

No. S-120712
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

AND

**IN THE MATTER OF THE CANADA BUSINESS CORPORATIONS ACT, R.S.C. 1985,
c. C-44**

AND

IN THE MATTER OF THE BUSINESS CORPORATIONS ACT, S.B.C.2002, c. 57

AND

**IN THE MATTER OF CATALYST PAPER CORPORATION
AND THE PETITIONERS LISTED IN SCHEDULE "A"**

PETITIONERS

NOTICE OF APPLICATION

Name of applicant: Her Majesty the Queen in right of the Province of British Columbia
(the "Province")

To: The Service List

TAKE NOTICE that an application will be made by the applicant to the Honourable Justice Sewell at the courthouse at 800 Smithe Street, Vancouver, British Columbia, on a date and at a time to be announced for the orders set out in Part 1 below.

In this Notice of Application, capitalized terms defined in the Plan of Compromise and Arrangement in this matter have the meaning set out in the Plan.

Part 1: ORDERS SOUGHT

The Province seeks the following orders:

1. A declaration that, notwithstanding section 3.8 of the Plan or any other order in this proceeding, the Province may set off against its claim of \$66,622.15 (the Province's "Claim") set out in its Proof of Claim (the "Proof of Claim") filed April 18, 2012, or any Restructuring Claim that the Province may have, any claim that any of the petitioners have against the Province whether those claims are in existence before or after the Commencement Date, including any liquidated or unliquidated claim and including, without limitation,
 - a. any refund of any taxes to any of the petitioners, including, without limitation, *Social Service Tax Act* tax refunds to any of the petitioners that may arise out of any of the tax appeals listed in section five of the schedule to the Proof of Claim; or,
 - b. any refund of all or part of a security deposit, including, without limitation, the security deposit amount of \$100,000 in the form of the letter of credit No. OCOS-702660, or any replacement or substitution for that letter of credit, for blanket security for tenures under the *Land Act* issued to Catalyst Paper Corporation; and
2. costs.

Part 2: FACTUAL BASIS

1. The Province filed its Proof of Claim in this matter on April 18, 2012. The total amount of the Province's Claim against Catalyst Paper Corporation ("Catalyst") is \$66,622.15. This amount consists of:
 - (a) \$30,248.68 in tax due under the *Carbon Tax Act*, S.B.C. 2008, c. 40;
 - (b) \$33,696.20 for costs associated with the operation, maintenance, and construction of hydrometric stations;
 - (c) a late payment penalty of \$2,503.42 under the *Water Act*, R.S.B.C. 1996, c. 483; and
 - (d) \$173.85 for Catalyst's share of BC Hydro bills shared with the Ministry of Transportation and Infrastructure.
2. At the time of filing this Notice of Application, the Province's counsel are not aware of the Province having any Restructuring Claims against any of the petitioners.
3. Catalyst has several outstanding appeals under the *Social Service Tax Act* [RSBC 1996] c. 431. The tax at issue has been paid. If any of Catalyst's appeals are successful, it will be entitled to a refund from the Province.

4. The petitioners may be entitled to other refunds under provincial taxation statutes if they have paid tax in error or meet the requirements of specific refund provisions. To receive a refund, they would need to commence an action or submit a refund application within the time specified under the applicable tax statute (for example, under the *Social Service Tax Act*, four years from the date tax was paid).

5. The Province obtained a \$100,000 letter of credit (the "Letter of Credit") from Catalyst as security for obligations under land tenures (the "Land Tenures") issued to Catalyst under the *Land Act* [RSBC 1996] c. 245.

6. The Province may be liable to repay some or the entire amount of the Letter of Credit to Catalyst if the Letter of Credit is not needed to secure Catalyst's obligations under the Land Tenures or cover costs arising from any unfulfilled obligations with respect to the Land Tenures.

7. The Province may hold other security deposits from the petitioners that become repayable to the petitioners.

8. Section 3.8 of the Plan purports to prevent the Province from setting off amounts that become payable by it to the petitioners after the Commencement Date against the Province's Claim. Section 3.8 provides as follows:

Despite any other provision of the Plan, the law of set off applies to all claims made by or against a Debtor (including Claims) to the same extent as if such Debtor were plaintiff or defendant, as the case may be. However, a Person may only set off as against a Claim, including a Restructuring Claim, an obligation of such Person to the Debtor (that is otherwise the proper subject of set off) and that existed on or before the Commencement Date and a Person may only set off as against a claim by such Person against a Debtor arising after the Commencement Date, an obligation of such Person to such Debtor arising after the Commencement Date (that is otherwise the proper subject of set off). [Emphasis added.]

Part 3: LEGAL BASIS

1. Section 21 of the *Companies' Creditors Arrangement Act* (the "CCAA") expressly preserves creditors' rights of set off in CCAA proceedings as follows:

The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

2. The law of set-off permits claims arising after the commencement of CCAA proceedings to be set off against claims that existed when the CCAA proceedings commenced:

- a. In *Blue Range Resource Corp.*, the Alberta Court of Appeal found that when cross-claims arise from the same contract the distinction between pre and post filing debts will not be a significant factor in determining whether or not equitable set off will be allowed in CCAA proceedings.

