the City, including those related to major infrastructure projects such as the Samuel De Champlain Bridge and the Turcot Interchange. However, the City refused to pay SM for its post-filing services on the basis that the City was entitled to effect compensation between its post-filing payables and the amounts due to it under the pre-filing VRP settlement.

Deloitte applied for a Court order to compel the City to pay for the post-filing services, arguing that pre-post compensation was prohibited pursuant to the Kitco principle. The City argued that the Kitco principle was not applicable in the circumstances, given that the VRP claim is the result of fraud and could not be compromised pursuant to Section 19(2) of the CCAA. In 2019, the Court found in favour of Deloitte and ruled that pre-post compensation could not be effected in favour of the City. The QCCA maintained the decision of the lower court.

Decision

Does the CCAA allow for pre-post compensation?

The SCC reiterated that a fundamental feature of the CCAA is the broad discretion granted to the supervising judge. In particular, sections 11 and 11.02 of the CCAA provide the courts with broad judicial discretion to stay rights of creditors, or alternatively lift the stay to allow creditors to effect pre-post compensation. In doing so, the SCC set aside the absolute prohibition in respect of pre-post compensation established under the Kitco decision.

The SCC explained that, although the above-noted sections of the CCAA provide the supervising judge with the discretion to allow pre-post compensation, the circumstances in which such orders should be made will be "rare" as they have the potential of being highly disruptive to the restructuring process. The SCC also found that section 21 of the CCAA, when read with sections 11 and 11.02 of the CCAA, did "not grant creditors a right to pre-post compensation that would be shielded from a supervising judge's power to order a stay".[3]

Unfortunately, the SCC did not provide examples of what might constitute a "rare" instance but noted that pre-post compensation should only be permitted "in furtherance of the *CCAA*'s remedial objectives."[4] The SCC reiterated the test established in *9354-9186 Québec inc. v. Callidus Capital Corp., 2020 SCC 10* and *Century Services Inc. v. Canada (Attorney General), 2010 SCC 60, [2010] 3 S.C.R. 379* for when a court can use its discretion under the *CCAA*, stating: "A court must keep three baseline considerations in mind:

1. the appropriateness of the order being sought;
2. due diligence; and
3. good faith on the applicant's part."[5]

Applying this test to the case at bar, the SCC found that the Court erred in relying on the Kitco absolute prohibition of pre-post compensation. However, in reviewing the underlying facts, the SCC agreed that a lift-stay order permitting pre-post compensation would not be appropriate in the circumstances for the following reasons:

- the City had not met its burden of proof that the VRP claim was based on fraud; and
- the City had not acted with due diligence, as it waited to assert its set off rights in respect of their VRP claim until long after it had become aware of SM's restructuring process.

Thus, the case at bar did not constitute one of the "rare" instances in which pre-post

compensation should be allowed.

Dissent

Writing in dissent, Justice Brown agreed that the Kitco principle should be overruled. However, Justice Brown would have returned the matter to the supervising judge for a determination on the facts.

Implications

This decision provides the courts with an additional tool to ensure fairness in the insolvency process. Creditors asserting pre-post compensation rights will need to act in good faith and with due diligence, and prove the existence of exceptional circumstances, failing which the current practice prohibiting pre-post compensation will continue to prevail. It remains to be seen in which circumstances the courts might deem it appropriate to authorize pre-post compensation. In all cases, the courts will need to strike a balance between preserving the ability of an honest debtor to successfully restructure, providing equitable treatment amongst all unsecured creditors and protecting public interests.

Finally, it will be interesting to see what implications this decision may have, if any, on future proceedings under Bill 26.

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[1] The authors refer in this text to « compensation », which is the civil law equivalent of the law of set-off.

[2] 2017 QCCA 268.

[3] Supra at para 63.

[4] *Montréal (City) v. Deloitte Restructuring Inc., 2021 SCC 53* at para 58; 62.

[5] Supra at para 85.