Cassels

CRA Denied: Court Rules to Permit Director Releases Despite Unpaid Excise Taxes

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On January 29, 2025, the Court of King's Bench of Alberta approved applications made by Delta 9 Cannabis Inc. (Delta 9), among others, for: (a) a sanction order and stay extension; and (b) a sale approval and vesting order and an approval and reverse vesting order. In the decision, the Court examined the standard for director releases in a reverse vesting transaction and ultimately approved the releases over the objections of the Canada Revenue Agency (CRA).

Background

Delta 9, a vertically integrated group of companies in the business of cannabis cultivation, processing, extraction, wholesale distribution, retail sales and business to business sales, suffered significant losses in recent years. Following a breach of covenants in its secured debt documents, Delta 9 sought and obtained relief under the *Companies' Creditors Arrangement Act* (CCAA). On July 15, 2024, the Court granted an initial order under the CCAA providing, among other things, a stay of proceedings against Delta 9 and its directors and officers.

Following a sales process, the debtor sought approval of a plan and two sale transactions intended to maximize recoveries and facilitate creditor distributions. The CRA took issue with the releases in the reverse vesting order (RVO) in favour of among others, the current and former directors and officers of Delta 9. In connection with its opposition, the CRA sought to lift the stay of proceedings to allow it to issue directors' liability assessments against certain directors of Delta 9 for arrears under the *Excise Tax Act* and the *Excise Act, 2001*.

Decision

The Court found that the releases were appropriate for the following reasons: (a) the releases were rationally connected to the transaction; (b) the releases were integral to the success of the transaction; (c) the releasees contributed significantly to the transaction; (d) the releases benefitted the company and its creditors generally; (e) the creditors had knowledge of the nature and effect of the releases; (f) the releases were fair, reasonable and not overly broad; (g) the effect of not approving the releases would have put the benefits of the plan and the two sale transactions at serious risk; and (h) the releases did not conflict with

the remedial purpose of the CCAA.

The Court analyzed the validity of the CRA's objection to the releases, including the CRA's argument that a liability assessment of the directors of Delta 9 "[would] not impact the plan going forward." The Court disagreed, finding that without the releases, the company's business would be disrupted, resulting in an immediate shut down and liquidation, which would ultimately garner a lower purchase price.

The CRA also argued that the Court should not accept the releases "simply because they have been packaged together as a condition precedent to a transaction or restructuring, and that "strong-arm tactics" of incumbent directors should be resisted." The Court found that an assessment of whether requiring releases constituted "strong-arming" must be based on the evidence available. In this case, without the releases, which were contemplated in a key employee retention plan (KERP) presented to management, certain directors would likely not have agreed to stay involved, which would have put the closing of the transaction at serious risk and impacted the overall success of the restructuring.

The CRA's core position was that the release of certain directors from assessment for arrears rendered the releases unfair. The Court found that the CRA's conduct was a relevant factor in determining whether the releases were unfair, stating that "a party seeking to oppose a release … should engage and advise of its position early in the process and build an evidentiary record..." Instead, the CRA waited until the last possible moment to ask the Court to reject the releases and lift the stay of proceedings without a filed application or supporting evidence. In the Court's view, the CRA's approach and lack of timeliness in advancing its position favoured the Court's approval of the releases.

Further, the Court found that although Delta 9 misused funds owed to the CRA, this was done in an attempt to maintain the business as a going concern during tumultuous times in a new industry. In the Court's view, this was also a relevant factor in the analysis of whether the releases were unfair. Upon considering the evidence available, the Court found that the releases were fair, reasonable and not overly broad.

The Court further considered whether there were viable alternatives to the transaction. The Court found that a liquidation of the Delta 9 businesses would result in the affected creditors receiving no recovery, reduced recovery for the priority secured creditor, the shut-down of retail outlets and the Delta 9 manufacturing business, the loss of jobs and increased fees and bankruptcy costs. Therefore, the Court found that the transaction produced an overall economic result better than liquidation.

Conclusion

The Delta 9 decision demonstrates the Court's willingness to grant a broad release to current and former directors and officers in the context of a CCAA proceeding where personal liability might otherwise apply. The decision also recognized the value to management of the promise of future releases in a KERP and

that without the expectation that releases will be included in a transaction, members of management may be unwilling to continue to serve. The decision also signalled significant deference to decisions of management that may preserve a company to continue as a going concern. Lastly, the Court's decision cautions creditors that the timeliness of an objection may be a factor of consideration in whether to permit a broad release to current and former directors and officers.

For more information on how this decision may affect you or your organization, we welcome you to contact our Securities or Restructuring & Insolvency Groups to assist you further.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.