IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *3S Printers Inc. (Re),* 2011 BCSC 630

Date: 20110504
Docket: S110439
Registry: Vancouver

In the Matter of the Companies' Creditors Arrangement Act,

R.S.C. 1985, C. C-36, as amended

AND

In the Matter of the Business Corporations Act, S.B.C., 2002, C. 57

AND

In the Matter of 3S Printers Inc. and Gamma Investments Ltd.

Petitioners

Before: The Honourable Mr. Justice Grauer

Oral Reasons for Judgment

In Chambers

Counsel for the Petitioners:	John R. Sandrelli Jordan D. Schultz
Counsel for Boale Wood & Company, Monitor:	Shawn Poisson
Counsel for CIT Financial Ltd.:	Gordon G. Plottel
Counsel for KBA Canada, Inc.:	Brian G. McLean
Counsel for HSBC Bank Canada:	John C.S. Fiddick
Counsel for Unisource Canada Inc.:	H. Lance Williams
Date and Place of Hearing:	May 4, 2011 Vancouver, B.C.
Date and Place of Reasons for Judgment:	May 4, 2011 Vancouver, B.C.

[1] **THE COURT:** Judgment. By an initial order pronounced January 24, 2011, I granted to the petitioners a stay of proceedings and certain other relief in order to facilitate the development of a plan of compromise and arrangement with the petitioners' creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

[2] Although the petitioners' application had technically been brought on an *ex parte* basis, several of the creditors attended to oppose the granting of the relief requested principally on the basis that in view of the history of this matter, there was no prospect of the petitioners successfully obtaining any financing. In the result, I granted the relief and stay, but reduced the time from 30 days to 25. The comeback hearing accordingly proceeded on February 18, 2011.

[3] At the comeback hearing, the petitioners sought an extension of the stay for a further period of 90 days to May 20, 2011. Once again the creditors, led by CIT Financial Ltd. vigorously opposed the application. They asserted that on the evidence, the prospect of the petitioners being able to negotiate further financing was illusory and their efforts doomed to failure.

[4] At that time, I was satisfied that the petitioners, who operate a printing business, had taken appropriate steps to stabilize their business in terms of meeting with employees, suppliers and clients and, as reported by the monitor, had improved the company's cash flow beyond what was projected at the time of the initial order. I noted that they sought no debtor-in-possession financing or any further administrative charge beyond the reduced amount of $100,000 I approved at the time of the initial order. The restructuring was expected to be self-financing, in that the professional fees of the monitor and the lawyers would be paid out of the cash flow.

[5] The petitioners maintained at that hearing that they were appropriately pursuing different restructuring options, a proposition which the respondents hotly disputed. Although the petitioners disclosed no details of potential refinancing plans or negotiations, the monitor expressed an initial view that the business was more valuable as a going concern and the recovery to the creditors would be higher if the business is carried on, as compared to a liquidation of the business assets.

[6] The monitor expressed the further view that the management of the companies had been acting, and would continue to act, in good faith and with due diligence, and that the extension sought was reasonable and would not materially prejudice the stakeholders.

[7] In those circumstances, I was satisfied that it was appropriate to extend the protection of the *CCAA* and that the policy objective of avoiding the social and economic losses resulting from the liquidation of an insolvent company was certainly engaged. I observed that the petitioners had had the benefit of *CCAA* protection for only 25 days and could not reasonably be expected to have reorganized their affairs within that time, notwithstanding previous dealings with their creditors. I

expressed the view that it was still too early to conclude that the petitioners' efforts were doomed to failure.

[8] I therefore granted the relief in the form requested. I warned counsel for the petitioners that should their clients move to extend the relief and stay yet further in 90 days time, they would be well advised to support the application with concrete and detailed evidence of what efforts and progress had been made.

[9] That extended stay has yet to expire, but the respondents now apply for an order terminating the *CCAA* proceedings or lifting the stay. The catalyst for these applications was a second report to the court from the monitor dated April 4, 2011, followed by an application from the monitor for an order amending the administration charge of $100,000 created in my order pronounced January 24, 2011, by increasing it to $200,000.