Blue Range Resource Corp. (Re) (2000) (261 A.R. 162) (CA) at paragraph 19

- b. In the *Canadian Airlines* case, Justice Paperny recognized the right of the Province to set off its tax rebate obligations, arising both before and after the filing of the initial order, against taxes owed to the Province, on the basis of both legal and equitable set-off.

British Columbia v. Canadian Airlines Corp., 2001 ABQB 146, at paras. 63 to 71

- c. In the 2003 *Air Canada* case the initial order contained a blanket prohibition on setting off a pre-filing debt owed by the debtor to the creditor against a debt that arose post-filing owed by that creditor to the debtor. Justice Farley concluded that mutuality was not severed on the granting of an initial order so as to preclude legal set off.

Air Canada (Re), 2003 CanLII 64234 (ON SC)

- d. At the time Algoma Steel Inc. obtained CCAA protection in the *Algoma* case it owed roughly \$2 million to Union Gas Limited. Algoma was potentially entitled to a rebate of roughly \$2.2 million from Union Gas, depending on the decision of the Ontario Energy Board. The Ontario Energy Board's decision had not been made by the time Algoma's plan was being voted on by its creditors. The Ontario Court of Appeal concluded that Union Gas could set off its potential rebate owing to Algoma against Algoma's debt to Union Gas.

Algoma Steel Inc. v. Union Gas Limited [2003] CarswellOnt. 115 (C.A.)

3. Canadian law recognizes both legal set-off and equitable set-off: see *Air Canada* at para. 5.

LEGAL SET OFF

4. There are two requirements for legal set-off: the parties' claims against each other must be for liquidated amounts, and they must be between the same parties. However, the claims need not be related: see *Canadian Airlines* at paras. 29 to 33.

5. The Province is not aware of any claims that the petitioners currently have against the Province that would meet the requirements of legal set-off.

EQUITABLE SET OFF

6. Equitable set-off is available with respect to both liquidated and unliquidated claims: see *Algoma Steel Inc. v. Union Gas Ltd.*, 2003 CanLII 30833 (ON CA), at para. 26.

7. For equitable set-off to be available, the claims must be closely connected, such that it would be unjust not to allow set-off. However, the claims need not arise out of the same contract: see *Canadian Airlines* at para. 35.

Potential Tax Refunds

8. A debt owed by a taxpayer to the government under one tax statute and a refund due to the taxpayer under another tax statute are sufficiently closely connected that "it would be manifestly unfair for a taxpayer not to pay taxes under one statute, while collecting a refund of tax under another statute, each involving the same tax collector": see *Canadian Airlines* at paras. 39 to 45.

9. Therefore, the Province submits that it is entitled to set off against Catalyst's debt under the *Carbon Tax Act*:

- (a) any amounts the Province may be required to pay to Catalyst as a result of any of Catalyst's appeals under the *Social Service Tax Act* being allowed; and
- (b) any other tax refunds that may become payable to the petitioners.

10. A tax liability has been found to be sufficiently connected to an amount owed by a taxpayer-funded Crown corporation to the taxpayer to justify equitable set-off: see *Canadian Airlines* at paras. 40 to 41. The Province submits that an equally close connection exists between tax refunds payable to a taxpayer and debts owed by the taxpayer to the government for costs that will otherwise be borne by taxpayers generally.

11. Therefore, the Province submits that it is entitled to set off against Catalyst's debts for hydrometrics costs and shared BC Hydro bills:

- (a) any amounts the Province may be required to pay to Catalyst as a result of any of Catalyst's appeals under the *Social Service Tax Act* being allowed; and
- (b) any other tax refunds that may become payable to the petitioners.

Security Deposits

12. The Letter of Credit was provided by Catalyst to the Province as security for Catalyst's obligations under the Land Tenures. The Land Tenures are used by Catalyst at its operations in BC. The Land Tenures include locations in Crofton, Port Alberni, Powell River and Elk Falls.

13. Catalyst's debts to the Province are for

- a. Hydrometric costs for the monitoring of water flow in the Cowichan River, near the Crofton mill;
- b. Carbon Tax for the burning of shredded tires at Catalyst's Port Alberni mill;
- c. a water bill for a water licence at the Powell River mill issued by the Province; and
- d. shared BC Hydro bills for the Elk Falls mill.

14. The Province submits that there is a close connection between the Letter of Credit for the Land Tenures and the debts owed by Catalyst: the Land Tenures are used in Catalyst's operations in Crofton, Port Alberni, Powell River and Elk Falls and the debts arise out of Catalyst's operations in those same locations. As a result, the Province submits that if the Province becomes liable to repay the Letter of Credit to Catalyst, it would be unjust to allow Catalyst to keep the Letter of Credit in the face of Catalyst's outstanding debts to the Province relating to those same operations.

