SUPREME COURT OF NOVA SCOTIA
Citation: ScoZinc Ltd. (Re), 2008 NSSC 399

Date: 20081231
Docket: Hfx No. 305549
Registry: Halifax

In the matter of: The *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended.

And in the matter of: A Plan of Compromise or Arrangement of ScoZinc Limited

Judge: Justice Duncan R. Beveridge

Heard: December 31, 2008, in Halifax, Nova Scotia

Released: January 8, 2009

Counsel: John D. Stringer, Q.C. and Ben Durnford, for the applicant
Robbie MacKeigan, Q.C. for Daniel Rozon
John McFarlane, Q.C. for Kamatsu

By the Court:

[1] On December 22, 2008 I granted ScoZinc Limited an initial order under s.11(3) of the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36 staying all proceedings taken or might be taken against ScoZinc. The order was granted *ex parte*. The order appointed a monitor and authorized priority for administrative charges reasonably incurred by the monitor and by the applicant's employment of counsel with respect to the proceedings and pending restructuring of the company. The administration charge was capped at $400,000.00.

[2] I also granted an order authorizing debtor-in-possession financing not to exceed $250,000.00 to cover the immediate cash needs of the company, mostly the payroll due December 24, 2008. This DIP financing was provided by the President and CEO of ScoZinc, William Felderhof and Mr. Terrence Coughlan. The DIP financing was given priority over all claims, secured or unsecured, second only to the administration charge. This order was also made *ex parte*.

[3] On December 22nd ScoZinc also sought a second order for DIP financing in the total amount of $1million, first to pay the initial DIP loan to Messrs Felderhof and Coughlan and then to provide the necessary cash flow to prevent a precipitous end to its operations and allow it an opportunity to restructure its affairs.

[4] There are two secured creditors, Acadian Mining, the parent company of ScoZinc, and Royal Roads a company that has, as I understand it, close ties and some interlocking shareholders and directorships with Acadian Mining.

[5] Both of these companies executed consents to the initial DIP financing. Acadian Mining as well consented to the second DIP financing request of $1 million. It was expected that Royal Roads would also do so, but consent had not yet officially been obtained. In light of the extraordinary nature of an order for DIP financing, I declined to make the requested second DIP financing order on an *ex parte* basis. In light of the apparent need to have this request heard in a timely basis I agreed to hear the application for the second DIP financing order on December 31, 2008 with notice to the secured creditors and all creditors, secured or otherwise, with an indebtedness in excess of $100,000.00. Notice has duly been given to the secured creditors and to the senior unsecured creditors.

[6] The law with respect to the jurisdiction of a court to grant an order authorizing DIP financing and the granting of super-priority of this new debt over existing secured and unsecured debt was recently canvassed in *Re Federal Gypsum* 2007 NSSC 347, 261 N.S.R. (2d) 299. MacAdam J. In *Re Federal Gypsum* referred, with approval, to a number of decisions including *Re Manderley Corp.* (2005) 10 C.B.R. (5th) 48; *Re Hunters Trailer & Marine Limited* 2001 ABQB 546, [2001] A.J. No. 857; and in *Re Simpson's Island Salmon Ltd.,* 2006 NBQB 6, [2005] N.B.J. No. 570.

[7] In *Re Hunters Trailer & Marine* Wachowich C.J.Q.B. wrote:

> [32] Having reviewed the jurisprudence on this issue, I am satisfied that the Court has the inherent or equitable jurisdiction to grant a super-priority for DIP financing and administrative charges, including the fees and disbursements of the professional advisors who guide a debtor company through the CCAA process. Hunters brought its initial CCAA application ex parte because it was insolvent

> and there was a threat of seizure by some of its major floor planners. If super-priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively would be denied a debtor company in many cases.
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> [33] I am aware, however, that administrative costs and DIP financing can erode the security of creditors. LoVecchio J. in Re Smoky River Coal Ltd. (2000), 19 C.B.R. (4th) 281 at 290 (Alta. Q.B.), raised a caution flag in this regard, stating at p. 290:
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> > While the CCAA requires a large and liberal interpretation in order to be effective, the need for caution arises when the Court exercises its inherent jurisdiction under this statute. Although the CCAA serves a vital and important role in a reorganization, the general statutory scheme of priorities of creditors must not be overlooked. As the Court is altering this scheme, the exercise of the power of the Court to create classes of creditors with a super-priority status should not be taken lightly. Especially in light of the fact that this action could prejudice the recovery of creditors who would, but for the Order, enjoy a priority if a receivership or bankruptcy ultimately ensues.

See also *Re United Used Auto and Truck Parts Ltd.*, [2000] B.C.J. No. 409 (B.C.C.A.)

[8] Based on these and other authorities there should no longer be any doubt that the Court has the jurisdiction to grant orders authorizing DIP financing and creating a super-priority for such new debt in priority over existing secured and unsecured debt. How then should this jurisdiction be exercised?

[9] In *Re Simpson's Island Salmon, supra,* Glennie J. succinctly set out the test as follows:

> [16] In order for DIP financing with super-priority status to be authorized pursuant to the CCAA, there must be cogent evidence that the benefit of such financing clearly outweighs the potential prejudice to secured creditors whose security is being eroded...
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> [17] DIP financing ought to be restricted to what is reasonably necessary to meet the debtors' urgent needs while a plan of arrangement or compromise is being developed.
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> ...
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> [19] A Court should not authorize DIP financing pursuant to the CCAA unless there is a reasonable prospect that the debtor will be able to make an arrangement with its creditors and rehabilitate itself...