[10] The parties and the monitor are agreed that if I allow the respondents’ application terminating these proceedings or lifting the stay, then the increase required by the monitor should be allowed at the reduced amount of $25,000. If, however, I dismiss the respondents’ application so that the stay will continue for the 90 days previously ordered, then it is acknowledged that the monitor is entitled to the full increase of $100,000.

[11] The purpose of the monitor's report was twofold. The first purpose in compliance with the monitor's obligations under s. 23(1)(d)(1) of the *CCAA* was to report "without delay" on certain material adverse changes in the petitioners' projected cash flow which, in the monitor's view, were to the prejudice of the respondents. The second was to provide an update on the information the monitor received with respect to the petitioners' restructuring efforts.

[12] Turning to the first purpose, the monitor commented on actual cash flows versus projected cash flows by noting that actual cash in-flows from sales had been slightly better than projected, material costs were approximately $64,000 higher than projected, while the cash out-flows for payment of restructuring professional fees were $100,000 lower than projected. In other words, the petitioners had been unable to pay those fees from cash flow after the payment of operating costs.

[13] This was the case notwithstanding the very substantial reduction in operating costs by reason of the relief from payments due to the creditors effected by the stay. The result was that the monitor and the petitioners' legal counsel were obliged to rely on the initial administrative charge of $100,000 to cover their costs, which was close to being exhausted.

[14] The monitor disclosed that he had been advised by the petitioners on March 17, 2011, that an anticipated recovery of significant receivables within one week would rectify the monitor's cash flow concern. That did not occur. On April 1, 2011, the petitioners gave the monitor a cheque for $10,000 towards his outstanding fees, but that cheque was returned NSF.

[15] Turning to the second purpose, the monitor was provided with a spreadsheet detailing the terms for real estate financing options and was advised that the petitioners were still considering whether the potential financing offers were workable to form the foundation of a broader restructuring plan. Other proposals provided to the monitor had expired in 2010. No term sheets were provided that would indicate commitment on the part of any proposed lenders.

[16] The spreadsheet set out four options from four different lenders for amounts to be secured by the petitioners' land, specifying loan amounts ranging from a low of $2,450,000 to a high of $3,000,000. The amount owed to the respondent CIT, the largest creditor, is approximately $4,000,000 secured by two mortgages on the land. The total secured debt is in the amount of approximately $10,000,000.

[17] The monitor noted that because current sales levels do not result in sufficient cash flow to allow for any payments to stakeholders, any restructuring plan must include new working capital that could be used to sustain operations and make payments to stakeholders until break-even sales levels were achieved. The monitor observed, however, that the financing being pursued, while allowing for the refinancing of certain secured creditors, made no provision for additional working capital.

[18] In his third affidavit, sworn April 11, 2011, Mr. Sandhu, principal of the petitioners, deposed that in addition to the options set out in the spreadsheet, he had been in discussions with various other parties and had recently met with a group of potential investors who expressed significant interest. In furtherance of this interest, Mr. Sandhu deposed, the investors had entered into a software licensing agreement at a cost of approximately $40,000 with a view to implementing an "online/web printing" business to complement the petitioners' boutique printing business.

[19] Mr. Sandhu exhibited to his affidavit a letter dated April 8, 2011, from Sahota Law Office, which acts for 0907548 B.C. Ltd. and its four principals, described as "the investors." The letter referred to an extensive initial discussion between the investors and the petitioners as a result of which the investors were prepared to "entertain" the "contemplation" of a two-phase process with respect to "possible business relations". Phase 1 contemplates the purchase and leaseback of the petitioners' building and land, the subject of the options set out in the earlier spreadsheet. Phase 2 envisions an investment in the printing business, the structure of which has yet to be determined. The letter included the following sentence:

> We realize that time is of the essence as far as the Companies and the CCAA process is concerned however, you must realize that despite the initial steps and investments made by our clients in good faith, further investigation of the affairs of the Companies is warranted.

