

Financial Services Flash

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Court of Appeal Confirmation: The “Interest Stops Rule” Applies in CCAA Proceedings

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On October 13, 2015, the Court of Appeal for Ontario (the “Court”) dismissed the so-called “interest stops rule” appeal in the Nortel matter,[1] thereby confirming that the rule applies in proceedings under the Companies’ Creditors Arrangement Act (the “CCAA”). The Court’s decision also appears to eliminate any suggestion that the rule only applies to so-called “liquidating” CCAA proceedings.

The interest stops rule operates upon the commencement of an insolvency proceeding to prevent additional contractual interest from accruing on unsecured debt. The rule effectively freezes the various unsecured creditors’ claims, such that the proportionality amongst each of them is not distorted during the insolvency proceeding by accruing interest at asymmetrical rates.

In the Nortel matter, Nortel Networks Corporation and other related Canadian entities filed for and obtained protection under the CCAA in January 2009, at which time Nortel Networks Inc. and other related U.S. entities also filed petitions under Chapter 11 of the United States Bankruptcy Code. Although the CCAA and its Chapter 11 counterpart in the United States are designed to bring about a restructuring, the Nortel matter has evolved to become a “liquidating” proceeding.

Unsecured bondholders affected by the Nortel insolvency under both the Canadian and U.S. regimes made claims for principal and pre-filing interest totalling over US\$4 billion.

A group of unsecured bondholders also claimed post-filing interest from 2009 through 2013 in the amount of US\$1.6 billion. At first instance, the Honourable Justice Newbould of the Ontario Superior Court of Justice (Commercial List) held that the interest stops rule applied – at the very least to “liquidating” CCAA proceedings – such that the unsecured creditors were not entitled to seek post-filing interest.

On appeal, the Honourable Justice Rouleau wrote for a unanimous panel of the Court and dismissed the appeal. The Court held that the *pari passu* principle, which requires unsecured creditors to be treated as a single class and receive equal treatment, is a fundamental tenet of insolvency law. The Court further held that a necessary corollary of the *pari passu* principle is the interest stops rule, as the fairness and orderly distribution sought by the *pari passu* principle would be lost if the claims of unsecured creditors were allowed to accrue post-filing at different interest rates.

Turning to the CCAA specifically, the Court held that the interest stops rule applies equally in CCAA proceedings, as it does in bankruptcy and winding-up proceedings, because of the following (and somewhat overlapping) reasons:

1. the Bankruptcy and Insolvency Act (the “BIA”) and the CCAA form part of an integrated insolvency regime, which regime would be disrupted if creditors were afforded

[1] Nortel Networks Corporation (Re), 2015 ONCA 681.

differential treatment depending on whether proceedings took place under the BIA or the CCAA. As the interest stops rule applies to BIA proceedings, and as the CCAA makes no provision for post-filing interest, it follows that the principle is equally applicable in the CCAA context;

2. creditors with no claim to post-filing interest would have skewed incentives against reorganization under the CCAA if the interest stops rule were not to apply. Those without a contractual right to post-filing interest would prefer to proceed under the BIA, where the interest stops rule operates to prevent creditors with a contractual right to interest from improving their proportionate claim(s);

3. the CCAA creates conditions for preserving the status quo, which principle would be violated if post-filing interest were allowed to accrue for one set of unsecured creditors, while a stay of proceedings prevented other unsecured creditors from asserting their rights to sue the debtor and obtain an interest-bearing judgment;

4. not applying the interest stops rule would create asymmetrical entitlement to interest. The Court found that this unequal entitlement to interest may undermine a key objective of the CCAA, namely, to facilitate the restructuring of corporations through creativity and flexibility, as those creditors entitled to significant post-filing interest would be less motivated to achieve a timely and effective compromise; and

5. the principle of fairness generally supports the application of the interest stops rule.

Unlike the decision at first instance, the appellate decision does not address the possibility that so-called “restructuring” CCAA proceedings may be exempt from the interest stops rule. Rather, the Court concludes that “the

decision clearly settles at the outset of a CCAA proceeding whether there is a legal entitlement to post filing interest,”[2] without referencing any distinction between “liquidating” and “restructuring” CCAA proceedings. The Court nonetheless held that the interest stops rule does not preclude the payment of post-filing interest under a plan of arrangement or compromise, but rather establishes the starting point for each party’s claim such that “the parties will know what they are or are not compromising and the court will be equipped to consider the fairness of such a plan.”[3]

In sum, the decision has important implications regarding the ability of unsecured creditors to make claims for post-filing interest. It remains to be seen whether the parties will seek leave to appeal to the Supreme Court of Canada, and if so, what guidance the Supreme Court of Canada will provide on the issue.

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[2] Ibid at para. 99.

[3] Ibid at para. 100.

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