[10] The evidence before me reveals that ScoZinc began operating Scotia Mine in May 2007. The mine produces and processes lead and zinc. As might be expected with any significant operation, it did not immediately operate profitably. However, in its first full year of operation or at least from January 2008 to the end of November 2008 it generated sales of some $25 million. The management deposes that any receivables from these sales are not in anyway doubtful. ScoZinc's cost of production is $22 million. Nonetheless, when all expenses are considered it had a net operating loss of just over $4 million and $5.4 million outstanding in trade payables. It is unable to pay its creditors as economic conditions now stand. Two factors are noted for this situation.

[11] The first were climatic factors that led to flooding causing increased production costs early in 2008 which caused the loss of availability of higher grade ore as well as the noted production cost escalation.

[12] The evidence is that the company would have been able to overcome this phenomenon but for the falling commodities market for metals.

[13] On January 1, 2008 zinc and lead prices were $1.08 and $1.23 U.S. per pound respectively. On October 1, 2008 the prices were down to 75¢ and 82¢. By December 1, 2008 they had declined a further 33% for zinc to 50¢ and for lead by 49% to 42¢ per pound. Cost of production is estimated to be 49¢ per pound based on a certain quantity of ore being processed.

[14] As noted earlier there are two secured creditors, Acadian Mining and Royal Roads. They both consented to the initial request for priority for administrative charges to be incurred in the effort of the company and the monitor to restructure the affairs of ScoZinc and for the initial DIP financing of $250,000.00. Acadian Mining consents to the second request for DIP financing of $1 million to be obtained from TCE Capital Corporation and for that financing to rank ahead of its own.

[15] It was expected that Royal Roads would also consent. However, it appears from the supplementary affidavit of Mr. Felderhof that this expectation has failed to materialize. The independent directors of Royal Roads are not prepared to consent to the subordination of this security to the requested DIP financing of $1 million. However, neither do they say that they are opposed to ScoZinc's application.

[16] Notice of the application was duly provided to Royal Roads. Apparently on behalf of the independent directors of Royal Roads a senior member of a Toronto law firm has been in electronic communication with representatives of ScoZinc. He has indicated that he is not seeking an adjournment of these proceedings in order to make submissions. None were made and no one appears on behalf of Royal Roads in opposition.

[17] I think it best that can be said that the position of Royal Roads is a neutral one. It neither opposes nor consents to the requested DIP financing.

[18] Mr. William Felderhof, President and CEO of ScoZinc in his affidavit of December 23, 2008 deposes that Komatsu, who holds significant capital leases with ScoZinc, stands to lose no priority if the second DIP financing order is granted except for a claim that it might assert to the equity that may or may not exist in the units that are under lease to ScoZinc. Komatsu is represented on this application by John McFarlane, Q.C. He advises the court that Komatsu in fact consents to the requested order for DIP financing subject to some minor amendments to the form of the order.

[19] Mr. Felderhof in his affidavit of December 23, 2008 also says that the unsecured creditors do not stand to suffer any prejudice as they would not likely recover anything should ScoZinc be forced into bankruptcy. Instead he asserts that it is not only in the interests of Komatsu but also the unsecured creditors that the DIP financing be put into place to permit the continued operation of ScoZinc at

least in the short term to permit the company to try to restructure its affairs. This he says can only occur if it obtains the requested DIP financing.

[20] The court appointed Daniel Rozon, Senior Vice-President of Grant Thorton as monitor. Mr. Rozon filed a report dated December 30, 2008. In his report he details a number of developments since the initial financial projections were done. Of significance is a delay in production that prevented a planned delivery of zinc on December 31, 2008 delaying a cash receipt of some $821,000.00. He says that, given the continued volatility of commodity prices, ScoZinc requires in the short term, somewhere between $391 to $794,000.00 of the second DIP financing facility, should the order be granted.

[21] Mr. Rozon reports that the second DIP financing is, in his view, required to safeguard ScoZinc's assets in order to benefit shareholders and secured and unsecured creditors. He sets out in his report some of the consequences, or at least potential effects if the second DIP financing is not approved. Mr. Rozon further offers his opinion that ScoZinc's management has been, and is acting, in good faith and with due diligence and his belief that creditors will not be materially prejudiced by the requested second DIP financing. He recommends approval of the financing up to the requested amount of $1 million.

[22] Not only do I not see any reason to take issue with Mr. Rozon's views, I adopt them.

[23] I am satisfied that the benefits clearly outweigh any potential prejudice to the secured creditors whose security is being eroded by the requested DIP financing.

[24] I am also satisfied that without the requested second DIP financing ScoZinc's prospects for successfully restructuring would be little to none. A premature closure of ScoZinc would not only harm ScoZinc but all of its creditors. Commodity prices may well not rebound, but there are other options to be explored by the company. Even if restructuring is not successful it is of significant importance that any shutdown be done in an orderly and controlled fashion to minimize harm to the assets of ScoZinc and the economic and environmental costs that may otherwise materialize. These goals are obviously in the best interests of all the stakeholders including all the creditors, secured and unsecured.

[25] I grant the order.

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Beveridge, J.