[20] Also exhibited to the affidavit was a Memorandum of Understanding between the petitioners and the investors dated March 31, 2011, which provided in part:

> 1. The investors shall, through their counsel, present to Gamma their terms and conditions for the purchase of the building within 10 (ten) business days of the execution of this

MOU.

2. Gamma, 3S and Sandhu shall provide to the Investors, through their counsel, all information and disclosure requested in a timely manner.

3. Based on Sandhu's representations and subject to further investigation, Investors are willing to purchase the building for $3,000,000 (three million) as phase 1 with a lease back for $20,000 ("Lease").

4. The Investors shall forgo the Lease payments for a period of 4 (four) months pending the completion of the due diligence process on 3S.

...

6. This MOU is non-binding in that the eventual proposed purchase agreement and the investment agreement if entered into shall be binding and have full contractual force and effect.

[21] The ten-day period referred to in article 1 of the MOU expired on April 14, 2011, shortly after this hearing. Accordingly I requested that a copy of the investors' terms and conditions be provided to me by April 15, 2011.

[22] The investors' offer was presented through a letter from their counsel, Sahota Law Office, dated April 15, 2011, and proposed the following relevant terms:

2. **Process**.

The Company intends to engage in a two-stage process in this intended relationship. The latter is made necessary due to the CCAA proceedings and the fact that the Companies are seeking an urgent resolution to the financial predicament it [*sic*] finds itself in. Whilst the matter of the building is a relatively simple matter, the intended relationship with respect to 3S is a [*sic*] rather more complicated and necessitates the appropriate due diligence process.

3. **Building**.

The Company offers to purchase the building for $3,000,000 (three million). Upon acceptance of the offer price, the Company shall commence the process of arranging finance.

4. **Lease Back**.

In anticipation of the future intended relations between the Companies and the Company, the Company shall lease the building back to 3S. The Company shall forgo the first 4 (four) months of rent calculated above as a rate of $16,000 per month.

5. **3S**.

Upon reaching an agreement on the offer on the Building, the Company shall commence a detailed due diligence process on the operations of 3S and the structuring of relations between the parties. As indicated in our preliminary discussions, we are committed in principle to working with 3S and forging a relationship perhaps in the form of a management buyout scenario, however, further investigation must be undertaken.

6. **Equipment**.

Based on the above, the Company must undertake further investigation on the equipment before it can make an informed offer.

[23] When he prepared his second report, the monitor had not had an opportunity to consider

this potential investment. Accordingly I asked that the monitor review this memorandum of understanding and the investors' offer and provide the court with any comments or concerns. In response, the monitor provided his third report of April 27, 2011.

[24] With respect to Phase 1, the purchase of the property belonging to Gamma Investments, the monitor noted that the proposed purchase price of $3 million is subject to financing, and significantly lower than both the appraised value of the property and the encumbrances. In particular it was lower than the amount owing to the first mortgagee, CIT, who was not the least bit interested in such a sale, at least in the absence of any indication that significant Phase 2 financing would be forthcoming.

[25] The purchase was not, however, tied to any commitment to the Phase 2 investment. Without such an investment, the monitor observed, the petitioners lack adequate funding to carry on the business and make any payments to stakeholders. There is, accordingly, no plan either in place or proposed that would provide the petitioners with the ability to continue operations after the sale and lease back of the land contemplated by Phase 1.

[26] In the meantime, the petitioners continue to experience cash flow difficulties and, in the monitor's view, are unlikely to be in a position to present a comprehensive plan of arrangement by the time that the current stay expires on May 20, 2011.

[27] Upon receipt of this report, I requested counsel to re-attend before me to make brief supplementary submissions. This took place this morning, May 4, 2011.

[28] The respondents continue to assert that it is time to end the stay and stop the hemorrhaging. The petitioners maintain that steps are, in fact, being pursued and they should therefore be permitted the time previously allotted to attempt to achieve an acceptable plan of arrangement.

