

## Appendix K

### NGX Insolvency Memo

#### INSOLVENCY OF NGX

#### How Would a Bankruptcy or Insolvency of NGX Proceed?

An insolvency of NGX would proceed by way of one of the following:

- a) Proceedings under the *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended (the "CCAA");
- b) Bankruptcy proceedings under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 as amended (the "BIA");
- c) Proposal proceedings under the BIA; or
- d) Receivership proceedings, either under a Provincial statute or as an Interim Receivership under the BIA.

The CCAA is the Canadian equivalent to Title 11 proceedings under the U.S. Bankruptcy Code. The CCAA only applies to debtor companies against whom there are claims exceeding \$5 Million. CCAA proceedings are "debtor-in-possession"; the debtor continues to operate its business and assets while a stay of proceedings is imposed, allowing the company to make a proposal for acceptance by its creditors and the Court.

In bankruptcy proceedings, all of the debtor's assets and property automatically vest in a Trustee in Bankruptcy. The debtor loses the ability to possess or deal with its assets. The Trustee in Bankruptcy's mandate is simply to liquidate the assets for the benefit of creditors.

Proposal proceedings under the BIA are similar in some ways to CCAA proceedings. The debtor retains possession of its assets and business, an automatic stay of proceedings is imposed against creditors, and the goal of the process is to come up with a proposal which is acceptable to the debtor company's creditors which can then be approved by the Court. A Trustee is appointed, whose task is to assist the debtor in formulating the Proposal and to accept or reject proofs of claim from the company's creditors, for the purpose of holding a vote on the Proposal.

In a Receivership, the Receiver or Interim Receiver takes legal custody and possession of all the assets of the debtor. The Receiver's mandate is to realize on the debtor's assets for the benefit of its creditors, and the Receiver has increased powers (as compared to a Trustee in Bankruptcy) to operate the debtor's business as part of the realization.

An insolvency of NGX would likely proceed under the CCAA.

**i) What entity would appoint the Trustee, Receiver, or Similar Officer under each Proceeding?**

CCAA proceedings are almost exclusively commenced by the debtor company, although it is theoretically possible for a creditor to commence the proceedings. A debtor can become bankrupt either by way of a petition commenced by one or more of its creditors, or by way of a voluntary assignment by the company. Proposal proceedings under the BIA can only be commenced by the debtor. Receivership proceedings are usually commenced at the instigation of a secured creditor.

**ii) What Protection or Priorities would NGX's Counterparties ("CPs") have the benefit of in an NGX Insolvency?**

Under Canadian law, NGX believes each Transaction (as defined in the NGX Contracting Party's Agreement (the "CPA")) entered into pursuant to the CPA qualifies as an eligible financial contract ("EFC"). Legal analysis of NGX Transactions as EFCs is provided by Bennett Jones LLP under separate cover. In Canada, counterparties to EFCs enjoy significant protection of their contractual rights in certain of the insolvency proceedings described above. Counterparties to EFCs are able to exercise the following contractual rights (despite the existence of an insolvency stay of proceedings that would otherwise prohibit all creditor action):

- the right to terminate, amend or claim any accelerated payment;
- the right to net or set-off obligations between the debtor and the counterparty; and
- the right to deal with financial collateral (selling, foreclosing, setting-off, compensating or applying proceeds).

The statutory EFC provisions also provide that financial collateral cannot be subordinated by Court Order.

The EFC provisions only apply in CCAA proceedings and Proposal proceedings under the BIA. The EFC protections had not historically applied in bankruptcy proceedings under the BIA. However, Parliament recently enacted amendments to the BIA, making it clear that all the EFC protections will apply in such bankruptcies.<sup>1</sup> In Receivership proceedings, despite the lack of express statutory protection, Canadian courts have the discretion to allow counterparties to exercise their EFC rights. There are precedents for courts providing this type of discretionary

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<sup>1</sup> It is anticipated that these provisions will come into force sometime in the near future, but the timing is at the discretion of the Federal government and cannot be predicted with any certainty.

protection<sup>2</sup>. The incentive for a Court to exercise such discretion in a receivership of an entity such as NGX would be great, since the vast majority of NGX's assets comprise commodity contracts with its participants/contracting parties (“CPs”).

In November 2007, Parliament enacted and brought into force significant amendments to the EFC provisions. Among other things, the amendments have substantially altered the definition of EFCs. No Canadian Court has yet considered the impact of these amendments; however, NGX is confident the CPA has historically and will continue to qualify as an EFC. CPs would therefore be entitled, in proceedings under the CCAA and Proposal proceedings under the BIA, to exercise all their rights under the CPA to terminate, accelerate, set-off and exercise remedies against financial collateral. CPs will also be able to enjoy those rights in bankruptcy proceedings under the BIA as soon as the applicable enacted amendments come into force. With respect to Receivership proceedings, while there is no explicit statutory authority mandating the protection of EFC rights, as discussed Canadian courts have the discretionary authority to protect EFC rights.

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<sup>2</sup> In *Re: Enron Canada Corp.* (2001), 31 C.B.R. (4<sup>th</sup>) 15 (Alta. Q.B.), Hart J. of the Court of Queen's Bench of Alberta refused to grant the stay of proceedings requested by Enron Canada Corp. under the *Canada Business Corporations Act*, because doing so would have prevented Enron's creditors from exercising their EFC rights. Therefore, the Court protected counterparties' EFC rights, in the absence of any statutory protection (there are no EFC provisions in the *Canada Business Corporations Act*). The Court reached this conclusion because it was of the view that there existed a clear public policy in favour of allowing the termination, set-off and close-out of derivative contracts. The policy expressed by Hart J. in *Enron Canada* is also apparent in other judicial initiatives. In the Province of Alberta, a working committee of insolvency judges, lawyers and trustees has produced a draft Alberta Template Receivership Order. This form of Order is now commonly used in Alberta receiverships (although its use is not mandatory). The Template Receivership Order provides: “Nothing in this Order shall prohibit any party to an “eligible financial contract” (as defined in section 11.1(1) of the *Companies’ Creditors Arrangement Act*) with the Debtor from terminating such contract or exercising any rights of set-off, in accordance with its terms.”