15. Moreover, the Province submits that it should be entitled to set off against its Claim against Catalyst any other security deposits in favour of the petitioners if those security deposits become repayable by the Province to any of the petitioners.

Potential Restructuring Claims

16. The Province further submits that, if it should have any Restructuring Claims against any of the petitioners, it will be entitled to set off against those Restructuring Claims any claims the petitioners may have against the Province, to the extent that the claims are sufficiently connected to justify equitable set-off.

STATUTORY SET OFF

17. Section 38 of the *Financial Administration Act* [RSBC 1996] c. 138 gives the Province a statutory right of set off:

Set-off of amounts owed

38 The Treasury Board may, by directive, authorize the Comptroller General to retain money by way of set-off, out of any money due or payable to a person by the government or out of a trust fund, if

- (a) that person owes money to the government,
- (b) an overpayment has been made by the government to that person, or

(c) an advance made to that person under section 36 has not been repaid or accounted for.

18. The Province's Treasury Board issued a general directive, effective August 3, 2000, authorizing the Comptroller General to retain money by way of set off.

19. The Province submits that even if legal and equitable set off are not available to it, s. 38 of the *Financial Administration Act* and the general Treasury Board Directive give the Province an additional statutory right to set off its Claim against any claim that any of the petitioners have against the Province.

20. Justice Paperny, in *obiter*, in the *Canadian Airlines* decision noted that section 38 "on its face appears to describe a broad right of set-off."

British Columbia v. Canadian Airlines Corp., 2001 ABQB 146, at para 47.

21. Justice Greer of the Ontario Superior Court of Justice in the *MacIntyre v. Ontario* case applied a similar section of Ontario's *Financial Administration Act* to allow the Ontario government to set off a payment it owed under its Motor Vehicle Accident Claim Fund against an amount owing to it under the *Criminal Code* to the same individual. Justice Greer's decision was upheld by the Ontario Court of Appeal.

MacIntyre v. Ontario 69 O.R. (3d) 236 (2003)

MacIntyre v. Ontario (2003) 129 A.C.W.S. (3d) 509 (OCA)

Part 4: MATERIAL TO BE RELIED ON

1. Affidavit #1 of Hanjia Yu, made May 8, 2012.
2. Such other material as counsel may advise.

The applicant estimates that the application will take1 hour..... .

[Check the correct box.]

This matter is within the jurisdiction of a master.

This matter is not within the jurisdiction of a master. This matter is to be heard before Mr. Justice Sewell.

TO THE PERSONS RECEIVING THIS NOTICE OF APPLICATION: If you wish to respond to the application, you must, within 5 business days after service of this notice of application or, if this application is brought under Rule 9-7, within 8 business days after service of this notice of application,

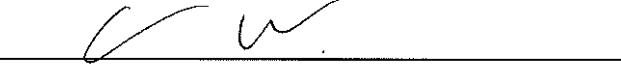
- (a) file an application response in Form 33,
- (b) file the original of every affidavit, and of every other document, that

- (i) you intend to refer to at the hearing of this application, and
- (ii) has not already been filed in the proceeding, and

(c) serve on the applicant 2 copies of the following, and on every other party of record one copy of the following:

- (i) a copy of the filed application response;
- (ii) a copy of each of the filed affidavits and other documents that you intend to refer to at the hearing of this application and that has not already been served on the person,
- (iii) if this application is brought under Rule 9-7, any notice that you are required to give under Rule 9-7 (9).

Date: May 9, 2012


Signature of
[] applicant [X] lawyer for applicant
Aaron Welch

To be completed by the court only:

Order made

[] in the terms requested in paragraphs of Part 1 of
this notice of application

[] with the following variations and additional terms:
.....
.....
.....

Date:[dd/mmm/yyyy].....

Signature of [] Judge [] Master

APPENDIX

[The following information is provided for data collection purposes only and is of no legal effect.]

THIS APPLICATION INVOLVES THE FOLLOWING:

[Check the box(es) below for the application type(s) included in this application.]

[] discovery: comply with demand for documents

- discovery: production of additional documents
- other matters concerning document discovery
- extend oral discovery
- other matter concerning oral discovery
- amend pleadings
- add/change parties
- summary judgment
- summary trial
- service
- mediation
- adjournments
- proceedings at trial
- case plan orders: amend
- case plan orders: other
- experts

This **NOTICE OF APPLICATION** is prepared by Aaron Welch, Barrister & Solicitor, of the Ministry of Justice, whose place of business and address for service is P.O. Box 9289, Stn Prov Govt, 400 - 1675 Douglas Street, Victoria, British Columbia, V8W 9J7; Telephone: (250) 356-8589; Facsimile: (250) 387-0700; Email Address: Aaron.Welch@gov.bc.ca.