[29] As Mr. Justice Gibbs for the court commented in the case of *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* (1990), 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.):

> When a company has recourse to the C.C.A.A., the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

[30] Ordinarily the court would not be expected to intervene within the period during which it has already determined that the creditors ought to be held at bay. To do so would only impede the debtor company in its attempt at compromise or arrangement. Here, however, the monitor was obliged to report a material adverse change in the petitioners' cash flow. This change has necessitated an application for an increase in the administrative charge, a need that had not

previously been anticipated. Such an increase would necessarily prejudice the respondents. The opportunity for a re-evaluation accordingly presented itself.

[31] The parties do not dispute that it would be wrong for me to exercise my discretion by lifting the stay and unleashing the creditors unless I were able to conclude that the petitioners' ongoing attempt at compromise or arrangement is doomed to failure, the onus of demonstrating which is on the respondents: *Chef Ready Foods Ltd.*, *supra* and *Re Philip's Manufacturing Ltd.* (1992), 67 B.C.L.R. (2d) 84, 9 C.B.R. (3d) 25 (C.A.).

[32] In *Canwest Global Communications Corp. (Re)* (2009), 61 C.B.R. (5th) 200 (On. Sup. Ct. J.), Madam Justice Pepall had this to say:

> [32] As with the imposition of a stay, the lifting of the stay is discretionary. There are no statutory guidelines contained in the Act. According to Professor R.H. McLaren in his book "Canadian Commercial Reorganization: Preventing Bankruptcy" (Aurora: Canada Law Book, looseleaf, at para. 3.3400), an opposing party faces a very heavy onus if it wishes to apply to the court for an order lifting the stay. In determining whether to lift the stay, the court should consider whether there are sound reasons for doing so consistent with the objectives of the CCAA, including a consideration of the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action: *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.* (2007), 33 C.B.R. (5th) 50 (Sask. C.A.) at para. 68. That decision also indicated that the judge should consider the good faith and due diligence of the debtor company.

[33] Madam Justice Pepall then referred to a list of nine situations enumerated by Professor McLaren in which the courts will lift the stay order. These situations all indicate, in my view, circumstances which tend to demonstrate that the debtor's company plan or attempt to arrange a plan is doomed to failure in the sense that maintaining the protection of its efforts is unlikely to achieve the objectives of the *CCAA*.

[34] The respondents here rely on the general principles referred to above as well as Professor McLaren's situation number 6:

> After the lapse of a significant time period, the insolvent is no closer to a proposal than at the commencement of the stay period.

[35] In applying these principles to this case, I ask first, what has changed since I granted the stay? Before, the monitor was satisfied that the petitioners' management had been acting and would continue to act in good faith, cash flow was better than expected. Most importantly, the monitor expressed the view that the business was more valuable as a going concern, holding out the hope of a higher recovery to the creditors compared to liquidation. The petitioners maintained that they were appropriately pursuing different restructuring options, and then had the benefit of only a brief period of protection.

[36] Since then cash flow difficulties have arisen, increasing the expense to be incurred in

priority to the respondents' claims. This is so notwithstanding that the petitioners have been relieved from making payments due to the secured creditors in an amount exceeding $100,000 per month. Moreover, as noted by the monitor in his second report, the petitioners' restructuring efforts have lacked an ingredient essential to any hope of success, the provision of adequate working capital.

[37] The petitioners argue that none of this satisfies the heavy onus on the respondents to justify a lifting of the stay. They maintain there has been no real change since the time of the comeback application other than the cash flow problem raised by the monitor. This, they note, arises not from any failure to achieve expected revenue, but rather from increased costs due to suppliers insisting on being paid well in advance.

[38] As for the proposed increase in the administrative charge, the petitioners assert that this is relatively minor and causes only minimal prejudice, not enough to justify lifting the stay. Finally the petitioners submit that the prospects for a plan of arrangement remain. Although there is at present no commitment, that is not required at this point given that the stay is set to continue until May 20.

[39] What about good faith and due diligence? The monitor has been silent on that point since the first report. On the evidence, it is difficult to maintain full confidence in the petitioners' good faith. In his affidavit filed in support of the comeback application, Mr. Sandhu had deposed as follows:

> 13) With respect to financing options, we are currently engaged in talks with various lenders to arrange a global refinancing of the companies.
>
> 14) On a narrower basis, the petitioners are working with City Mortgage Investment Corporation to source a financing over particular assets. Through City Mortgage, the petitioners have received several term sheets and other expressions of interest from private investors to provide funding secured over various assets, including offers to finance secured against the property and against the accounts receivable. The petitioners are considering these forms of financing in conjunction with its efforts to obtain overall financing in order to achieve the best possible result and maximize the funds available for a plan of arrangement.

[40] The monitor's report on the petitioners' restructuring efforts contained in his second report refers to the monitor's efforts to obtain details of the company's dealings with prospective financiers, investors and strategic partners and all relevant documentation. Very little was forthcoming. It seems that the term sheets referred to in paragraph 14 of Mr. Sandhu's affidavit were proposals that had expired in 2010, as no term sheets had been issued in relation to the four options set out in the spreadsheet referred to above.

[41] Counsel for the petitioners argues that there was nothing misleading about that because Mr. Sandhu had received term sheets, even though they had expired, and he had received expressions of interest as set out on the spreadsheet, even though they were not in writing and had not led to the provision of term sheets.

[42] Given that it is term sheets that establish some level of commitment, it seems to me that the disclosure set out in Mr. Sandhu's affidavit was less forthcoming than the court is entitled to expect from one who seeks the protection of the *CCAA*.

[43] And so we come to the recent proposal that the petitioners depose they are now pursuing. With respect to the purchase of the building, this proposal offers no improvement at all over what had already been deemed unsatisfactory. As to the provision of working capital, it is speculative at best. What is contemplated is the completion of the purchase of the building with a lease back, followed by four months to complete due diligence in relation to the possibility of making an investment in the business.

[44] There is not only no commitment from the proposed investors, there is no reasonable prospect of a commitment. The proposal would, in effect, require the secured creditors to approve the sale or the court to order it without any kind of assurance that a viable plan would be forthcoming, leaving the investors in a position of being able to sell the property and profit while the creditors gain nothing. It makes no sense at all and there is no logic to proceeding with Phase 1 before Phase 2 is in place and confirmed.

[45] From this it is evident, as noted by the monitor, that there is no realistic prospect that the basis of an adequately comprehensive arrangement will be in place by the end of the current stay. At best, the petitioners would require the creditors to be held at bay for a further 90 to 120 days beyond that to await the potential investors' completion of due diligence, all without any commitment whatsoever.

[46] In the meantime, there are cash flow issues and the continuance of the stay requires an increase in the administrative charge with no sound basis for expecting a change in these circumstances and no prospect at all of any payments to creditors. Instead further administrative charges must be expected.

[47] The significant changes then are twofold. The first is the adverse change in cash flow reported by the monitor. This means that not only are the petitioners not paying their creditors, they have been unable to pay the professionals and have had difficulty paying their suppliers.

[48] The second, exposed by the first, is the petitioners' failure, again as observed by the monitor, to demonstrate any reasonable prospect of developing a plan that will provide working capital. The result of these changes is that the concept of the business being more valuable as a going concern yielding a higher recovery to the creditors as compared to the liquidation of the business assets, which underlay the extension of the stay, has evaporated. This leaves the equipment creditors, for instance, bereft of any prospect of lease payments being forthcoming while the equipment continues to depreciate with continued use. On the evidence, there is nothing left that can give the court any confidence that continuing to hold off the creditors will

promote the objectives of the *CCAA*.

[49] I conclude in the unusual circumstances of this case that the petitioners' efforts are doomed to failure. Accordingly it is time to terminate these proceedings and lift the stay. There will, however, be an increase in the administrative charge of $25,000 to cover professional costs incurred since the start of this hearing.

[50] Anything further at this point? Thank you very much for your helpful submissions, gentlemen.

"GRAUER, J."